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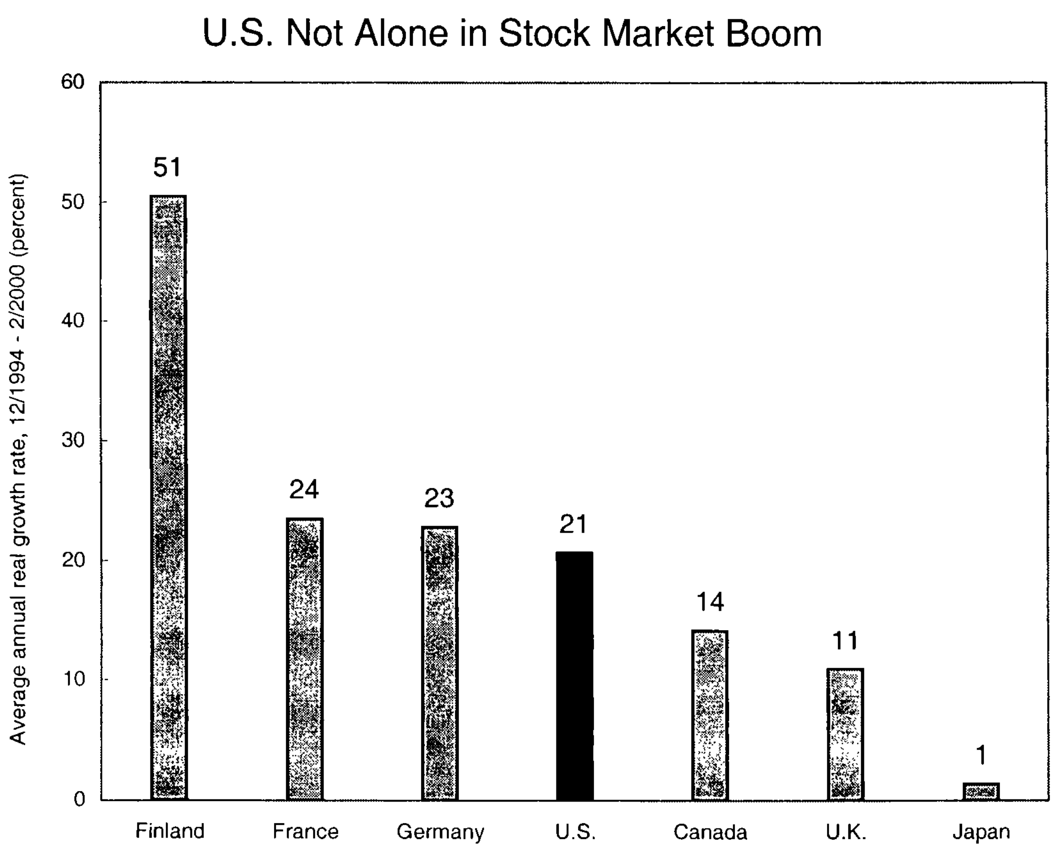
EYES ONLY

WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

Prepared by the Council of Economic Advisers
with the assistance of the Office of the Vice President

March 31, 2000

CHART OF THE WEEK



Stock markets have boomed in many developed countries over the last 5 years. In fact, real stock gains in Finland, France, and Germany exceeded those in the United States over that time. Finland's amazing stock market boom is primarily driven by the impressive performance of one technology firm, Nokia. In contrast, Japan's weak economy has contributed to a stagnant market.

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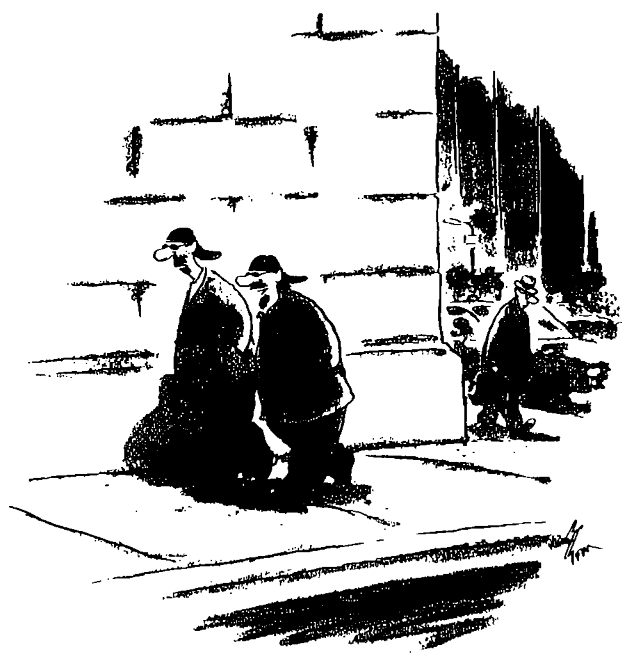
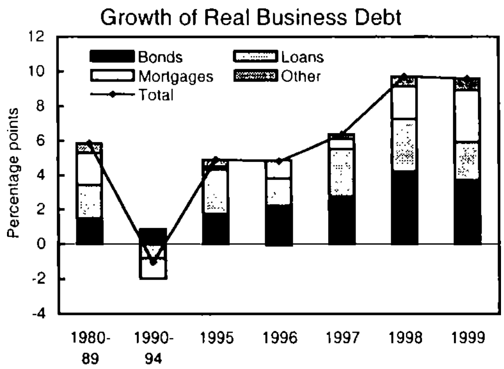


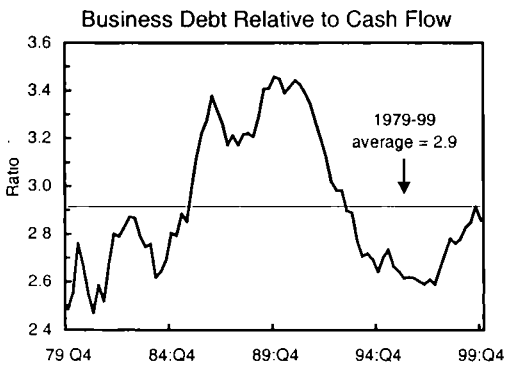
"Have you ever wanted something so bad that you'd actually save up the money to buy it?"

CURRENT DEVELOPMENT

The Financial Condition of Businesses

Business borrowing was robust in 1999 for the second straight year. But strong cash flow has kept the debt burden manageable. Other indicators suggest businesses generally enjoy good financial health.





Business debt is on the rise ... Real debt in the non-financial business sector climbed 9.6 percent in 1999, nearly the same rate as in 1998 (see upper chart). Commercial mortgage borrowing was especially strong last year, accounting for about a third of the total increase in business debt. Corporate bond issuance continued to soar, with bond financing accounting for about 40 percent of debt growth. Banks, however, tightened terms on business loans in 1999, according to Federal Reserve surveys, and bank loans accounted for a relatively low 23 percent of debt growth.

... but, the debt burden remains under control. Real cash flow increased 6.5 percent in 1999, marking the third consecutive year that cash flow growth lagged behind borrowing. As a result, the debt-to-cash flow ratio is up about 10 percent from its low mid-1990s level, and is now close to its long-run average (see lower chart). Low interest rates, however, have helped to keep the debt service burden from escalating. The ratio of interest payments to cash flow over the last few years has remained low and stable. Both ratios are well below their peaks reached in the 1980s.

Other indicators of business sector health. Delinquency rates and business failures remained at very low levels, although both picked up somewhat in 1999. However, the default rate on high-yield "junk" bonds reached levels not seen since the 1990-91 recession and more non-financial debt was downgraded than was upgraded in 1999, indicating some financing difficulties for some firms.

Businesses mirror households. Robust cash flow gains and low interest rates have allowed business debt to surge without a dangerous rise in debt burden. This pattern mirrors that of household finances reported in an earlier *Weekly Economic Briefing*. An economic downturn, coupled with higher interest rates, could push up the debt burden appreciably, but most likely not to the levels of the 1980s.

SPECIAL ANALYSIS

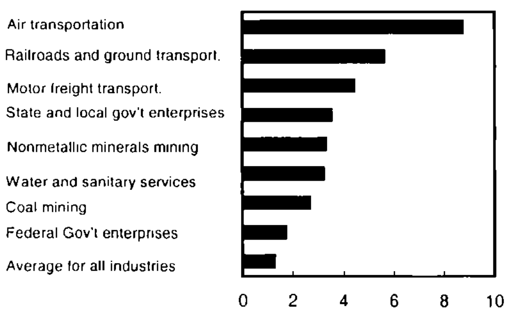
Who Feels the Pain of Higher Oil Prices?

With significant improvements in energy efficiency and structural change, the economy is much less dependent on oil today than it was a quarter century ago. Since 1974, U.S. petroleum consumption has increased 17 percent while the economy has grown nearly 120 percent. Nonetheless, the rise in oil prices over the past year has increased the costs to users of petroleum products.

Impacts of gasoline prices on the typical household. The national average price for gasoline appears to have plateaued this month just above $1.50 per gallon. The average gasoline price this year will likely be about 30 cents per gallon higher than last year ($1.14 per gallon in 1999). The typical household will pay over $300 more to fill up its vehicles in 2000 than in 1999, representing more than a 25 percent increase. Nevertheless, gasoline cost as a share of a household's income has fallen significantly over the past 20 years. In 1980, the typical household spent 5 percent of its income to fuel its vehicles, while in 2000, fueling costs will require about 1.6 percent of the typical household's income.

Impacts of gasoline prices on motor vehicle purchases. In 1999, more than 16.8 million cars and light trucks (including SUVs) were sold in the United States. So far this year, the pace of new vehicle purchases is even higher; light weight vehicle sales in February exceeded an annual rate of 19 million units. In recent years, the average fuel economy of all new motor vehicles purchased has fallen as consumers have shifted away from more fuel-efficient automobiles to less fuel-efficient light trucks. The costs to fuel vehicles vary significantly. For example, assuming an average of 11,300 miles traveled per year, it will cost the typical driver this year more than $1800 to fuel a Ferrari 550, about $1000 for a Jeep Grand Cherokee, about $850 for a Dodge Caravan, more than $600 for a Toyota Camry, and less than $400 for a Volkswagen New Beetle. Still, the recent high gasoline prices do not appear to have influenced America's love affair with SUVs despite their high fuel costs.

Petroleum-Intensive Sectors in the U.S. Economy



Impacts of oil prices on airlines. The air transportation industry spends 7 times as much for petroleum products per unit of economic output than the average industry (see chart). However, between 1987 and 1996, the air transportation sector reduced the petroleum intensity of its output by 22 percent. This reflects in part the significant improvement in fuel economy of airplanes manufactured by Boeing. High oil prices would not appear to provide a competitive advantage to either Boeing or Airbus, the two largest airplane manufacturers in the world, because of the similar fuel economies of their comparable models. While fuel costs are an important component of operating costs for airlines, they do not always serve as a good predictor of changes in airfares.

Impacts of diesel prices on motor freight. Expenditures on petroleum products represent less than 4½ percent of economic output for the motor freight transportation and warehousing industry. However, fuel costs of small carriers may make up more than three times as much of their operating costs as large carriers. With the average price for diesel estimated to be nearly 30 cents per gallon higher this year than last, tractor-trailer operators will likely have to pay over $3,000 more to fuel their trucks this year compared to last year.

Impacts of oil prices on state and local governments. Petroleum products represent nearly 7 percent of all input costs for state and local governments. Higher oil prices can increase the costs of operating various government vehicle fleets, such as police cars, fire trucks, and school buses. For example, with the increase in diesel prices, the costs of operating a school bus will increase on average by more than $250 this year over last year.

Conclusion. While the recent increase in oil prices appears to have less effect on the economy than previous hikes in oil prices, those who rely on petroleum products have experienced a significant increase in costs. Improvements in energy efficiency and higher incomes have helped many consumers adapt to higher fuel prices.

ARTICLE

The Experience of Foreign Investors in China

China's WTO accession will give foreign firms the right to distribute products in China directly. A recent study draws on extensive interviews with managers and professionals in foreign (disproportionately American) firms in China and sheds light on the potential benefits of these rights. Foreign investors find the murky legal environment a challenge; nevertheless, the study highlights the steady trend towards increased transparency and reliance on the rule of law. WTO accession will further this trend.

The murky legal environment. The study notes that China had no legal system in the Western sense in 1977. Shortly after its founding, the People's Republic of China had declared all previous laws invalid—but never replaced them with a new code of law. Instead, China relied on often secret decrees, bureaucratic regulations, and personal orders of various officials. In the late 1970s, China began promulgating new laws and codes. Although numerous gaps still remain, China has by now published and circulated the major laws affecting foreign enterprises.

Even with this progress, the legal system is clearly in transition. Existing laws are often ambiguous, so that the distinction between what is permissible and what is not often depends less on clearly stated codes, and more on personal relationships with influential officials. Businesses find these legal ambiguities to be a source of risk, since official interpretations might change. On the other hand, they see a need to move aggressively to avoid being boxed out by competitors.

Legal hurdles to selling in China. Many of the firms in the study invested in China to gain access to the Chinese market. However, they continue to face significant obstacles in selling their products there. Foreign firms face severe legal limitations on their ability to provide distribution and other services (such as after-sales maintenance). Because these services are so crucial to selling their products in China, foreign firms have become more deeply involved in distribution than the law might suggest is possible. For example, they work hard to exploit subtle loopholes in ambiguous laws; they may also let a Chinese firm technically provide the needed services—with the foreign firm in fact providing all the actual management and marketing.

Conclusions. WTO accession will alleviate the need for creative efforts to circumvent restrictions on distribution and services, and reduces uncertainty about whether current legal interpretations will change. Clear rules benefit Chinese firms as well as foreigners. Nevertheless, complete reliance on a rule of law will take time, since the necessary institutions, skills, and culture are not yet developed. As the study notes, China is in a transition that will take decades to complete."

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

Job Corps Does Good. Participation in the Job Corps raises initial education and earnings outcomes and reduces arrests and incarcerations, especially for those aged 16 and 17, according to a recent study. A sample of youths eligible for Job Corps were randomly assigned to either a program group or a control group in the mid-1990s and then followed for 30 months. Job Corps led to more education and training, higher GED attainment, and large increases in vocational certification relative to the control group, even though many control group members participated in other education and training activities. Arrests, convictions, and incarcerations were about 20 percent lower and average earnings were significantly higher for Job Corps participants. Self-reported alcohol and illegal drug use and family formation were unaffected by program participation. A full cost-benefit analysis of this more-than-$1-billion-per-year program awaits completion of a 48-month follow-up study.

Asian Crisis Hit States' Manufacturing Exports. A recent study finds that most states' exports to East Asia declined during the East Asian crisis, but the severity of the decline varied across states. East Asian markets accounted for 30 percent of U.S. merchandise exports prior to the crisis. Six states had manufacturing exports to East Asia of more than $1,000 per capita prior to the crisis, and 19 states exported more than $500 per capita. In general, western states—especially Alaska, Arizona, and California—were more dependent on East Asian markets, and were hit hardest by the trade shock. Overall, forty states experienced declines in exports to East Asia from 1997 to 1998, with seven states and the District of Columbia seeing exports to East Asia fall by more than 30 percent.

Another Look at Adolescent Fertility. As reported in a previous *Weekly Economic Briefing*, the birth, pregnancy, and abortion rates for teens aged 15-19 have declined in recent years. A study released by the National Center for Health Statistics examines these and related trends in greater depth. One of the interesting findings is related to changes in the rates of teens having their second child. The teen birth rate for a first child declined 10 percent between 1991 and 1997 (with most of the decline occurring in the final 2 years). The rate of second births to teenagers has fallen even more sharply, 21 percent since 1991. This decline was especially evident for African-American teenagers, for whom the second birth rate dropped 28 percent. The study also finds that among the factors accounting for the overall falling teenage pregnancy rates are decreased sexual activity, increased condom use, and the adoption of injectable and implant contraceptives. The switch from the pill to Depo-Provera and Norplant among African-American teenage mothers may be an important factor in the recent sharp decline in their second birth rates during the 1990s.

INTERNATIONAL ROUNDUP

EU Sets Strategic Economic Goals. European Union leaders agreed to a broad set of economic and social initiatives that are intended to strengthen employment, promote innovation, and prepare for the transition to a knowledge-based economy. One goal is to raise the employment rate from 61 percent today (compared to 74 percent in the United States) to 70 percent by 2010, while increasing the employment rate of women from 51 percent (67 percent in the United States) to 60 percent. Proposed policies include a Europe-wide database on jobs and learning opportunities, promotion of training for the service sector, and improved childcare provision. The Council advocated the completion of a single EU market, by eliminating barriers to trade in services and liberalizing public utilities. In the area of information technology, the Council called for adopting pending legislation on the legal framework for electronic commerce and introducing greater competition in local access networks before the end of 2000 to substantially reduce the costs of Internet access. The latter proposal would be similar in many respects to the U.S. Telecommunications Act of 1996. The Council also urged the Member States to ensure that all schools have access to the Internet by the end of 2001.

Combating TB. Last week, 20 countries heavily burdened by Tuberculosis (TB) participated in a Ministerial Conference on TB and Sustainable Development, hosted by the World Bank and the World Health Organization. Around 8 million people annually become sick with TB, and about 2 million die each year from the disease, 98 percent of which are in developing countries. Moreover, inadequate supplies of drugs, ineffective treatment, and poor management increase the risk of an outbreak of drug-resistant TB, which is extremely costly to treat. A proven cost-effective strategy of fighting TB called DOTS (Directly Observed Treatment, Short-course), which stresses close observation of dosages, has been available for many years. The DOTS program costs between $10 to $20 per patient, and has a cure rate of about 80 percent (compared with 45 percent for non-DOTS areas). As of 1998, 119 countries have adopted DOTS, and 43 percent of the global population had access to this program; still, only 21 percent of estimated global TB cases received DOTS. The Conference set a goal of providing DOTS to 70 percent of TB cases by 2005.

Japan to Cut Retirement Benefits. Japan's parliament voted this week to reduce retirees' pensions and raise the retirement age to stabilize the long-term funding of the public pension system. This reform will cut public pension benefits for new retirees by 5 percent on April 1 and will gradually raise the age at which retirees start to receive benefits from 60 to 65 by 2025. Japan's public pension account is expected to run a deficit this year. An aging society and low birth rate will only exacerbate this problem. While there were 4.2 working age people for every person age 65 or over in 1998, this ratio is expected to drop to 2.2 in 2025 and to 1.7 in 2050. Some economists have argued that the new reforms do far too little, as the current pay-as-you-go pension system is unsustainable and needs a drastic overhaul.

EYES ONLY

RELEASES THIS WEEK

Gross Domestic Product

According to revised estimates, real gross domestic product grew at an annual rate of 7.3 percent in the fourth quarter of 1999.

Consumer Confidence

Consumer confidence, as measured by The Conference Board, declined 4.1 index points in March, to 136.7 (1985=100).

MAJOR RELEASES NEXT WEEK

NAPM Report on Business (Monday)
Leading Indicators (Tuesday)
Employment (Friday)

EYES ONLY

U.S. ECONOMIC STATISTICS

	1970-1993	1999	1999:2	1999:3	1999:4
Percent growth (annual rate)					
Real GDP (chain-type)	N.A.	**4.6**	1.9	5.7	**7.3**
GDP chain-type price index	N.A.	1.6	1.3	1.1	2.0
Nonfarm business (NFB) sector:					
Productivity (chain-type)	1.7	3.6	0.6	5.0	6.4
Real compensation per hour:					
Using CPI	1.0	1.7	1.4	2.1	0.8
Using NFB deflator	1.5	3.0	2.9	4.0	2.1
Shares of Nominal GDP (percent)					
Business fixed investment	11.4	12.6	12.6	12.7	12.5
Residential investment	4.5	4.4	4.5	4.4	4.4
Exports	8.2	10.8	10.7	10.8	10.9
Imports	9.2	13.5	13.4	13.8	14.0
Personal saving	6.6	1.7	1.8	1.5	1.3
Federal surplus	-2.8	**1.2**	1.3	1.4	**1.2**

	1970-1993	1999	December 1999	January 2000	February 2000
Unemployment Rate (percent)	6.7**	4.2**	4.1	4.0	4.1
Payroll employment (thousands)					
increase per month			309	384	43
increase since Jan. 1993					20823
Inflation (percent per period)					
CPI	5.8	2.7	0.2	0.2	0.5
PPI-Finished goods	5.0	3.0	0.1	0.0	1.0

**Figures beginning 1994 are not comparable with earlier data.

New or revised data in **boldface**.

EYES ONLY

FINANCIAL STATISTICS

	1998	1999	January 2000	February 2000	March 30, 2000
Dow-Jones Industrial Average	8626	10465	11281	10542	10980
Interest Rates (percent per annum)					
3-month T-bill	4.78	4.64	5.32	5.55	5.71
10-year T-bond	5.26	5.65	6.66	6.52	6.06
Mortgage rate, 30-year fixed	6.94	7.43	8.21	8.33	8.23
Prime rate	8.35	8.00	8.50	8.73	9.00

INTERNATIONAL STATISTICS

Exchange Rates	**Current level March 30, 2000**	**Percent Change from** Week ago	Year ago
Euro (in U.S. dollars)	0.959	-1.0	-10.6
Yen (per U.S. dollar)	105.5	-1.8	-12.1
Major currencies index (Mar. 1973=100) (trade-weighted value of the U.S. $)	95.44	-0.5	-0.3

International Comparisons [1/]	**Real GDP growth** (percent change last 4 quarters)	**Unemployment rate** (percent)	**CPI inflation** (percent change in index last 12 months)
United States	4.6 (Q4)	4.1 (Feb)	3.2 (Feb)
Canada	4.7 (Q4)	6.8 (Jan)	2.7 (Feb)
Japan	0.0 (Q4)	4.7 (Dec)	-0.9 (Jan)
France	3.2 (Q4)	10.4 (Dec)	1.4 (Feb)
Germany	2.3 (Q4)	8.7 (Jan)	1.8 (Feb)
Italy	2.1 (Q4)	11.1 (Oct) [2/]	2.4 (Feb)
United Kingdom	3.0 (Q4)	5.9 (Nov)	2.3 (Feb)

1/ For unemployment data, rates approximating U.S. concepts as calculated by the U.S. Department of Labor, Bureau of Labor Statistics, except as noted in footnote 2.
2/ Data from OECD standardized unemployment rates.

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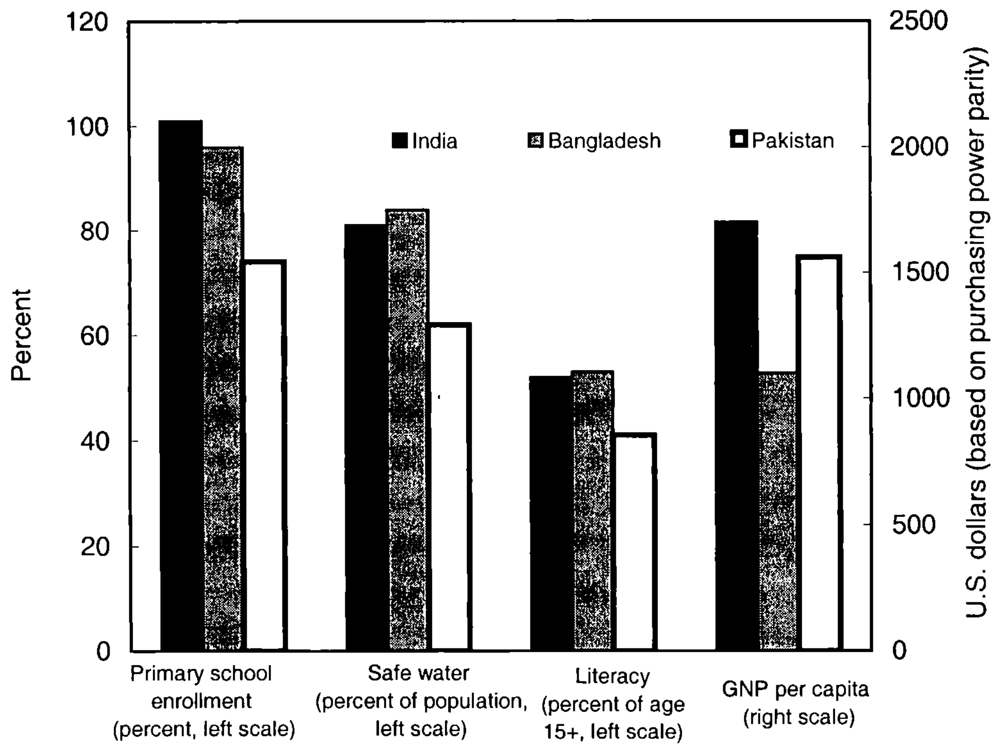
WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

Prepared by the Council of Economic Advisers
with the assistance of the Office of the Vice President

March 17, 2000

CHART OF THE WEEK

South Asia Social and Economic Indicators



Bangladesh, India, and Pakistan have similar levels of economic development, typical of low-income countries. Bangladesh is the poorest of the three in terms of GNP per capita, but Pakistan lags behind in other social and economic indicators.

CONTENTS

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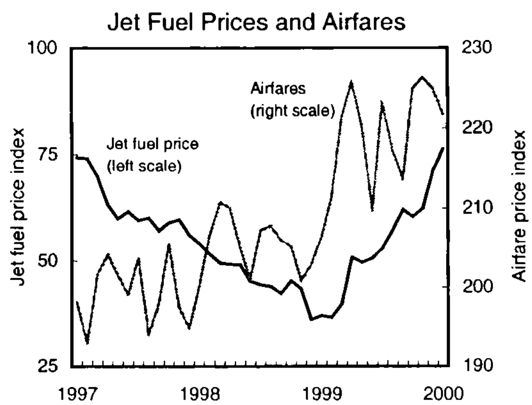
SPECIAL ANALYSIS

Supply and Demand for Air Travel

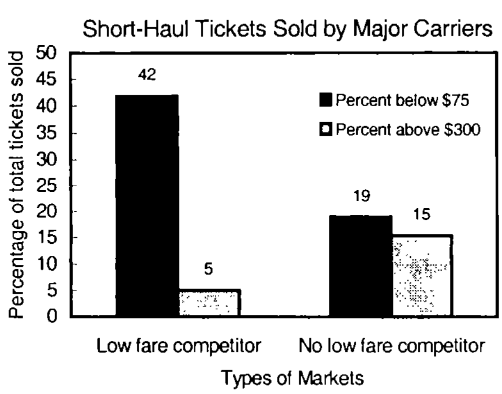
Airfares have risen 7 percent over the last year, while jet fuel costs have soared. High demand for air travel and tight capacity have also contributed to rising airfares. Looking forward, competition from low-fare carriers should help reduce average airfares as these airlines enter more routes.

Fuel prices and airfares. Fuel accounts for about 10 percent of airlines' total operating expenses, so that the doubling in the price of fuel over the last year implies a 10 percent increase in airlines' operating costs. The price of jet fuel is expected to fall back to its December 1999 level over the second half of this year. Although fuel prices and airfares have risen together over the last year (see upper chart), changes in fuel prices are not always a good predictor of changes in airfares. For example, between January 1997 and January 1999, fuel prices declined by 50 percent, yet airfares rose 4 percent.



Surging demand. A second explanation for the rise in airfares over the last several years is that surging demand has lead airlines to increase fares. Load factors (which represent a weighted average of seats filled) on domestic flights increased from about 65 percent in 1995 to over 70 percent in 1998 and 1999. With load factors running at record highs compared to the past two decades, airlines have less to gain from lowering fares. Although a recent attempt to raise fares faltered last weekend, rising fuel prices may provide an additional incentive for an oligopolistic industry to raise fares when demand is high.

Competition from low-fare carriers. Low-fare competitors force major airlines to be more generous in allocating seats to low-fare categories. With a low-fare competitor present, major carriers allocate 42 percent of short-haul seats to tickets selling below $75 each way, but if no low-fare carrier is present, the majors allocate only 19 percent of capacity to these low fares (see lower chart). By contrast, major airlines sell barely 5 percent of their capacity to travelers paying above $300 each way in markets where low-fare carriers are present, compared to 15 percent of capacity otherwise.



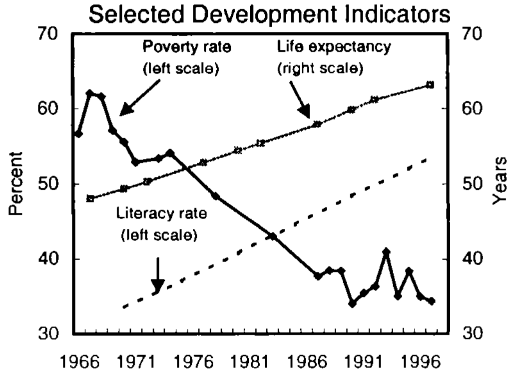
ARTICLE

Poverty and Development in India

India has made substantial strides in reducing poverty since Independence in 1947. Its development strategy has helped expand the economy at a strong 6 percent annual rate for the past 2 decades, as well as eliminate famines, bring down high illiteracy and fertility rates, and establish a diversified industrial base with a relatively sophisticated financial sector. Nevertheless, growing inequality across states and large fiscal deficits, resulting in part from inefficient subsidies, remain pressing challenges.

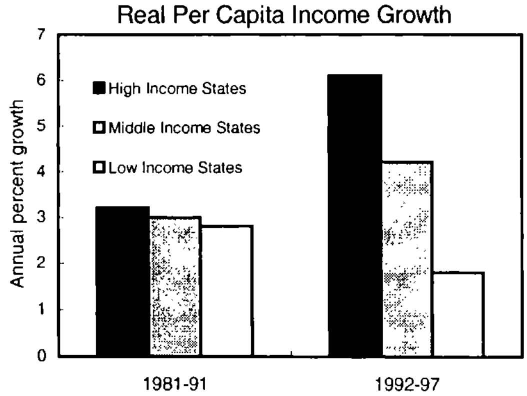
Progress, crisis, and reform. The poverty rate in India has declined significantly since the late 1960s and other social indicators have improved substantially as well (see upper chart). In the 1980s, real per capita GDP grew nearly 4 percent per year. However, the development strategy of the 1970s and 1980s was rooted in an extensive system of trade protection and government regulation, which proved unsustainable and resulted in the 1991 balance of payments and fiscal crisis. Subsequent stabilization and reforms moved in the direction of opening up the economy, reducing the public sector's role, and liberalizing and strengthening the financial sector. These policies generated a quick recovery and unprecedented GDP growth, led by productivity increases and a booming private sector. The apparent stagnation of the poverty rate in the 1990s may well be a statistical artifact resulting from a change in poverty survey methodology, as income per capita has grown nearly 5 percent each year. Nevertheless, with over 200 million people still undernourished, further reforms and liberalization are essential.

Selected Development Indicators



Differential growth and widening disparities among states. Recent growth has been uneven across India's 25 states (see lower chart). While poverty declined in all states, progress was generally slower in low-income states, which constitute about 40 percent of India's total population. For example, although both states had around two-thirds of the population living below the poverty line in 1978, the poverty rate fell only 4 percentage points by 1994 in Bihar, India's poorest state, while it fell 24 percentage points in Maharashtra, a rich state containing

Real Per Capita Income Growth



Mumbai (Bombay). More broadly, the gap in poverty rates between a group of low-income and other large states reached nearly 18 percentage points in 1997, more than twice as large as the gap in the 1980s.

Fiscal reform. The combined central and state government fiscal deficit is approaching 10 percent of GDP, posing another concern for sustainable development. In addition to crowding out private sector investment and raising risks of macroeconomic instability (such as inflation), high deficits and public debts constrain social and infrastructure spending that is critical to poverty reduction. Reducing the implicit and explicit subsidies, which are especially large in the power and irrigation sectors, would help contain fiscal deficits, increase efficiency, encourage private investment, and also free up resources for much-needed development spending.

Conclusion. The series of reforms carried out by the Indian government have had a profound effect on India's one billion people. Nevertheless, India remains an extremely poor country—with national per capita income less than a third of the world average—and much work remains to be done.

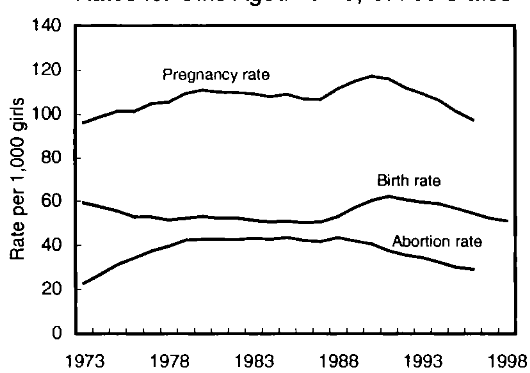
ARTICLE

Adolescent Pregnancy: Trends and Comparisons

Rates of adolescent childbearing, abortion, and pregnancy have declined in the United States in the 1990s. A new study shows that these trends have also occurred in many other developed countries. Nevertheless, the levels in the United States remain relatively high and are similar to those in transition economies like Ukraine and Bulgaria.

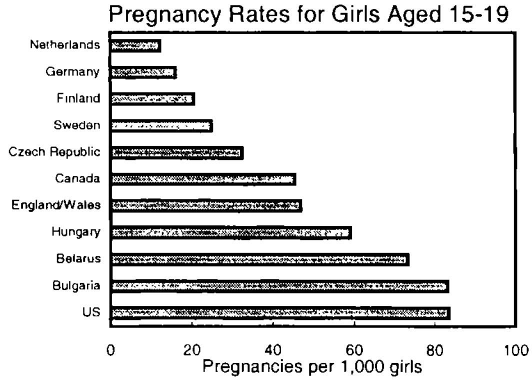
Trends for America's teenagers. Preliminary data for 1998 from the National Center for Health Statistics show a continued decline in the birth rate for American teens (see upper chart). The 1998 rate of 51 births per 1,000 females 15-19 is nearly 18 percent lower than the recent peak of 62 reached in 1991. The birth rate for black teenagers showed an even sharper decline, while that of Hispanic teenagers declined more modestly. The current rates for African Americans and Hispanics are about 2.5 times that of non-Hispanic whites. Other data show recent declines in teen pregnancy and abortion rates. The teen pregnancy rate decreased by approximately 16 percent between 1991 and 1996 (the latest year available). The abortion rate declined by 22 percent over the same period, and the share of pregnancies ending in abortion fell.

Rates for Girls Aged 15-19, United States



International comparison. A recently published study compiled data on adolescent birthrates for 46 developed countries over recent decades, and gathered abortion and pregnancy rates for a subset of these countries. The range in the pregnancy rates across these countries in the mid-1990s is very wide, from a low of 12 births per 1,000 adolescents females in the Netherlands to a high of about 83 per 1,000 in Bulgaria and the United States (see lower chart). Western European and other developing countries generally have lower teen pregnancy rates than eastern European countries and the United States. Over the early 1990s adolescent pregnancy rates declined in nearly all of the reporting countries. International comparisons of adolescent birth and abortion rate data reveal a similar pattern.

Pregnancy Rates for Girls Aged 15-19



Conclusion. Adolescent childbearing has been tied to a number of negative outcomes for both the mother and the child. Recent declines in teen pregnancy rates are clearly good news. The pervasive decline seen across countries suggests the causes behind this trend are not limited to any one country.

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

Effects of Welfare Reform. A follow-up study to the 1997 and 1999 CEA reports on welfare caseloads examines the effects of welfare waivers and TANF on women without high school diplomas. The study found declines in welfare participation and poverty and increases in employment in waiver states. Effects on earnings and incomes were ambiguous. Waivers were associated with a modest increase in these women's probability of being married and a reduction in their probability of being the head of their household. TANF had a similar effect on poverty, and had twice as large an effect on welfare participation. The study found no effects of TANF on employment, earnings, family income, or household makeup. The study also looks at the distributional effects of welfare reform, and finds income gains to be evenly distributed under waivers, but concentrated among the middle and upper parts of the distribution of these women since implementation of TANF.

Stable, High-Quality Child Care Increases Work. The presence of a well-developed and stable child care market has a strong positive effect on the probability that current and former welfare recipients will work, according to a recent study of Massachusetts families that received child care vouchers. In addition, reductions in the cost of child care significantly increase the probability of work. Availability of pre-kindergarten and kindergarten programs are also important. Whereas full-day programs are more conducive to working full-time, the results suggest that part-day kindergarten, pre-K, and Head Start programs are more conducive to parents continuing their education, which is easier to do on a part-time basis.

Income Redistribution under Social Security. While Social Security is highly progressive at the individual level—redistributing income from high- to low-earners—a recent study suggests that the progressivity is less pronounced when looking at family incomes. Much of the total redistribution occurs from primary to secondary earners (usually from husbands to wives) within families. In addition, the spousal and survivor benefits cause a sizable redistribution from families where both spouses work in the labor force to families where a spouse spent a significant number of years outside of the labor force. This implies that one-earner families benefit under the current system more than two-earner families with the same lifetime earnings.

INTERNATIONAL ROUNDUP

China Relaxes Rules on Encryption Technology. This week China backed away from restrictions on the use and sale of encryption technology that would have severely impeded the use of foreign software, mobile phones, e-mail and other communications products. In a statement released this week, the Chinese State Encryption Management Commission (SEMC) provided a "clarification" of regulations issued last year, stating that limits will only be placed on hardware and software for which encryption and decoding operations are core functions. The statement specifically stated that wireless telephones, browser software, and Microsoft Windows software are not included in this category and thus will not be restricted. The SEMC also stated that they will not carry out "encryption key trusteeship," allaying fears that the government would gain access to corporate secrets and undermine intellectual property rights by requiring companies to hand over their encryption codes.

IT and Communications Sectors Growing in OECD. Spending on Information and Communications Technology (ICT) in OECD countries rose from 6 percent of GDP in 1992 to nearly 7 percent in 1997, according to a new OECD report. ICT industries are R&D-intensive and account for more than 20 percent of total business R&D in eight major countries including the United States. Moreover, 10 of the world's top 15 corporate R&D spenders in 1998 were in the electronics and IT hardware sectors. Patent data suggest an increase in innovative activity within ICT industries. Computers, office machinery, and electronic equipment accounted for 25 percent of U.S. industrial patents granted to OECD country inventors in 1996, up from 13 percent in 1980. ICT businesses in the United States account for about 30 percent of world ICT production. These businesses have been on an investment spree of late and now absorb two-thirds of all venture capital in the United States.

Water, Water Everywhere, Not a Drop to Drink. The world's ability to feed itself is threatened by a water shortage, reports the World Commission on Water for the 21st Century. Currently, 1.4 billion people live without clean drinking water, and nearly 450 million people in 29 countries confront water shortage. Half the world's rivers and lakes are seriously polluted, and other water sources are being used at an unsustainable rate. India, for example, uses twice as much water from its aquifers as is being replenished naturally, potentially leading to a loss of a quarter of its food production over the next 25 years. With the global population projected to increase by 3 billion by 2025, some 20 percent more water will be needed than is now available. As most fresh water is used for agriculture, failure to bridge this water gap may imply higher food prices and expensive food imports for water scarce countries, which are predominantly poor. The Commission emphasized technology improvements, market pricing, and raising public awareness as key solutions.

EYES ONLY

RELEASES THIS WEEK

Consumer Price Index

****Embargoed until 8:30 a.m., Friday, March 17, 2000****

The consumer price index increased 0.5 percent in February. Excluding food and energy, consumer prices rose 0.2 percent.

Producer Price Index

The producer price index for finished goods increased 1.0 percent in February. Excluding food and energy, producer prices rose 0.3 percent.

Housing Starts

Housing starts increased 1 percent in February to 1.781 million units at an annual rate.

Industrial Production and Capacity Utilization

The Federal Reserve's index of industrial production increased 0.3 percent in February following an increase of 1.1 percent in January. Capacity utilization was unchanged at 81.7 percent.

Retail Sales

Advance estimates show that retail sales rose 1.1 percent in February following an increase of 0.4 percent in January. Excluding sales in the automotive group, retail sales rose 1.0 percent following a decrease of 0.5 percent.

MAJOR RELEASES NEXT WEEK

U.S. International Trade in Goods and Services (Tuesday)
Advance Durable Shipments and Orders (Friday)

EYES ONLY

U.S. ECONOMIC STATISTICS

	1970-1993	1999	1999:2	1999:3	1999:4
Percent growth (annual rate)					
Real GDP (chain-type)	3.0	4.5	1.9	5.7	6.9
GDP chain-type price index	5.2	1.6	1.3	1.1	2.0
Nonfarm business (NFB) sector:					
Productivity (chain-type)	1.7	3.6	0.6	5.0	6.4
Real compensation per hour:					
Using CPI	1.0	1.7	1.4	2.1	0.8
Using NFB deflator	1.5	3.0	2.9	4.0	2.1
Shares of Nominal GDP (percent)					
Business fixed investment	11.4	12.6	12.6	12.7	12.5
Residential investment	4.5	4.4	4.5	4.4	4.4
Exports	8.2	10.8	10.7	10.8	10.9
Imports	9.2	13.5	13.4	13.8	14.0
Personal saving	6.6	1.7	1.8	1.5	1.3
Federal surplus	-2.8	N.A.	1.3	1.4	N.A.

	1970-1993	1999	December 1999	January 2000	February 2000
Unemployment Rate (percent)	6.7**	4.2**	4.1	4.0	4.1
Payroll employment (thousands)					
increase per month			309	384	43
increase since Jan. 1993					20823
Inflation (percent per period)					
CPI	5.8	2.7	0.2	0.2	**0.5**
PPI-Finished goods	5.0	3.0	0.1	0.0	**1.0**

**Figures beginning 1994 are not comparable with earlier data.

New or revised data in **boldface**.
CPI data **embargoed until 8:30 a.m., Friday, March 17, 2000**.

EYES ONLY

FINANCIAL STATISTICS

	1998	1999	January 2000	February 2000	March 16, 2000
Dow-Jones Industrial Average	8626	10465	11281	10542	10631
Interest Rates (percent per annum)					
3-month T-bill	4.78	4.64	5.32	5.55	5.70
10-year T-bond	5.26	5.65	6.66	6.52	6.26
Mortgage rate, 30-year fixed	6.94	7.43	8.21	8.33	8.24
Prime rate	8.35	8.00	8.50	8.73	8.75

INTERNATIONAL STATISTICS

Exchange Rates	**Current level March 16, 2000**	**Percent Change from Week ago**	**Year ago**
Euro (in U.S. dollars)	0.971	0.3	-11.0
Yen (per U.S. dollar)	105.6	-0.8	-10.3
Major currencies index (Mar. 1973=100) (trade-weighted value of the U.S. $)	95.53	0.1	0.7

International Comparisons [1]	**Real GDP growth** (percent change last 4 quarters)	**Unemployment rate** (percent)	**CPI inflation** (percent change in index last 12 months)
United States	4.5 (Q4)	4.1 (Feb)	**3.2** (Feb)
Canada	4.7 (Q4)	6.8 (Jan)	2.3 (Jan)
Japan	0.0 (Q4)	4.7 (Dec)	-0.9 (Jan)
France	3.2 (Q4)	10.4 (Dec)	1.6 (Jan)
Germany	2.3 (Q4)	8.7 (Jan)	1.7 (Jan)
Italy	1.2 (Q3)	11.1 (Oct) [2]	2.2 (Jan)
United Kingdom	2.9 (Q4)	5.9 (Nov)	1.9 (Jan)

U.S. CPI data **embargoed until 8:30 a.m., Friday, March 17, 2000.**

1/ For unemployment data, rates approximating U.S. concepts as calculated by the U.S. Department of Labor, Bureau of Labor Statistics, except as noted in footnote 2.

2/ Data from OECD standardized unemployment rates.

EYES ONLY

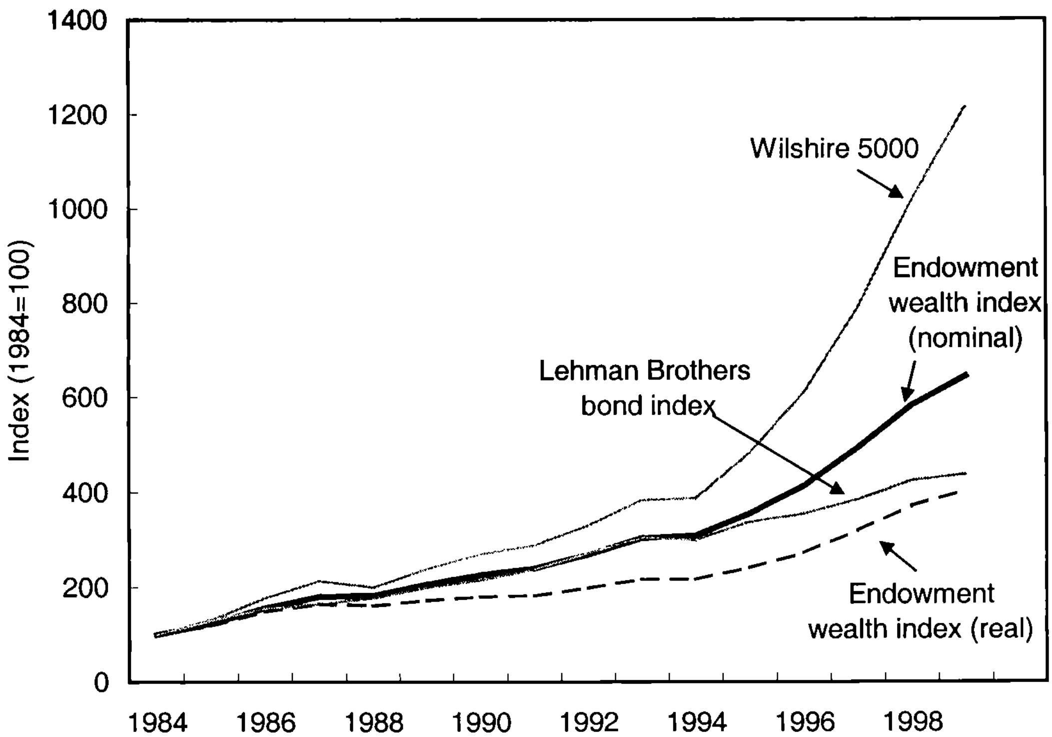
WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

Prepared by the Council of Economic Advisers
with the assistance of the Office of the Vice President

March 10, 2000

CHART OF THE WEEK

Performance of College and University Endowments



The increase in the aggregate value of college and university endowments in recent years has been better than bonds but not as good as stocks, most likely because few if any endowments are exclusively invested in stocks. In addition, changes in endowments reflect fund raising and withdrawals. Adjusted for inflation, endowments in 1999 were 300 percent higher than they were in 1984. (An article in this briefing describes increases in tuition and financial aid at colleges and universities.)

EYES ONLY

CONTENTS

"It's not just me, Dad. Amazon.com has never made a cent, either."

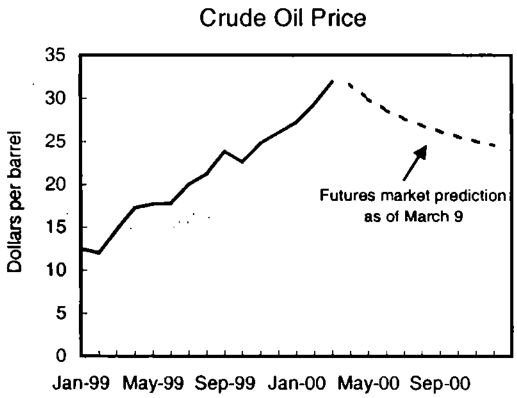
EYES ONLY

CURRENT DEVELOPMENT

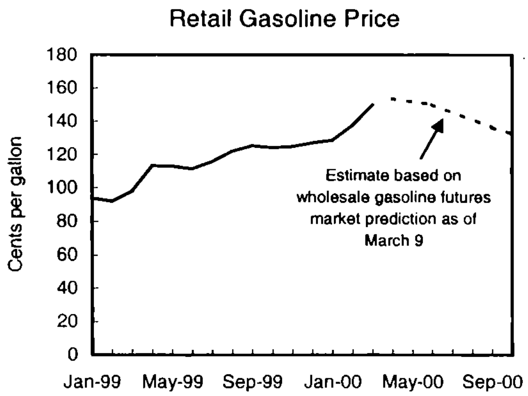
Oil and Gasoline Outlook

Although crude oil prices reached a post-Gulf War high earlier this week before retreating a bit, lower prices in the futures market reflect expectations that OPEC will announce a supply increase at its March 27 meeting. Nevertheless, gasoline prices this summer will be substantially higher than they were last year.

Crude oil. This week's peak price of over $34 per barrel capped a year of increases (see upper chart). However, oil futures prices are signaling a decline to about $25 per barrel by the end of the year. Given current projections for world oil demand, these futures prices imply that markets are expecting an increase in supply of about 1 million barrels per day by this spring, 2 million barrels per day by the end of the summer, and 3 million barrels per day by the end of the year.



Gasoline. Low gasoline inventories and rising crude oil prices have led to rising gasoline prices, with the national average retail price reaching $1.50 per gallon (see lower chart). Since refiner margins historically increase during the spring and summer months because of the summer driving season, gasoline prices may keep rising even as crude oil prices fall. Nevertheless, futures prices suggest that the retail price of gasoline will decline to just above $1.30 per gallon by October. Local prices vary considerably around the national average. For example, in a recent survey, retail prices in Tulsa were about 20 cents per gallon lower than the national average while those in San Francisco were about 25 cents higher.



Risks. The decline in oil and gasoline prices implicit in the futures markets is subject to uncertainty. For example, the Department of Energy's most recent energy market forecast, released this week, estimates that gasoline prices will average about $1.50 per gallon throughout the summer, in part at least because DOE appears to expect less additional world crude supply than the markets. As a rough rule of thumb, each 1 million barrel per day increase in supply above current production and demand growth decreases crude prices by $4 per barrel and gasoline prices by about 10 cents per gallon in the short run. The markets appear to expect OPEC to increase supply by about a million barrels per day. But in the past 2 weeks, 1-month-out futures prices have shown considerable volatility, based in part on statements by various OPEC members about what will be decided at the March 27 meeting.

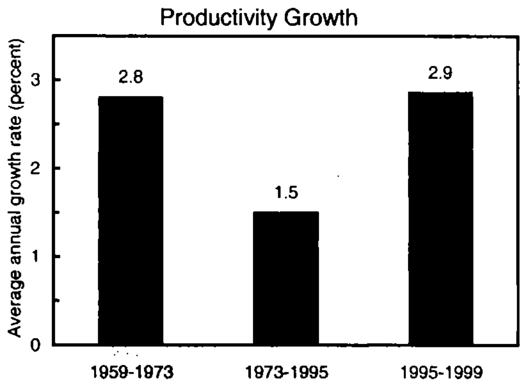
With gasoline inventories low, there is also uncertainty in the gasoline market over and above that associated with crude oil prices. Local price spikes may occur due to supply shocks such as a refinery or pipeline shutdown for repair. Such short-term price spikes occurred in the gasoline market in California last year due to a refinery fire, as well as in the home heating oil market in New England this winter because of weather-related delivery problems. DOE estimates that unexpected supply shocks could push monthly average gasoline prices up into the $1.75 to $1.80 per gallon range.

Macroeconomic effects. The higher crude oil prices will likely add an additional 0.2 to 0.3 percentage point to the consumer price index for February, and if gasoline prices remain at their current levels, another 0.2 to 0.3 percentage point in March. (A national average increase of 10 cents per gallon for gasoline increases the CPI by about 0.25 percentage point and the producer price index by about 0.6 percentage point.) However, the drop in oil prices over the rest of the year implied by the futures market would undo these increases.

SPECIAL ANALYSIS

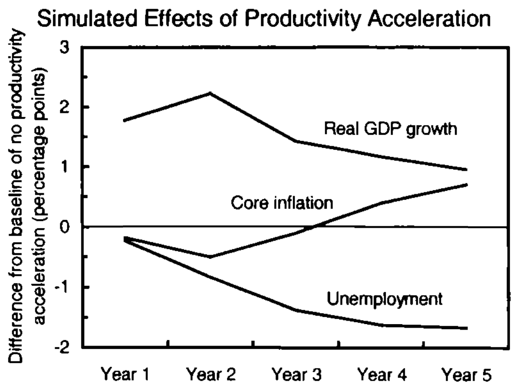
Growing Pains in the New Economy

The sustained increase in productivity growth since 1995 (see chart) bodes well for future growth in real wages. The recent productivity acceleration has also helped lower core inflation. Paradoxically, however, it may also be a source of potential overheating of the economy in the short run. Alan Greenspan pointed to such a possibility in recent testimony, observing that the improvement in productivity trends may be a reason why increases in spending have been outstripping increases in domestic supply, causing unemployment to fall and the current account deficit to widen, and increasing the risk of inflation.



A spending boom. One implication of accelerating productivity is higher expected future corporate profits through the effects of lower costs and increased sales. This improved profit outlook, in turn, justifies higher stock prices. The resulting increase in household wealth encourages greater consumer spending through the wealth effect described in last week's *Weekly Economic Briefing*. But the productivity acceleration also causes wages and incomes to rise faster, and as people come to expect this to continue, they raise their spending patterns accordingly. Together, these effects can cause current spending to increase more than current income, because households might rationally borrow against the income they expect to receive in the future in order to pay for rising standards of living starting today. A further boost to aggregate spending comes from business investment, as firms ramp up capacity to meet growing demand for their products.

An experiment. Record levels of consumer confidence, the booming stock market, and rapid growth in consumer and business spending offer circumstantial evidence of a spending boom fueled by the productivity acceleration. Still, sustained changes in productivity growth are rare, making a careful empirical test of the link between accelerating productivity and spending difficult. An experiment using the Federal Reserve's macroeconomic model provides some indirect support for this hypothesis, however. The experiment involves comparing two simulations: a base case with a constant trend rate of growth of productivity, and a second case with a 1 percentage point higher trend rate of growth of productivity. The Federal Reserve is assumed to hold the real federal funds rate constant in both simulations. The results of the experiment are meant to be illustrative of the linkages between productivity and spending; they are not mean to measure the extent to which productivity increases have contributed to actual economic developments.



Model results. In the experiment, the spending boom outlined above causes real GDP to grow faster than potential GDP for the first 4 years (see chart). The shortfall in supply is made up by hiring additional labor (which causes the unemployment rate to fall by 1.7 percentage points) and a widening of the current account deficit (not shown in chart) as imports make up for the share of demand not met by domestic producers.

The productivity acceleration has two competing effects on inflation. Because it takes several years for wage increases to catch up with the rise in productivity, unit labor costs initially fall, putting downward pressure on inflation. This impulse for falling inflation diminishes over time. If it were not for increased labor market tightness, the inflation rate would eventually stabilize at a lower level. This outcome could be accomplished if the Federal Reserve were to raise interest rates sufficiently to keep spending in line with potential GDP. Without such rate increases, however, the tighter labor markets resulting from the spending boom put upward pressure on wages and prices, eventually leading to a pickup in core inflation.

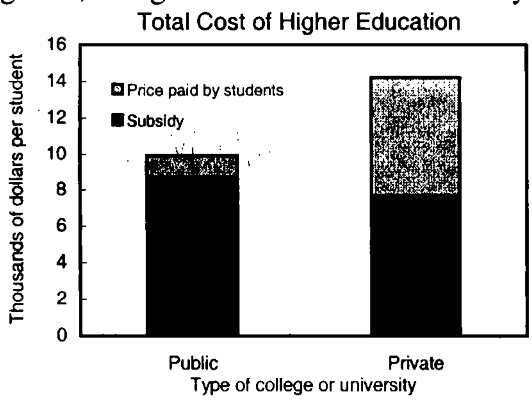
Conclusion. This model-based experiment provides one basis of support for Chairman Greenspan's contention that the productivity acceleration may be a key factor behind the recent spending boom and fall in unemployment. Other models might produce different results. But as long as the inflationary pressure from tight labor markets outweighs the dampening effect of lower unit labor costs, a policy tightening is needed to forestall rising inflation.

ARTICLE

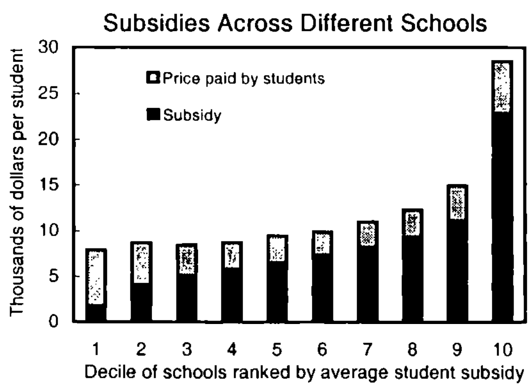
The Market for Higher Education

Tuition has been rising faster than inflation at many colleges, but a significant proportion of the increase in the "list" price of a college education has been offset by increases in financial aid. Many colleges use aid to compete for students, and such competition appears to have increased the likelihood that well-qualified applicants from financially disadvantaged backgrounds will attend good schools.

Subsidies for higher education. Most colleges and universities are non-profit institutions that subsidize the cost of educating their students. Those subsidies come in two forms: subsidies targeted at individual students through financial aid grants, and general subsidies received by all students because even the full tuition price does not cover the total cost of a student's education. On average, financial aid accounts for only about 25 percent of the total subsidy across all types of schools. A study of educational costs and net payments by students during the 1994-1995 school year found that the average subsidy (from both financial aid and general subsidies) was about $8,700 per year at public universities and colleges, and about $7,700 at private schools (see upper chart). Student payments make up the difference between the subsidy and the total cost of a college education, and these payments averaged $1,200 per year in the public sector and $6,500 per year at private institutions.



Subsidy differences across institutions. These averages conceal wide differences among individual institutions. When institutions are grouped according to subsidy levels, those in the upper 10 percent look very different from the rest (see lower chart). Among these institutions, which include both private schools like Harvard, Stanford, and Williams and public schools like Berkeley, UCLA, and the University of Minnesota, the average subsidy per student was $22,800 during the 1994-1995 school year. Students at these institutions paid an average of $5,700, which is also higher than at most other schools. The institutions with the highest subsidy level are also the most selective, and they attract students with better academic credentials. Students at these institutions are paying more for a more expensive (and presumably higher quality) education than most students at



less well subsidized schools. As the subsidy level declines, however, so does school selectivity and student quality.

Competition in higher education. This disparity in subsidy levels reflects the fact that at the upper end of the distribution, schools place a high value on their academic reputation and compete aggressively for the top caliber students necessary to maintain that reputation. By setting a price below the market clearing level, these schools can increase the pool of applicants and thereby select among applicants with better academic credentials.

Trends in tuition increases in higher education. Competition has led to changes in how schools price their services. Between the 1986-87 school year and the 1994-95 school year, real tuition "list" prices increased by 34 percent. As a result of increases in financial aid, however, the amount students actually paid increased only about half as much.

Effects on student access to college. The increasing competition for high quality students has helped students from disadvantaged financial backgrounds. One study found that in 1972 students from low income families who scored well on the SAT and who were in the top quarter of their high school class had a 6 percent probability of not going to college at all, and a 33 percent probability of going to one of the most expensive colleges. In 1992 students with the same background had a zero percent chance of not going to college, and a 43 percent chance of ending up at one of the top schools.

Conclusion. The cost of providing a college education varies widely among institutions, as does the amount of that cost which is subsidized. At the most selective schools with the largest subsidies, however, competition for students through financial aid awards appears to be helping those from financially disadvantaged backgrounds.

EYES ONLY

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

Beige Book Reports Growth Continuing in First Quarter. Reports from the twelve Federal Reserve Districts indicated appreciable expansion of economic activity during late January and February. The majority of districts reported strong growth, with the remaining reports pointing to moderate growth or continued high levels of activity. Retail sales expanded significantly over their year-earlier levels. Gains in manufacturing output were widespread. Providers of services to businesses and consumers continued to expand output and employment substantially. Real estate market activity and construction were at high levels, although slight cooling was evident in some areas. Conditions in the agricultural and resource extraction sectors were mixed. Demand for bank loans generally was strong, but several districts reported slower activity in some loan categories, especially consumer loans and residential mortgages. Constraints on the availability of labor and other production inputs were apparent in many areas. Most districts reported tight supplies and upward wage pressure for various types of labor, both skilled and entry level. Despite faster wage growth for some workers, increases in the prices of final goods and services were limited overall, although the prices of transportation services and some industrial commodities rose noticeably.

Class Size Research: a Critique of the Critics. A critical question in the economics of education policy is whether changes in school spending such as reductions in class size affect student performance. Evaluations of Tennessee's STAR experiment provide some of the strongest evidence that reducing class size has a positive effect on student performance, but other studies are less conclusive. In fact, one influential scholar who conducted a quantitative summary of the literature concluded that there is no strong or consistent relationship between school inputs and student performance. But this agnostic conclusion has been called into question by one of the leading proponents of the view that class size matters, who argues in a new study that once the quality of individual estimates is taken into account the weight of the evidence supports the conclusion that class size is systematically related to student achievement. In addition, the new study performs a cost-benefit analysis of class size reduction, based on the STAR experiment. The key finding is that the present value of the benefits of class size reduction in terms of increased student income is greater than, or roughly equal to, the costs, depending upon assumptions about the discount rate and productivity growth.

INTERNATIONAL ROUNDUP

Education Access Improving in Developing Countries. A new OECD report measuring educational performance in 18 non-OECD developing countries finds that most have achieved universal primary education and are closing the gap at the lower secondary level. In most countries, the percentage of the population that has completed at least a lower secondary education is significantly higher in the 25-34 year old age group than in the 55-64 year old age group, indicating broad progress in increasing education access over time. However, of the countries studied, only Argentina, Brazil, and Chile have participation rates higher than 75 percent for the final year of compulsory schooling, indicating that most countries still have not met the objective of universal compulsory education. Interestingly, all but one of the countries in the study invest a higher proportion of their public budgets in education than the average OECD country, indicating that education is a high priority. However, expenditure per student in these countries still lags far behind the OECD average at both the primary and secondary levels.

EC Endorses Emissions Trading. As a stepping stone to help the EU achieve its internationally agreed emission reduction targets, the European Commission launched the European Climate Change Program this week and released a Green Paper advocating greenhouse gas emissions trading. The latest data show that CO_2 emissions are increasing in the EU, and the Commission emphasized that without additional measures, the EU will not meet its Kyoto Protocol target of cutting greenhouse gas emissions by 8 percent between 1990 and 2008-12. Besides reducing emissions from specific sources, the EC advocates the adoption of an internal EU emissions trading scheme that will allow the energy sector and big industrial installations to buy and sell pollution permits.

Congressional Commission Recommends Contraction of Fund and Bank. This week, the International Financial Institution Advisory Commission, established by Congress in 1998, released a report advocating major reductions in the activities of the International Monetary Fund and the World Bank. The report recommends that the IMF restrict its lending to providing short-term liquidity and stop extending long-term loans in exchange for member countries' agreeing to abide by IMF-imposed conditions. The emergency loans would be made at a penalty (above-market) rate and have a limited maturity. The report suggests that the Bank end all resource transfers to countries that enjoy access to private capital markets (the bulk of current Bank lending) or that have per capita incomes exceeding $4,000. It recommends replacing loans and guarantees for physical infrastructure and social service projects with grants. It also calls for the World Bank to transfer primary responsibility for Latin America and Asia to these regions' development banks. The commission also proposes that both the IMF and the World Bank write off all their claims against heavily-indebted poor countries that implement an effective economic and social development strategy.

EYES ONLY

RELEASES THIS WEEK

Productivity

According to revised estimates, nonfarm business productivity rose 6.4 percent at an annual rate in the fourth quarter of 1999. Manufacturing productivity rose 10.3 percent.

MAJOR RELEASES NEXT WEEK

Advance Retail Sales (Tuesday)
Industrial Production and Capacity Utilization (Wednesday)
Producer Prices (Thursday)
Housing Starts (Thursday)
Consumer Prices (Friday)

EYES ONLY

U.S. ECONOMIC STATISTICS

	1970-1993	1999	1999:2	1999:3	1999:4
Percent growth (annual rate)					
Real GDP (chain-type)	3.0	4.5	1.9	5.7	6.9
GDP chain-type price index	5.2	1.6	1.3	1.1	2.0
Nonfarm business (NFB) sector:					
Productivity (chain-type)	1.7	**3.6**	0.6	5.0	**6.4**
Real compensation per hour:					
Using CPI	1.0	**1.7**	**1.4**	**2.1**	**0.8**
Using NFB deflator	1.5	**3.0**	2.9	4.0	**2.1**
Shares of Nominal GDP (percent)					
Business fixed investment	11.4	12.6	12.6	12.7	12.5
Residential investment	4.5	4.4	4.5	4.4	4.4
Exports	8.2	10.8	10.7	10.8	10.9
Imports	9.2	13.5	13.4	13.8	14.0
Personal saving	6.6	1.7	1.8	1.5	1.3
Federal surplus	-2.8	N.A.	1.3	1.4	N.A.

	1970-1993	1999	December 1999	January 2000	February 2000
Unemployment Rate (percent)	6.7**	4.2**	4.1	4.0	4.1
Payroll employment (thousands)					
increase per month			309	384	43
increase since Jan. 1993					20823
Inflation (percent per period)					
CPI	5.8	2.7	0.2	0.2	N.A.
PPI-Finished goods	5.0	3.0	0.1	0.0	N.A.

**Figures beginning 1994 are not comparable with earlier data.

New or revised data in **boldface**.

EYES ONLY

FINANCIAL STATISTICS

	1998	1999	January 2000	February 2000	March 9, 2000
Dow-Jones Industrial Average	8626	10465	11281	10542	10011
Interest Rates (percent per annum)					
3-month T-bill	4.78	4.64	5.32	5.55	5.66
10-year T-bond	5.26	5.65	6.66	6.52	6.35
Mortgage rate, 30-year fixed	6.94	7.43	8.21	8.33	8.23
Prime rate	8.35	8.00	8.50	8.73	8.75

INTERNATIONAL STATISTICS

Exchange Rates	**Current level March 9, 2000**	**Percent Change from Week ago**	**Percent Change from Year ago**
Euro (in U.S. dollars)	0.968	0.7	-10.9
Yen (per U.S. dollar)	106.5	-0.9	-12.3
Major currencies index (Mar. 1973=100) (trade-weighted value of the U.S. $)	95.44	-0.5	-0.1

International Comparisons [1]	**Real GDP growth** (percent change last 4 quarters)	**Unemployment rate** (percent)	**CPI inflation** (percent change in index last 12 months)
United States	4.5 (Q4)	4.1 (Feb)	2.7 (Jan)
Canada	4.7 (Q4)	6.8 (Jan)	2.3 (Jan)
Japan	1.0 (Q3)	4.7 (Dec)	-0.9 (Jan)
France	3.2 (Q4)	10.4 (Dec)	1.6 (Jan)
Germany	2.3 (Q4)	8.7 (Jan)	1.7 (Jan)
Italy	1.2 (Q3)	11.1 (Oct) [2]	2.2 (Jan)
United Kingdom	2.9 (Q4)	5.9 (Nov)	1.9 (Jan)

1/ For unemployment data, rates approximating U.S. concepts as calculated by the U.S. Department of Labor, Bureau of Labor Statistics, except as noted in footnote 2.

2/ Data from OECD standardized unemployment rates and reflects new series for Italy.

EYES ONLY

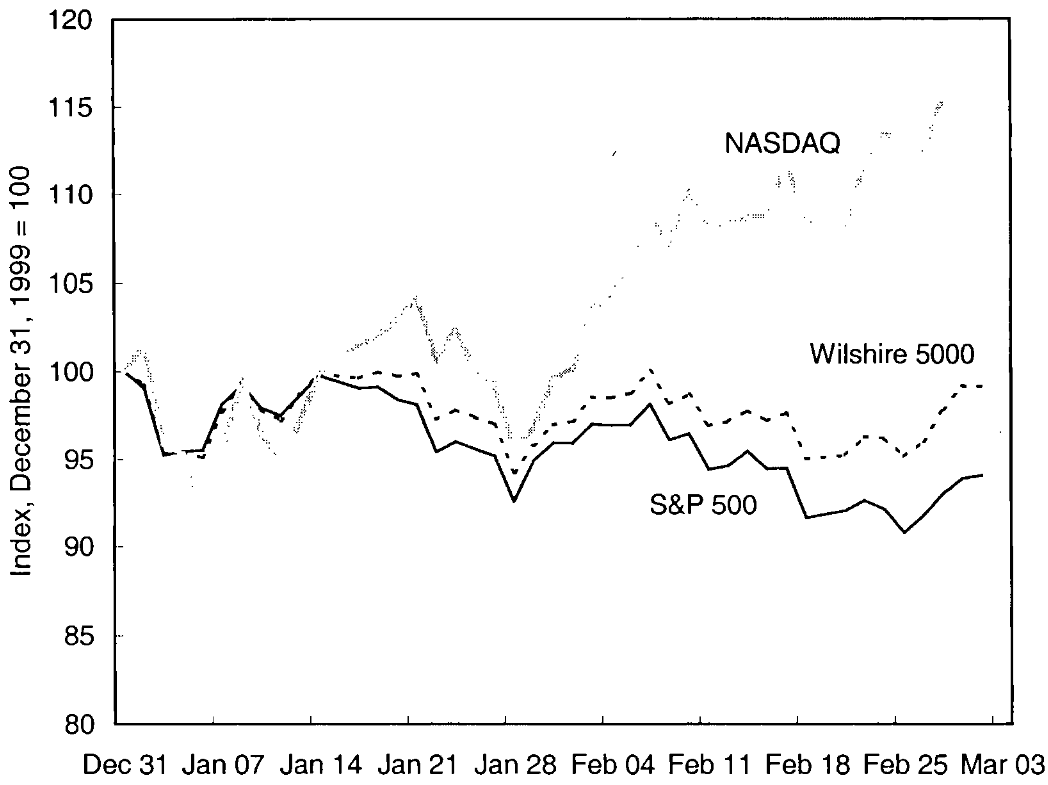
WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

Prepared by the Council of Economic Advisers
with the assistance of the Office of the Vice President

March 3, 2000

CHART OF THE WEEK

A Tale of Two Stock Markets



Thus far in 2000, the technology-heavy NASDAQ stock market index has risen another 17 percent (after an increase of 86 percent in 1999). The Standard and Poor's 500 index (as well as the Dow Jones Industrial Index), by contrast, has fallen in value. Reflecting these divergent trends, the broadly based Wilshire 5000 index has been essentially flat.

EYES ONLY

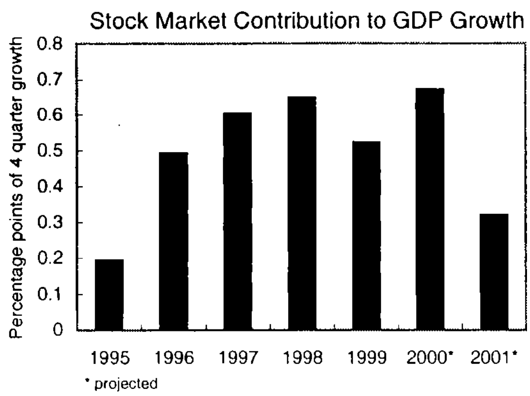
CONTENTS

CURRENT DEVELOPMENT

The Wealth Effect: Past, Present, and Future

Despite the tepid performance of the stock market so far this year, last year's $3 trillion increase in stock market wealth will continue to affect household spending this year and into the future. In recent testimony, Federal Reserve Chairman Alan Greenspan emphasized the role of the "wealth effect" in spurring high spending growth, which he cited as contributing to the widening current account deficit, increasingly tight labor markets, and potential inflationary pressures.

Only 3½ cents on the dollar (but there are a lot of dollars). According to the standard "life-cycle" model of consumer behavior, an increase in wealth is not spent all at once; instead, people generally aim to raise their living standards over the remainder of their lives by spending only a portion each year. The evidence suggests that each dollar change in stock market wealth leads to a permanent change in the level of consumer spending in the future of about 3½ cents per year, with the full response kicking in after several years. Although the wealth effect is thought to be permanent, only *changes* in wealth affect the growth rate. The contribution of household spending to GDP growth from the rise in stock market wealth relative to overall income over the past 5 years has averaged about one-half percentage point (see chart, which assumes that the stock market grows in line with income during 2000 and 2001). Some of the increase in spending owing to the wealth effect goes to imported goods, however, which offsets a portion of the contribution to GDP growth.



The legacy of past stock market gains. Because the effects of last year's booming stock market have yet to be realized fully, the wealth effect will continue to contribute strongly to spending growth this year and, to a lesser extent, next year. An open question—discussed by Chairman Greenspan in his testimony and one we will examine in a later *Weekly Economic Briefing*—is the extent to which the stock market boom and other developments in aggregate supply and demand are related to the apparent acceleration in productivity growth.

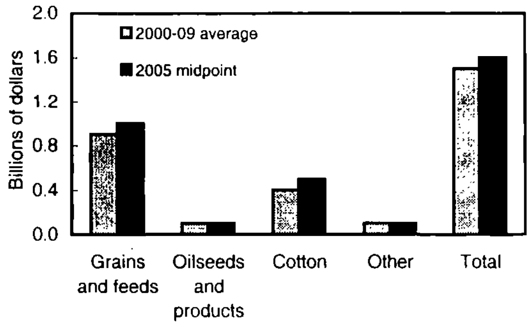
SPECIAL ANALYSIS

China, the WTO, and U.S. Agriculture

U.S. agricultural exports and farm income are projected to rise with China's entry into the World Trade Organization, according to a recent analysis by the USDA's Economic Research Service (ERS). Increased demand for agricultural products and higher farm prices would also raise consumer prices slightly.

More U.S. exports. The ERS estimates that with China's WTO accession, U.S. global exports of major field crops over the 2000-09 period would rise above baseline levels by an average of $1.5 billion per year, based on China's market opening commitments in our bilateral agreement. By 2005, the increase would be about $1.6 billion. Much of the increase in field crop exports would come from direct U.S. sales to China arising from significantly greater access to that large market. The largest absolute gains would be in grains and feeds, followed by cotton (see chart). Exports of oilseeds and products are expected to rise overall, with a shift from soybeans to processed soybean products. Other commodities not explicitly treated in the analysis (such as fruit and vegetables, animal products, and tree nuts) would also enjoy increased access once reductions in Chinese duties are implemented.

Potential Gains in U.S. Exports of Major Field Crops Resulting from China's WTO Entry



Higher farm income. ERS estimates that net farm income would rise above baseline levels by an average of $1.1 billion annually in the 2000-09 period, after accounting for changes in Federal government payments.

- Higher cash receipts. Stronger crop demand, resulting in higher prices, would raise annual cash receipts from crops by $1.5 billion per year. An additional $1.2 billion per year would come from sales of livestock products. However, this latter increase is driven by higher production expenses, which lead to lower output and higher prices for livestock products. In fact, ERS projects that overall farm production expenses would rise by roughly the same amount as livestock product sales, primarily as a result of higher feed costs. (Some additional net farm income might come from reduced tariffs for poultry, pork, or beef, which would boost U.S. exports of these products.)

- Lower government payments. Higher farm prices are projected to reduce Federal spending on loan deficiency payments by about $300 million per year.

A slight rise in consumer prices. ERS estimates that with higher prices for agricultural products, especially livestock products, under the WTO accession

EYES ONLY

scenario, the consumer price index for all food would be about 0.2 percent higher, on average, over the 2000-09 period than under the baseline scenario. This translates into increased average annual food expenditures of about $1.2 billion (roughly 0.1 percent higher than in the baseline scenario).

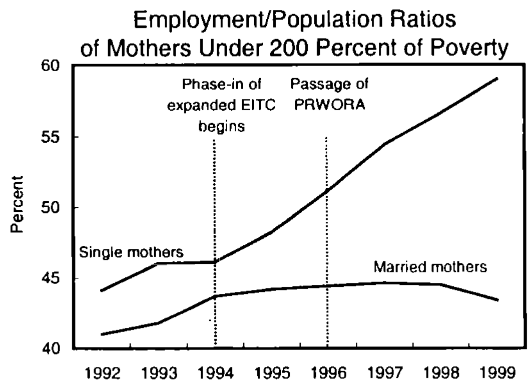
Conclusion. USDA's analysis, which focuses on major field crops, suggests that China's WTO accession would result in additional U.S. exports, higher farm incomes for some producers, and lower government payments. The increase in demand for agricultural products would also result in a modest increase in retail food prices. On balance, the gains to U.S. producers, combined with the reduction in Federal spending, would outweigh the impact on U.S. consumers by an average of about $200 million annually.

ARTICLE

Recent Growth in the Employment of Single Mothers

The strong labor market has surely been one reason for the rapid growth in employment among single mothers in recent years. But a forthcoming review of the research literature by the CEA and the Treasury presents persuasive evidence that policies such as the EITC expansions and welfare reform have played an important role as well.

Employment of low-income mothers. A comparison of employment growth among low-income single and married mothers (see chart) illustrates the nature of this evidence. In March of 1992 the employment/population ratio was only 3 percentage points higher for the single mothers than for the married mothers, but by 1999 this gap had increased to 16 percentage points. This comparison is instructive because reforms to welfare policy substantially affect the first group but not the second. And the EITC unambiguously encourages labor supply by single parents, while having ambiguous effects on work incentives for second earners in married households. (The EITC can reduce incentives to work for second earners in some households because the additional income would cause the couple to lose some or all of their EITC credits.)



The EITC. By raising the after-tax return to employment, the EITC is a powerful incentive to work for single parents. Single mothers receive more than two-thirds of EITC dollars. (The bulk of the remainder boost incomes of married taxpayers.) As a result of the expansions in the program enacted in 1993, the maximum EITC credit increased dramatically in 1994, 1995, and 1996. Over these same years, the employment/population ratio of single mothers increased relative to that of similar married mothers, and also relative to those of two other groups less affected by changes in the EITC, African American men and single women without children. A detailed statistical analysis concludes that the EITC accounted for about 36 percent of the increase in employment of single mothers between 1992 and 1996.

Welfare reform. The 1996 Personal Responsibility and Work Opportunity Reconciliation Act (PRWORA), and the Federal waivers that preceded the Act, transformed welfare by allowing states to establish work requirements, time-limit assistance, and improved child support. In addition to lowering caseloads dramatically, these policy changes have also affected employment, as many individuals previously on welfare get jobs. An aggregation of recent state reports indicates that more than 1.3 million welfare recipients nationwide went to work in just the 1-year period between October 1997 and September 1998. Further evidence comes from an analysis of Current Population Survey data. For the years 1988 to 1992 there was a 20 to 21 percent employment rate (in March of the year) for individuals on welfare the previous year. This rate increased steadily starting in 1993, rising to more than 36 percent by March 1999. Statistical analysis indicates that over the span 1992 to 1996, about 33 percent of the increase in employment of single mothers was due to the state-level changes in welfare policy that preceded PRWORA.

Other policies. There is some evidence to suggest that other policy changes, notably expanded funding for child care and the provision of training to welfare recipients, have effectively provided additional work incentives for low-income women. Among the proposals in the 2001 budget that can be expected to encourage additional labor supply are policies that reduce the "marriage penalty" for low- and middle-income families, proposals involving child care expenses, and further expansion of the EITC.

EYES ONLY

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

Census Provides First Official E-Commerce Estimate. Retail E-commerce sales were $5.3 billion in the fourth quarter of 1999, according to the first official estimate of such sales, released this week by the Census Bureau. Such sales, defined as sales of goods and services over the Internet and other online systems, were 0.64 percent of total retail sales of $821.2 billion in the quarter. Available evidence suggests that about 15 percent of retail firms are involved in E-commerce sales.

Boskin Commission Members See Smaller CPI Bias. Members of the Boskin Commission believe that methodological changes implemented by the Bureau of Labor Statistics have reduced the bias in the CPI from the 1.1 percentage point level reported by the Commission in 1996. Responding to a survey by the General Accounting Office, the individual members put the remaining bias at between 0.73 and 0.9 percentage point annually, and they attribute the remaining bias to what the Commission referred to as "new products/quality change bias."

Expanded Insurance Can Mean Fewer Avoidable Hospitalizations. By increasing access to hospital care, expansion of public health insurance should lead to more hospitalizations. At the same time, however, it might reduce avoidable hospitalizations—defined as those that might not have occurred had patients received effective, timely, and continuous outpatient medical care for certain chronic disease conditions. In the case of children, a recent study found that expansions in Medicaid eligibility between 1983 and 1996 led to a net increase of 10 percent in overall pediatric hospitalizations but a decline of 22 percent in avoidable ones. The study notes that because an average inpatient hospital visit is roughly 40 times more expensive than an average outpatient visit, this reduction in avoidable hospitalizations makes medical care more efficient. The eligibility expansions also appear to have been associated with a significant shift in the types of hospitals where children are treated, from public hospitals to for-profit facilities.

Homelessness Persists but Services Improve. Between 2.3 and 3.5 million people, nearly 40 percent of them children, are estimated to experience homelessness at least once during a year, according to a recent Urban Institute study based on 1996 data. People living at or below the poverty line are the most vulnerable to experiencing a homeless episode; between 6.3 and 9.6 percent of those in poverty are likely to be homeless at some point during the year. At the same time, the network of homeless services is larger and more diverse than it was in the late 1980s. The nation's shelter and housing capacity grew by 220 percent between 1988 and 1996. Soup kitchen and meal distribution services in central cities nearly quadrupled between 1987 and 1996, from 97,000 to 382,100 meals on an average day in February. Much of the new growth, according to the study, is due to new funding and to priorities placed on developing transitional and permanent housing.

EYES ONLY

INTERNATIONAL ROUNDUP

ECB Holds the Line on Rates. This week the European Central Bank decided to leave interest rates unchanged, keeping the main refinancing rate at 3.25 percent. A pickup in inflation, plus the recent decline of the euro, have provoked speculation that the ECB may raise rates in the near future.

African Skills Flight Hurting Development. According to United Nations data, an average of 20,000 African professionals (including doctors, university lecturers, and engineers) have emigrated from the continent annually since 1990, up from about 12,000 per year in the 1985-90 period. This human capital flight, or "brain drain," reduces the availability of skilled human resources that African countries badly need for self-reliant and sustainable development. The flight of doctors is most striking. For instance, 60 percent of all Ghanaian doctors trained locally in the 1980s left the country, and Nigeria suffers from an acute shortage of health personnel even as 21,000 Nigerian doctors practice in the United States. In part because of the brain drain, the entire continent has only 20,000 scientists, or 3.6 percent of the world total. Poor economic conditions, political violence, repression of human rights, and a lack of an open political atmosphere have contributed to the brain drain. Another contributing factor may be scholarship programs for study abroad coupled with a lack of training institutes in Africa.

India PM Vajpayee's First Budget. Amidst concern about growing fiscal deficits and sluggish progress in reducing poverty, India's Ministry of Finance released its budget for fiscal 2000/01 this week. The budget proposes to cut the central government's deficit from an estimated 5.6 percent of GDP to 5.1 percent, and to "abolish" poverty by boosting annual growth to 7 to 8 percent from the current rate of around 6 percent. In addition to loosening foreign investment rules and reducing state controls on banks, the budget continues to channel substantial resources into energy, transport, and communications. The budget disappointed some, however, because it fails to take tougher measures to reduce the fiscal deficit and makes little progress in eliminating subsidies to the power and irrigation sectors. The new budget proposes to increase defense expenditures by 28 percent, the largest-ever rise for the world's fourth-biggest military.

British Woman Files Patent Application on Herself. According to Reuters News, a British woman has become the first person to attempt to patent herself. The UK national patent office confirmed on Tuesday that it has received an application with the title "myself" from a poet and casino waitress who was angered at the patenting of gene sequences by businesses. "It has taken 30 years of hard labor for me to discover and invent myself, and now I wish to protect my invention from unauthorized exploitation, genetic or otherwise," the woman said. The patent office, however, said, "It is not really worth patenting something unless you make a lot of money from it."

EYES ONLY

RELEASES THIS WEEK

Employment and Unemployment

****Embargoed until 8:30 a.m., Friday, March 3, 2000****

In February, the unemployment rate was 4.1 percent; it was 4.0 percent in January. Nonfarm payroll employment increased by 43,000.

Leading Indicators

The composite index of leading indicators increased 0.3 percent in January.

NAPM Report on Business

The Purchasing Managers' Index increased 0.6 percentage point in February to 56.9 percent. (A reading above 50 percent indicates that the manufacturing economy is generally expanding.)

Consumer Confidence

Consumer confidence, as measured by The Conference Board, declined 2.9 index points in February, to 141.8 (1985=100).

MAJOR RELEASES NEXT WEEK

Productivity (Tuesday)

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U.S. ECONOMIC STATISTICS

	1970-1993	1999	1999:2	1999:3	1999:4
Percent growth (annual rate)					
Real GDP (chain-type)	3.0	4.5	1.9	5.7	6.9
GDP chain-type price index	5.2	1.6	1.3	1.1	2.0
Nonfarm business (NFB) sector:					
Productivity (chain-type)	1.7	3.3	0.6	5.0	5.0
Real compensation per hour:					
Using CPI	1.0	1.8	1.2	2.0	1.1
Using NFB deflator	1.5	2.9	2.9	4.0	1.8
Shares of Nominal GDP (percent)					
Business fixed investment	11.4	12.6	12.6	12.7	12.5
Residential investment	4.5	4.4	4.5	4.4	4.4
Exports	8.2	10.8	10.7	10.8	10.9
Imports	9.2	13.5	13.4	13.8	14.0
Personal saving	6.6	1.7	1.8	1.5	1.3
Federal surplus	-2.8	N.A.	1.3	1.4	N.A.

	1970-1993	1999	December 1999	January 2000	February 2000
Unemployment Rate (percent)	6.7**	4.2**	4.1	4.0	**4.1**
Payroll employment (thousands)					
increase per month			**309**	**384**	**43**
increase since Jan. 1993					**20823**
Inflation (percent per period)					
CPI	5.8	2.7	0.2	0.2	N.A.
PPI-Finished goods	5.0	3.0	0.1	0.0	N.A.

**Figures beginning 1994 are not comparable with earlier data.

New or revised data in **boldface**.
Employment and unemployment data **embargoed until 8:30 a.m., Friday, March 3, 2000**.

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FINANCIAL STATISTICS

	1998	1999	January 2000	February 2000	March 2, 2000
Dow-Jones Industrial Average	8626	10465	11281	10542	10165
Interest Rates (percent per annum)					
3-month T-bill	4.78	4.64	5.32	5.55	5.60
10-year T-bond	5.26	5.65	6.66	6.52	6.40
Mortgage rate, 30-year fixed	6.94	7.43	8.21	8.33	8.27
Prime rate	8.35	8.00	8.50	8.73	8.75

INTERNATIONAL STATISTICS

Exchange Rates	**Current level March 2, 2000**	**Percent Change from Week ago**	**Percent Change from Year ago**
Euro (in U.S. dollars)	0.962	-3.1	-12.0
Yen (per U.S. dollar)	107.4	-3.2	-10.9
Major currencies index (Mar. 1973=100) (trade-weighted value of the U.S. $)	95.88	0.4	0.6

International Comparisons [1/]	**Real GDP growth** (percent change last 4 quarters)	**Unemployment rate** (percent)	**CPI inflation** (percent change in index last 12 months)
United States	4.5 (Q4)	**4.1** (Feb)	2.7 (Jan)
Canada	4.7 (Q4)	6.9 (Dec)	2.3 (Jan)
Japan	1.0 (Q3)	4.6 (Nov)	-0.9 (Jan)
France	3.2 (Q4)	10.4 (Dec)	1.6 (Jan)
Germany	2.3 (Q4)	8.8 (Dec)[2/]	1.7 (Jan)
Italy	1.2 (Q3)	12.1 (Apr)	2.2 (Jan)
United Kingdom	2.9 (Q4)	5.9 (Oct)	1.9 (Jan)

U.S. unemployment data **embargoed until 8:30 a.m., Friday, March 3, 2000.**

1/ For unemployment data, rates approximating U.S. concepts as calculated by the U.S. Department of Labor, Bureau of Labor Statistics.

2/ Rate for unified Germany.

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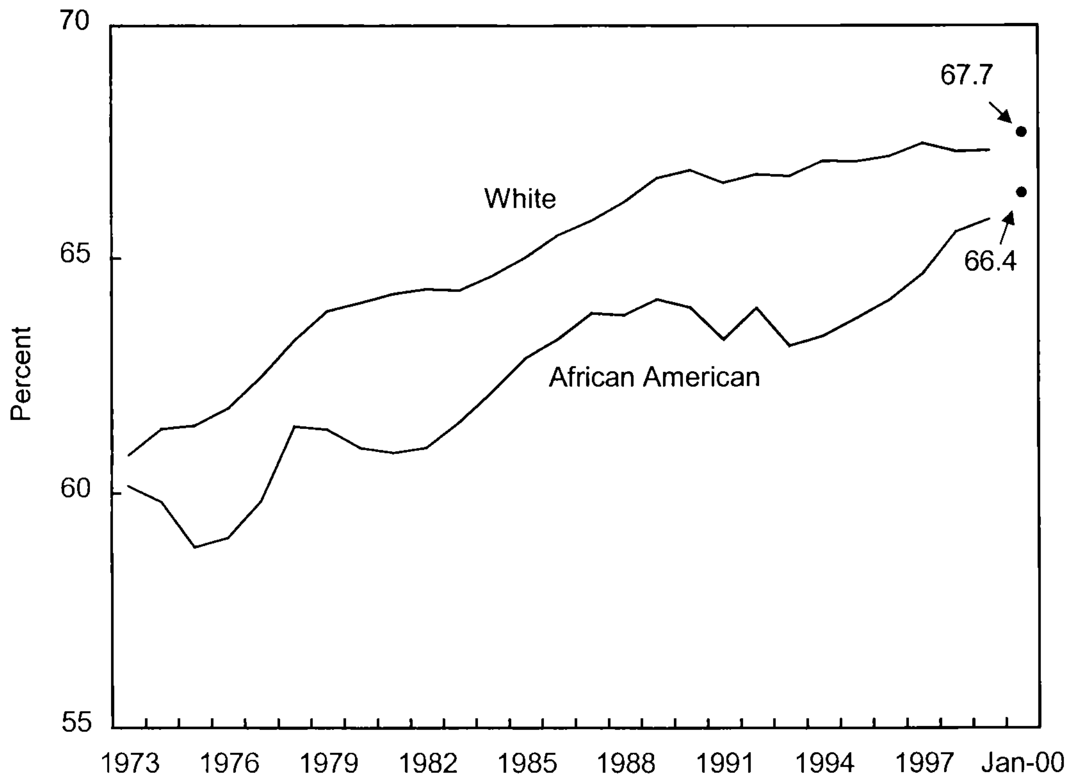
WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

Prepared by the Council of Economic Advisers
with the assistance of the Office of the Vice President

February 18, 2000

CHART OF THE WEEK

Labor Force Participation Rate, Aged 16 and Over



The labor force participation rate of African Americans has been lower than that of whites and has shown greater variability through time. However, gains in African American labor force participation in this expansion have narrowed the gap to the smallest it has been since 1973.

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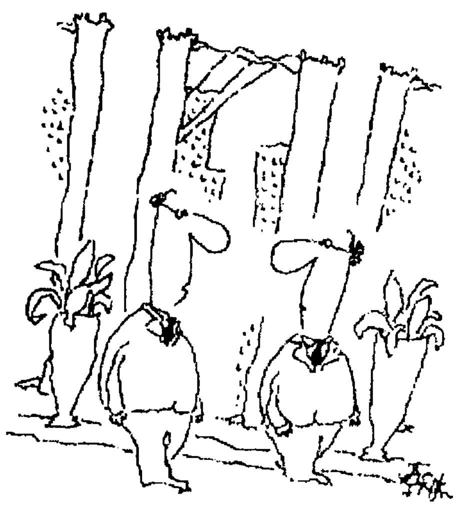
CONTENTS



"I'd really like to fire that terrible new advisor, but he keeps advising me not to."

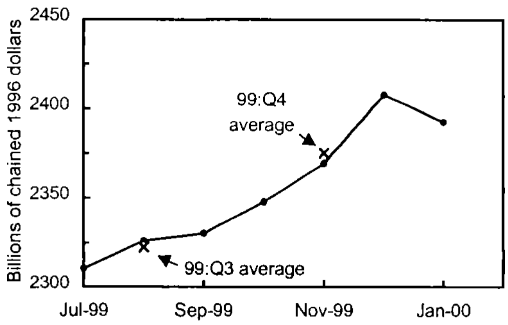
EYES ONLY

MACROECONOMIC UPDATE

Still Going Strong

Large gains in industrial production and production-worker hours point to the first quarter being another of solid growth. Y2K effects altered the monthly pattern of activity around the turn of the year but are likely to have limited effects on the quarter. Growth in real GDP in the fourth quarter, estimated at 5.8 percent in the advance report, is likely to be revised up to about 6½ percent at an annual rate.

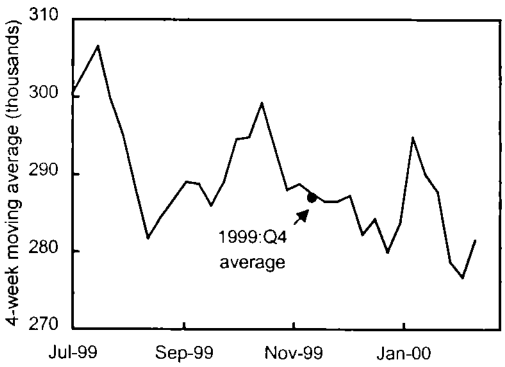
Goods Consumption Less Motor Vehicles



Note: Figures for November, December, and January are adjusted based on latest retail sales reports.

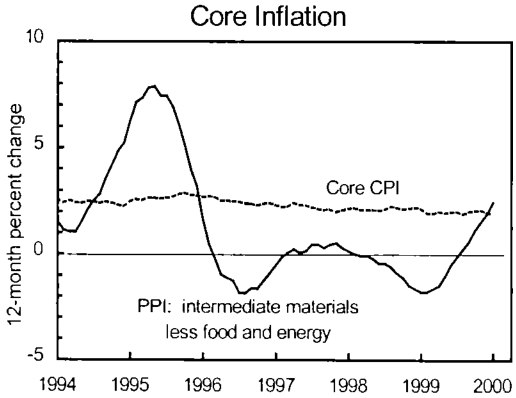
Sales. Y2K effects were clear in retail sales. Real consumption of goods excluding motor vehicles rose sharply in November and December, and then declined in January (see upper chart). The swing was pronounced for sales at grocery, drug, jewelry, and furniture stores. Despite the drop, real sales of non-auto goods in January remained well above the fourth-quarter level.

Unemployment Insurance Initial Claims



Y2K and inventories. Inventory accumulation, which added 1.2 percentage points to real GDP growth in the fourth quarter, may have been boosted by the desire to buffer production against Y2K disruptions. No data are yet available for the first quarter, but a drop in stockbuilding is likely.

Core Inflation



Note: Core CPI is measured by the core CPI-U-RS

Other indicators. Indicators that were not obviously affected by Y2K are uniformly strong. Housing starts were up sharply in December and posted a further gain in January. Motor vehicles sold at a strong 17¾ million unit annual rate in January. Payroll employment increased 387,000 in January. And initial claims for unemployment insurance for the 4 weeks ending in mid-February stayed below the fourth-quarter level, indicating continuing strong demand for labor (see middle chart).

Inflation. Prices of commodities and intermediate goods (especially petroleum products) have accelerated sharply—likely reflecting the strength of the world economy. But core consumer prices remain low and stable in the face of the price acceleration at the earlier stages of processing (see lower chart on previous page). Labor costs outweigh all other production costs, and these have been contained by the stunning growth of productivity—which now appears to have grown in excess of 5 percent at an annual rate in the second half of 1999.

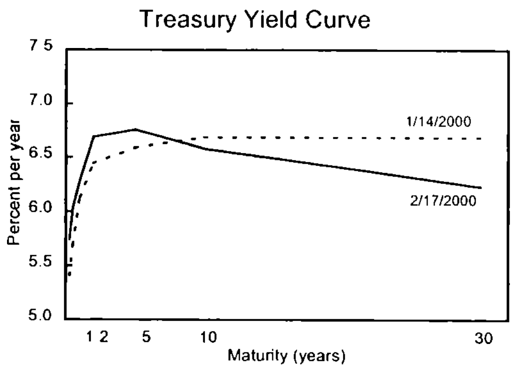
EYES ONLY

SPECIAL ANALYSIS

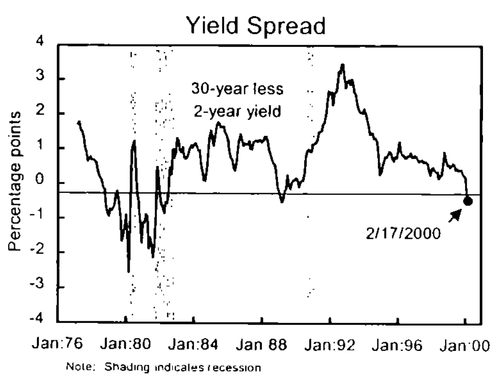
Debt Paydown, the Bond Market, and the Economy

Yields on Treasury bonds have dropped below yields on short- and intermediate-duration Treasury securities. Such an "inversion" of the yield curve usually is associated with a tightening of monetary policy and the possibility of an economic downturn. In this case, however, part of the explanation lies in the market's response to a future of declining public debt, and the macroeconomic impact so far looks to be small.

An inverted yield curve. Since mid-January, yields on 1-to-5-year Treasury securities have increased about 25 basis points, reflecting heightened concerns that the continued strength of the economy would cause the Fed to tighten further. Normally, Fed tightening causes long-term yields to rise, but by less than short-term rates, because the market expects the tightening to be temporary. In fact, however, yields on 30-year Treasury bonds have fallen about 50 basis points. These opposite movements have inverted the usually upward-sloping yield curve (see upper chart). The current inversion is atypical in that much of the action is occurring at the long end of the yield curve rather than the short end, as would be the case if the cause were entirely a tightening of monetary policy.



Supply and demand? Changes in inflationary expectations, monetary policy, and risk factors do not appear to explain fully this sharp downturn in long-term Treasury bond yields. Instead, the decline appears to be related to anticipated reductions in the relative supply of these securities. Recent fiscal projections may have focused investors' attention on the implications for debt management of growing surpluses, and in particular the future reduction in the supply of Treasury notes and bonds. Ongoing volatility in Treasury bond yields suggests that markets are still digesting the implications of reduced debt. While it is unclear whether the downward slope of the yield curve will persist, it is interesting to note that the yield curve in the United Kingdom is likewise inverted—resulting from shifts in supply and institutional demand—and that this condition has persisted for over 6 months.



Does this matter for the economy? Yield-curve inversions occurring because of restrictive monetary policy are often associated with the onset of a recession (see lower chart on previous page). In contrast, the flattening of the yield curve in 1997 resulted from a drop in long-term yields, not a rise in short-term rates, and economic growth continued to be robust in the following 2 years. Although expectations of a policy tightening have contributed to the current inversion of the yield curve, an additional cause has been the sharp decline in long-term yields, suggesting that monetary policy is not so tight as is implied by the slope of the yield curve. The fall in long-term Treasury yields does not look to have much effect on private spending, either. Thus far, there appears to have been little passthrough to private borrowing rates.

Conclusion. Recent declines in long-term Treasury bond yields appear to be related to expected reductions in the supply of these securities in an era of expanding Federal Government surpluses. So far, the macroeconomic implications of the fall in Treasury bond yields appear to be small.

ARTICLE

Recent Changes in Family Finances

As discussed last week, aggregate household debt and debt service payments have been rising faster than disposable personal income in recent years. Recent evidence suggests, however, that for most families assets have been growing even faster than debt.

The SCF. The main source of data on how financial conditions vary among families is the Federal Reserve's Survey of Consumer Finances (SCF), a survey of about 4,300 families that is conducted every 3 years, most recently in 1998. Because wealth is highly concentrated, the SCF oversamples relatively wealthy households in order to get more statistically reliable estimates of the pattern of wealth holdings. However, it explicitly excludes members of the *Forbes* 400 list of the wealthiest Americans as well as a few very famous people.

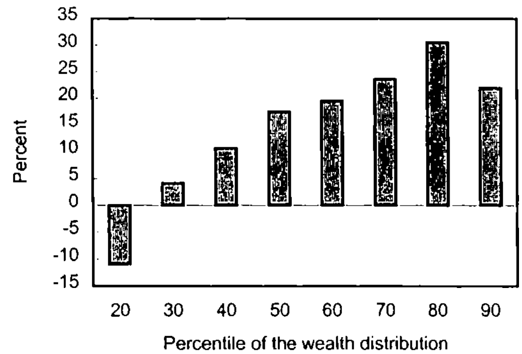
Changes in net worth. A recent Fed analysis of the latest SCF indicates that net worth—the difference between gross assets and liabilities—grew strongly between 1995 and 1998. Real median net worth rose 18 percent, to $71,600. This is 20 percent higher than in 1989, the last full year of the previous economic expansion. Mean net worth, which is more sensitive to the size of the gains in the upper part of the distribution, rose 26 percent between 1995 and 1998, to $282,500. Because some of this gain represented a recovery from a decline in mean net worth between 1989 and 1992, mean net worth in 1998 was also about 20 percent higher than it was in 1989.

Variation by income. The Fed analysis reports that these increases in net worth were broadly shared by different demographic groups, though not by all. In general, older, higher-income, and better-educated families had the largest gains. In terms of levels, 1998 median net worth ranged between $3,600 for families with income below $10,000 and $510,800 for families with incomes of $100,000 or more. Mean net worth was considerably higher in each group. Even in the lowest income category, mean net worth was $40,000—more than 10 times the median, suggesting that even among those with low incomes some proportion of families have substantial net worth relative to their income.

Variation by race. The study reports on just two categories, white non-Hispanics and all others. Levels and changes in the first group closely track those of the population as a whole. For the others, mean net worth increased almost as rapidly as for all families between 1995 and 1998, but the median actually fell slightly. This sharp divergence between the median and the mean suggests considerable variability in the recent changes experienced by non-white and Hispanic families. Since 1989, by contrast, mean and median net worth grew substantially more rapidly for these minorities than for white non-Hispanics. Nevertheless, the median net worth of white, non-Hispanic families was $94,900 in 1998, or almost six times the $16,400 of minority families.

The distribution of wealth. Wealth is distributed much more unevenly than income. In 1998, the wealthiest 10 percent of families held more than two-thirds of all wealth, and the top 0.5 percent held more than a quarter. (In the distribution of household income, by contrast, the highest income fifth received about half of aggregate income and the top 5 percent received 21 percent.) Unpublished Fed estimates show a small increase in the Gini measure of wealth inequality between 1995 and 1998, but one that is within the range of sampling error. Nevertheless, these data also show that larger percentage gains in real net worth occurred at the wealthier end of the distribution (see chart). In the wealthiest 10 percent of families, stocks and privately held businesses were the most important sources of gains and debt was relatively unimportant. In the rest of the distribution a variety of assets, including principal residences and stocks, were important. In this group, increases in debt offset about a quarter of the rise in assets.

Change in Real Net Worth, 1995-98



Conclusion. Survey data on family finances show that recent rapid increases in net worth relative to income have been broadly shared. Nevertheless, the extraordinary gains in the stock market appear to have contributed to larger gains among families that in many cases were already well-off.

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

Teens Respond to Cigarette Price Hikes. An increase in the price of cigarettes has a negative impact on older teenagers' decision to smoke, indicating that raising cigarette taxes may be an effective policy to decrease youth smoking, according to a recent study. Sharp price reductions for cigarettes in the early 1990s were found to account for 30 percent of the increase in youth smoking between 1991 and 1997. Moreover, teens from traditionally socioeconomically disadvantaged groups, such as African Americans and children of less-educated parents, were found to be particularly price sensitive. In contrast, younger teens were not sensitive to price (either in their decision to smoke or in the amount they smoked), indicating that younger teenagers smoke for non-economic reasons such as experimentation or acceptance by peers. Non-price policies were found to have a mixed impact on youth smoking. There is some suggestion that laws which restrict youth access to tobacco products reduce the amount that teens smoke but do not affect their decision to smoke. In addition, the study finds little consistent evidence that clean air regulations matter for youth smoking decisions.

Malpractice Reform Increases Productivity with No Harm to Health. Reforms of medical malpractice liability law designed to reduce the level of compensation to potential claimants improve medical productivity by reducing hospital expenditures without harming patients' health, according to a recent study. Moreover, other policies that reduce non-financial costs to the doctor, such as the time spent and the amount of conflict involved in defending against a claim, may also substantially reduce hospital expenditures. The study found that malpractice pressure leads to highly significant increases in hospital expenditures by encouraging doctors to practice "defensive medicine." A 1 percentage point decrease in a physician's probability of defending against a malpractice claim in a given year results in a 2 to 3 percent decrease in real expenditures. Moreover, these changes in medical practice induced by changes in malpractice pressure do not have systematic or substantial effects on patient health outcomes, at least for the elderly heart-disease patients that were studied.

Trapped in Poor Neighborhoods? A recent study estimates that while over one-third of poor African Americans will live in a high poverty neighborhood for at least 1 year out of 10, most will not stay long. Only 7 percent will live in such a neighborhood for 10 or more consecutive years. Although only a small percentage of those who ever live in a poor neighborhood stay a long time, those who do make up the bulk of residents at any moment in time. In the study, more than three-quarters of residents in high poverty neighborhoods at any given time will likely be there for more than 10 years, and over 50 percent for more than 20 years. Moreover, many of those who do "escape" are likely to return; 40 percent of poor African Americans who leave such neighborhoods will return to one within 5 years, nearly 50 percent within 10 years. This result suggests that, for many poor African Americans, the most difficult part of escaping from high poverty neighborhoods is not moving out at a point in time, but staying out for a long duration.

INTERNATIONAL ROUNDUP

Investment in the Internet for the Developing World. In a major initiative intended to promote the digital economy in the developing world, The World Bank's International Finance Corporation (IFC) has joined with the Japanese Internet company SOFTBANK to invest in Internet businesses in about 100 developing countries. The new venture, called SOFTBANK Emerging Markets (SBEM), will commit $500 million to global Internet development. SBEM will invest seed money in new Internet enterprises and provide an array of technological, legal, and management support to help turn ideas into solid businesses. The initiative will seek to improve Internet access in targeted countries by generating investor interest in emerging markets, which should help lower the price of Internet access and increase the number of subscribers. It will also promote free or subsidized Internet service to schools and other educational institutions.

Development Assistance Rises in the OECD. After more than 5 years of continuous decline, net Official Development Assistance (ODA) by the 21 Development Assistance Committee (DAC) countries of the OECD rose in 1998 by nearly 10 percent in real terms, to $52 billion. Over 60 percent of this increase was accounted for by jumps in bilateral loans and emergency and distress relief. Despite this increase, the ratio of ODA relative to income in the DAC has fallen to 0.25 percent, well below the 0.33 percent average maintained in the 1970s and 1980s. The United States, which gave nearly $9 billion in 1998, was the second largest net donor of ODA; however, it devoted just 0.10 percent of its GNP to ODA, the lowest in the DAC. About half of total ODA in 1998 went toward education, health, and other social and economic infrastructure, with debt relief accounting for 9 percent.

Multinationals Cautiously Optimistic about Investment in Africa. A recent survey of 63 of the world's largest multinational firms by the International Chamber of Commerce and the United Nations Conference on Trade and Development reveals that companies are generally optimistic about investment opportunities in Africa. One-third of firms surveyed expect to increase investment in Africa over the next 3 to 5 years, while more than half expect their investment to remain at present levels. Only 6 percent plan to decrease their investment or pull out of Africa altogether. The growth and size of local markets and the profitability of FDI were the most commonly cited factors influencing investment positively, while the prevalence of bribery was by far the most cited discouraging factor. South Africa was the most attractive country for FDI in Africa, followed by Egypt, Morocco, and Nigeria. Several least developed countries, including Ethiopia, Mozambique, Uganda, and Tanzania, were among the nations expected to make the most progress in creating a business-friendly environment and thus were also seen as attractive destinations for FDI.

EYES ONLY

RELEASES THIS WEEK

U.S. International Trade in Goods and Services
****Embargoed until 8:30 a.m., Friday, February 18, 2000****

The goods and services trade deficit declined to $25.5 billion in December from $27.1 billion in November. For 1999, the goods and services trade deficit was $271.3 billion; for 1998, the deficit was $164.3 billion.

Consumer Price Index
****Embargoed until 8:30 a.m., Friday, February 18, 2000****

The consumer price index rose 0.2 percent in January. Excluding food and energy, consumer prices also rose 0.2 percent.

Producer Price Index

The producer price index for finished goods was unchanged in January. Excluding food and energy, producer prices fell 0.2 percent.

Housing Starts

Housing starts rose 2 percent in January to 1.775 million units at an annual rate.

Industrial Production and Capacity Utilization

The Federal Reserve's index of industrial production increased 1.0 percent in January. Capacity utilization rose 0.5 percentage point to 81.6 percent.

MAJOR RELEASES NEXT WEEK

Advance Durable Shipments and Orders (Thursday)
Gross Domestic Product (Friday)

EYES ONLY

U.S. ECONOMIC STATISTICS

	1970-1993	**1999**	**1999:2**	**1999:3**	**1999:4**
Percent growth (annual rate)					
Real GDP (chain-type)	3.0	4.2	1.9	5.7	5.8
GDP chain-type price index	5.2	1.6	1.3	1.1	2.0
Nonfarm business (NFB) sector:					
Productivity (chain-type)	1.7	3.3	0.6	5.0	5.0
Real compensation per hour:					
Using CPI	1.0	1.8	1.2	2.0	1.1
Using NFB deflator	1.5	2.9	2.9	4.0	1.8
Shares of Nominal GDP (percent)					
Business fixed investment	11.4	12.6	12.6	12.7	12.5
Residential investment	4.5	4.4	4.5	4.4	4.4
Exports	8.2	10.8	10.7	10.8	10.9
Imports	9.2	13.5	13.4	13.8	14.1
Personal saving	6.6	1.7	1.8	1.5	1.4
Federal surplus	-2.8	N.A.	1.3	1.4	N.A.

	1970-1993	**1999**	**November 1999**	**December 1999**	**January 2000**
Unemployment Rate (percent)	6.7**	4.2**	4.1	4.1	4.0
Payroll employment (thousands)					
increase per month			257	316	387
increase since Jan. 1993					20790
Inflation (percent per period)					
CPI	5.8	2.7	**0.2**	0.2	**0.2**
PPI-Finished goods	5.0	3.0	**0.2**	**0.1**	**0.0**

**Figures beginning 1994 are not comparable with earlier data.

New or revised data in **boldface**.
CPI data **embargoed until 8:30 a.m., Friday, February 18, 2000**.

EYES ONLY

FINANCIAL STATISTICS

	1998	1999	December 1999	January 2000	Feb. 17, 2000
Dow-Jones Industrial Average	8626	10465	11246	11281	10515
Interest Rates (percent per annum)					
3-month T-bill	4.78	4.64	5.20	5.32	5.57
10-year T-bond	5.26	5.65	6.28	6.66	6.58
Mortgage rate, 30-year fixed	6.94	7.43	7.91	8.21	8.38
Prime rate	8.35	8.00	8.50	8.50	8.75

INTERNATIONAL STATISTICS

Exchange Rates	**Current level February 17, 2000**	**Percent Change from**	
		Week ago	**Year ago**
Euro (in U.S. dollars)	0.986	-0.0	-12.2
Yen (per U.S. dollar)	110.3	1.4	-7.4
Major currencies index (Mar. 1973=100) (trade-weighted value of the U.S. $)	95.38	0.4	1.9

International Comparisons [1]	**Real GDP growth** (percent change last 4 quarters)	**Unemployment rate** (percent)	**CPI inflation** (percent change in index last 12 months)
United States	4.2 (Q4)	4.0 (Jan)	**2.7** (Jan)
Canada	4.2 (Q3)	6.9 (Dec)	2.6 (Dec)
Japan	1.0 (Q3)	4.6 (Nov)	-1.1 (Dec)
France	2.9 (Q3)	10.4 (Dec)	1.3 (Dec)
Germany	1.3 (Q3)	8.8 (Dec)[2]	1.2 (Dec)
Italy	1.2 (Q3)	12.1 (Apr)	2.1 (Dec)
United Kingdom	1.8 (Q3)	5.9 (Oct)	1.8 (Dec)

U.S. CPI data **embargoed until 8:30 a.m., Friday, February 18, 2000**.

1/ For unemployment data, rates approximating U.S. concepts as calculated by the U.S. Department of Labor, Bureau of Labor Statistics.

2/ Rate for unified Germany.

EYES ONLY

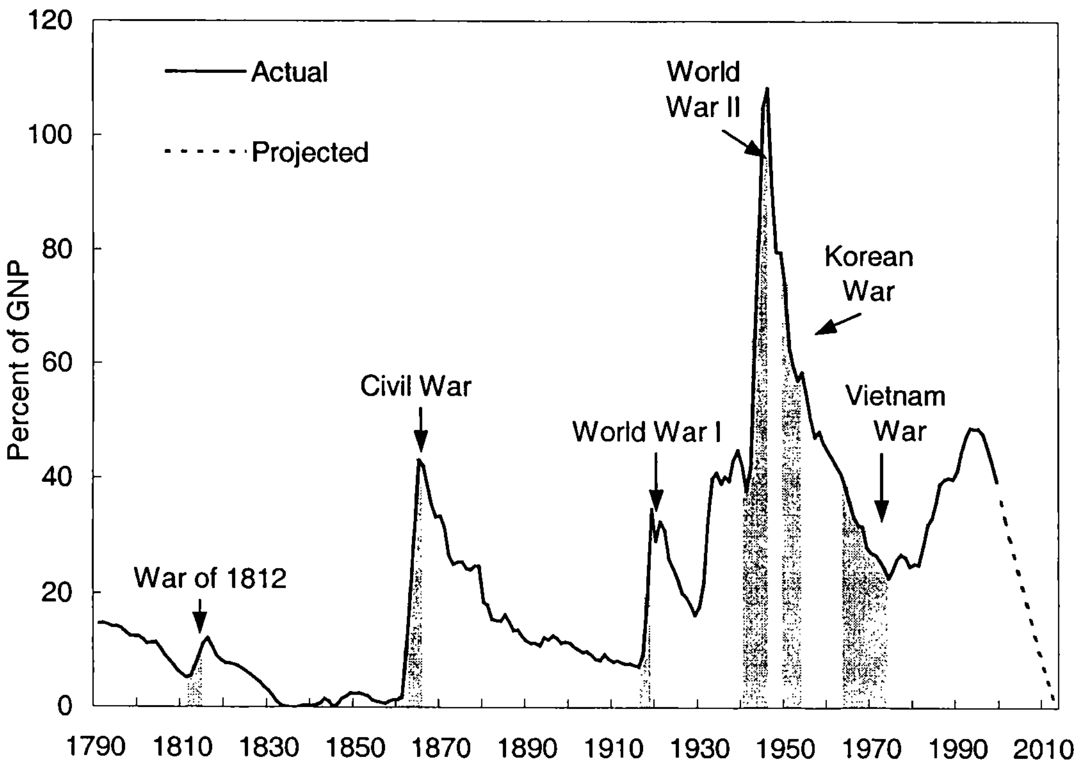
WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

Prepared by the Council of Economic Advisers
with the assistance of the Office of the Vice President

February 11, 2000

CHART OF THE WEEK

Federal Debt Held by the Public as a Percent of GNP, 1791-2013



Publicly held Federal debt relative to GNP has generally risen sharply in times of war, and otherwise has tended to decline. Two notable exceptions are the Vietnam War when the debt-GNP ratio fell, and the 1980s and early 1990s, when the debt-GNP ratio rose steadily although the country was mostly at peace. Projections are based on the 2001 Budget. GNP data for 1791-1868 are very rough estimates.

EYES ONLY

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DEPARTMENTS

"Go ask your search engine."

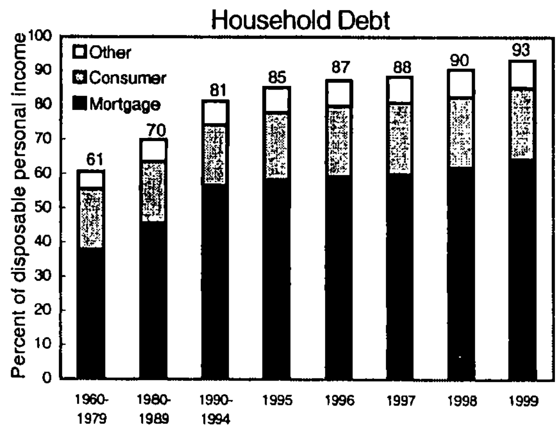
EYES ONLY

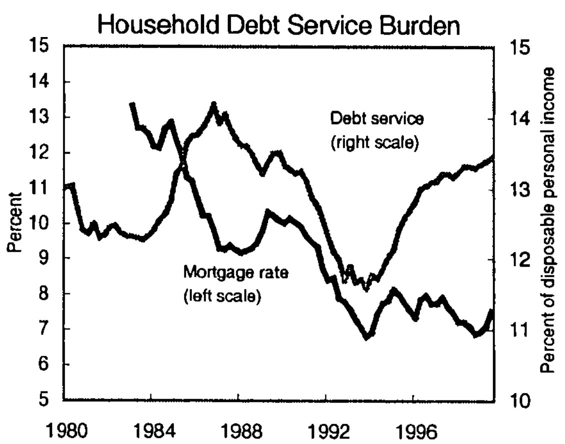
CURRENT DEVELOPMENT

The Financial Condition of Households

Consumer debt increased 7.6 percent in 1999, well above the 5.4 percent increase recorded in 1998. Total household debt (including home mortgages and other debt) increased 9 percent at an annual rate over the first three quarters of 1999 (the latest period for which data are available), up a bit from the rate of increase in 1998. Real estate loan delinquency rates remain low and stable while the number of personal bankruptcies fell for the first time in 4 years.

Trends in household debt. Household debt increased more than 3 percentage points faster than disposable personal income in 1999. Although household debt has been growing faster than disposable income for most of the postwar period, the divergence in these growth rates has been more pronounced over the last 2 years. As a result, the level of household debt reached about 93 percent of disposable personal income in 1999 (upper chart). Growth in non-consumer debt, although strong, is well below the torrid pace witnessed in the mid-1990s. The composition of household debt has shifted over time with mortgages now accounting for nearly 69 percent of household debt, up about 4 percentage points from the 1980s.





Debt service burden. The ratio of debt service to disposable income reached 13.4 percent in the third quarter of 1999, slightly above the 20-year average of 12.9 percent (lower chart). The recent rise in the debt service burden reflects rising debt levels and a pickup in interest rates on car loans and home mortgages. Looking forward, further increases in interest rates would likely push the debt service burden upward.

Indicators of financial distress. The real estate loan delinquency rate remained below 2 percent through the first three quarters of 1999 and has been trending downward since peaking at over 7½ percent in 1991. The delinquency rate for non-mortgage consumer loans remained stable at about 3¾ percent. Based on preliminary data, there were 1.3 million personal bankruptcies in 1999—112,000 fewer than in 1998. This marks a reversal of the trend that saw bankruptcies rise by nearly 80 percent from 1994 to 1998.

Conclusion. Although growth in household debt continues to outstrip that of income, loan delinquency rate has remained stable and personal bankruptcies have fallen sharply. With debt service burdens already high, however, a drop-off in income growth or an increase in interest rates could put pressure on household finances.

EYES ONLY

SPECIAL ANALYSIS

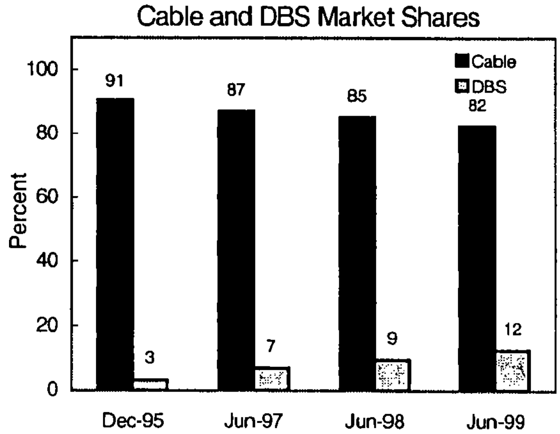
Competition for Cable TV

The Federal Communications Commission recently released its sixth annual report assessing the status of competition in markets for the delivery of video programming. The report finds that competition to cable from direct broadcast satellite (DBS) is growing, and that cable prices are not escalating as rapidly as in the past.

Cable TV and DBS. Cable TV has been the dominant technology for delivering multichannel programming, but the superior quality of DBS technology appears to be eroding cable's market share. Historically, cable systems have been based on analog technology that limits the number of channels available to subscribers. DBS operators use satellites to transmit digital programming to their subscribers' small dishes. This digital technology enables DBS to deliver more channel capacity than many cable systems, digital quality pictures, and specialized programming. In response to this new competitor, cable providers have been investing in upgrading their systems and offering more channels using digital technology. According to cable industry data, while about 64 percent of all cable subscribers are served by systems with 54 or more channels, only about 5 percent of cable subscribers are served by systems with more than 90 channels. By comparison, DBS firms are able to offer packages with more than 100 channels of programming.

Market share shifts. Since 1995, cable's share of the multichannel programming market has declined from 91 percent to 82 percent (see chart). At the same time, DBS technology has grown from just 3 percent to about 12 percent of the market. Although DBS gets a number of customers from areas not served by cable, about 60 percent of its customers have access to cable. The largest DBS operator (DirecTV) has about 9 percent of all multichannel subscribers, which makes it the third largest multichannel programming provider after AT&T and Time Warner.

Cable and DBS Market Shares



Cable prices. Between December 1998 and December 1999, cable prices increased 2.8 percent, far less than the 6.9 percent increase between December 1997 and 1998. Part of these rate increases were driven by higher prices for programming, which increased about 15 percent between 1998 and 1999. Cable firms have also been investing heavily in upgrading their systems, and are expected to have spent nearly $7 billion on system rebuilds and upgrades during 1999.

EYES ONLY

DBS competition and improved cable service. Direct evidence of competition's effect on reducing cable prices comes from areas where one cable system "overbuilds" another, and then competes head-to-head for the same customers. Examples of overbuilds, however, are comparatively rare. Because DBS is available nationwide, it is difficult to discern the direct effect of DBS competition on cable rates. Nonetheless, competition from DBS. for cable does appear to provide an incentive for cable providers to upgrade their systems to compete with the greater number of channels offered by DBS.

Recent changes brought about by SHVIA. Until recently, one of the principal limitations of DBS service was the inability to offer local broadcast channels via satellite. With the signing of the Satellite Home Viewer Improvement Act (SHVIA) in November 1999, satellite providers can now retransmit local broadcasts into local markets. DBS providers now offer local TV broadcasts in a number of major cities, making further inroads into cable TV's market share likely as competition among multichannel program providers intensifies.

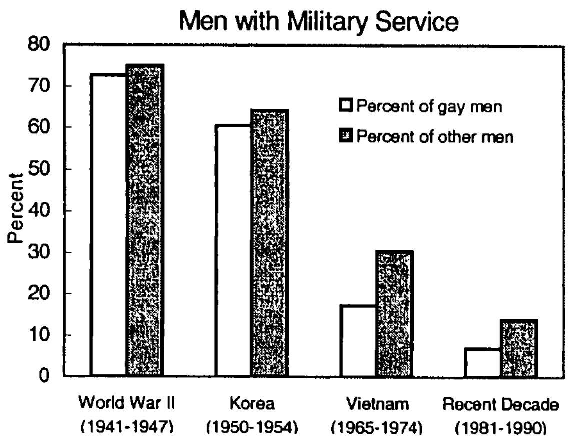
SPECIAL ANALYSIS

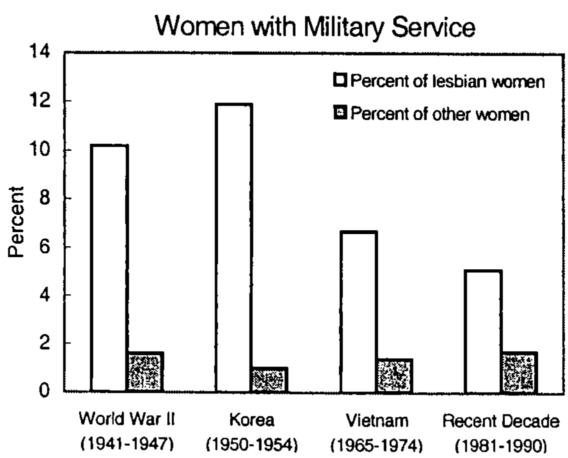
Historical Trends of Gays and Lesbians in the Military

Over the past several decades many gay men and lesbian women have served in the United States military. Until very recently, though, there has been virtually no demographic research to document even basic facts about this record of service.

Rates of military service. In a survey of several thousand adults conducted from 1988 to 1994, about 17 percent of gay men indicated that they had served in the military, compared with 32 percent of heterosexual men. About 8 percent of lesbian women had served in the military, compared with 1.4 percent of heterosexual women. Analysis of same-sex partners in the 1990 Census yields patterns of military service that mirror the survey results (though it is not possible with Census data to examine non-partnered gays and lesbians).

Cohort analysis of military service for men. Cohort analysis of the same-sex partner data from the Census reveals some interesting trends in military service. Gay men who reached draft age (age 18) during the World War II or Korean Conflict eras served in the military in nearly the same proportions as other men. In addition, during these eras the average number of years of service was only slightly lower for gay military men than for other men. The rate of military service has been falling for men in general over the past several decades, and has been falling more rapidly for gay men. Among men turning age 18 from 1981 to 1990 the fraction of gay men with military service was about half as large as for other men, and the length of service was about 1 year shorter.





Cohort analysis of military service for women. Among partnered lesbian women who turned 18 during the World War II and Korean Conflict eras, more than 10 percent served at some time in the military. Among other women in these cohorts, less than 2 percent served at some time. Moreover, lesbian military women accumulated far more years of duty than other women. Among women turning 18 during the Korean Conflict era, for instance, lesbian servicewomen averaged 3.5 years compared with 0.6 years for other women.

Indeed, in the Korean and Vietnam Conflict eras, average years of service for lesbians in the military were similar to the number of years served by men. More recently, there has been a narrowing in the large differences between lesbian women and other women in military service rates, perhaps as a result of changes in military policy that previously barred married women and pregnant women from service.

Conclusion. Best estimates indicate that gays and lesbians make up less than 5 percent of the population. Nonetheless, the service record of this group is of considerable interest. Large numbers of gays and lesbians have served in the U.S. military—many, no doubt, with honor and distinction. Gay men were about as likely as other men to serve in the military during World War II and the Korean Conflict eras, periods when a high percentage of young men were drafted. Lesbian women were more likely to serve than other women during these periods. Indeed, over this span gays and lesbians combined served in the military in higher proportion than heterosexual individuals. However, younger cohorts of gay men are much less likely than other men to have military service, and traditionally high service rates for lesbian women have also declined. Changing social norms about gay "openness" combined with the military policy on sexual orientation and the conversion to an all-volunteer military have likely contributed to these trends.

EYES ONLY

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

BP Amoco/Arco Merger Challenged by FTC. The Federal Trade Commission announced last week that it would challenge the proposed merger between BP Amoco and Arco. The FTC argues that the merger would lessen competition in the exploration and production of Alaskan crude oil and in its sale to West Coast refineries. Some West Coast refineries specialize in processing Alaskan crude oil, and the combined company could use its 75 percent share of Alaskan oil production to raise prices by restricting the supply of Alaskan crude oil. The FTC argues that BP Amoco discriminates in price among these refiners, charging the highest price to refiners that have the least ability to substitute for Alaskan oil while charging lower prices to those with more flexibility. The FTC's next step will be to seek a preliminary injunction in court to stop the merger. A crucial issue for the court will be determining whether the market for Alaskan crude oil on the West Coast is distinct from the world market. If crude oil from the rest of the world can be readily substituted for Alaskan crude, then BP Amoco would be unable to use its control of Alaskan oil to raise prices without encouraging imports from other sources.

Welfare-to-Work May Not Be Enough. According to a study which has received much attention recently (but has not yet been published in full), welfare reform's goal of improving child outcomes is unlikely to succeed unless several factors are addressed. Despite evidence that high-quality child care can improve early learning, the quality of child care used by the study's sample of current and former welfare mothers was generally quite low. In center-based care, educational materials were often scarce and little reading or storytelling was observed. In home-based care, where most children were placed, there were even fewer educational materials, and much greater use of television and videos. In addition, these children's early learning and development may be limited by uneven parenting practices and high rates of maternal depression. Although the authors acknowledge that they cannot draw causal links between welfare reform and poor child development outcomes, they argue that welfare-to-work alone may not improve children's well-being without addressing these deeper issues.

Why Don't Households Save? Vast differences exist in the wealth holdings of American households with a large percentage arriving close to retirement with little or no wealth, according to a recent study using data from the Health and Retirement Survey. One quarter of households where the respondent was between 50 and 61 years of age had less than $30,000 in net worth, and one-tenth had a net worth of $850 or less. Moreover, savings are often invested in low-return assets: nearly one-half of these households do not own any stocks, bonds, or real estate. Planning for retirement appears to be one predictor of wealth: households who plan accumulate significantly more wealth by retirement age. Unfortunately, about one-third of households nearing retirement have done little or no planning for retirement. Factors that tend to raise the likelihood of retirement planning include education level, being married, and having a sibling older than 62.

EYES ONLY

INTERNATIONAL ROUNDUP

Oil Prices in 2000 May be Higher than Previously Expected. The U.S. Energy Information Administration (EIA) recently raised its average crude oil price forecast for 2000 by $2 per barrel, assuming continued decline in world petroleum inventories and greater compliance by OPEC to targeted cuts. Prices in the futures market showed a similar pattern. The EIA still expects that OPEC production will increase substantially in 2000, although more slowly than previously projected. If OPEC production does expand as assumed, crude oil prices should gradually recede in the second half of 2000 after remaining relatively high for the first half of the year. The average cost per barrel of crude oil imported into the United States (a broad gauge of international oil costs) is projected to fall from around $25 per barrel this January to about $22.50 per barrel by January 2001, and continue to fall the rest of that year. On average, world demand will still exceed production this year, so a net withdrawal from inventories worldwide is expected. However, year-over-year declines in stocks are expected to end during the second half of 2000.

Japan's Economy Continues to Struggle. Japan's Economic Planning Agency said this week that the economy is likely to have contracted during the fourth quarter of 1999. This follows on the heels of the third quarter's 4 percent (annual rate) decline in real GDP. Recent high-profile job cuts, lower year-end bonuses, and falling wages are thought to have contributed to a sharp drop-off in December household spending, making 1999 the seventh straight year of decline. On a more positive note, industrial production rose in the fourth quarter of last year, and data released yesterday showed a larger-than-expected gain in private industrial machinery orders in December 1999, boosting hopes that higher private capital investment will bolster the economy.

FDI Flows Rose Sharply in 1999. Worldwide flows of foreign direct investment (FDI) rose 25 percent in 1999 to a record $827 billion, according to preliminary estimates by United Nations Conference on Trade and Development. This increase follows a 41 percent jump in 1998, and marks a more than doubling of FDI flows over the last 3 years. In the industrialized countries cross-border mergers and acquisitions have become the primary mode of entry into foreign markets, and are growing in importance in developing countries. In 1999, the United Kingdom overtook the United States as the largest outward investor for the first time since 1988, while the United States likely remained the world's largest recipient of foreign direct investment. FDI flows to developing countries rose last year by 15 percent after stagnating in 1998, with China the largest recipient at $40 billion.

EYES ONLY

RELEASES THIS WEEK

Retail Sales

****Embargoed until 8:30 a.m., Friday, February 11, 2000****

Advance estimates show that retail sales rose 0.3 percent in January following an increase of 1.7 percent in December. Excluding sales in the automotive group, retail sales declined 0.3 percent following an increase of 1.9 percent.

Productivity

Nonfarm business productivity rose 5.0 percent at an annual rate in the fourth quarter of 1999. Manufacturing productivity rose 10.7 percent.

MAJOR RELEASES NEXT WEEK

Industrial Production and Capacity Utilization (Tuesday)
Housing Starts (Wednesday)
Producer Prices (Thursday)
Consumer Prices (Friday)
U.S. International Trade in Goods and Services (Friday)

EYES ONLY

U.S. ECONOMIC STATISTICS

	1970-1993	**1999**	**1999:2**	**1999:3**	**1999:4**
Percent growth (annual rate)					
Real GDP (chain-type)	3.0	4.2	1.9	5.7	5.8
GDP chain-type price index	5.2	1.6	1.3	1.1	2.0
Nonfarm business (NFB) sector:					
Productivity (chain-type)	1.7	**3.3**	0.6	**5.0**	**5.0**
Real compensation per hour:					
Using CPI	1.0	**1.8**	1.2	**2.0**	**1.1**
Using NFB deflator	1.5	**2.9**	2.9	**4.0**	**1.8**
Shares of Nominal GDP (percent)					
Business fixed investment	11.4	12.6	12.6	12.7	12.5
Residential investment	4.5	4.4	4.5	4.4	4.4
Exports	8.2	10.8	10.7	10.8	10.9
Imports	9.2	13.5	13.4	13.8	14.1
Personal saving	6.6	1.7	1.8	1.5	1.4
Federal surplus	-2.8	N.A.	1.3	1.4	N.A.

	1970-1993	**1999**	**November 1999**	**December 1999**	**January 2000**
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**Figures beginning 1994 are not comparable with earlier data.

New or revised data in **boldface**.

EYES ONLY

FINANCIAL STATISTICS

	1998	1999	December 1999	January 2000	Feb. 10, 2000
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10-year T-bond	5.26	5.65	6.28	6.66	N.A.
Mortgage rate, 30-year fixed	6.94	7.43	7.91	8.21	8.36
Prime rate	8.35	8.00	8.50	8.50	8.75

INTERNATIONAL STATISTICS

Exchange Rates	**Current level February 10, 2000**	**Percent Change from Week ago**	**Percent Change from Year ago**
Euro (in U.S. dollars)	0.987	-0.2	-12.9
Yen (per U.S. dollar)	108.7	0.8	-5.0
Major currencies index (Mar. 1973=100) (trade-weighted value of the U.S. $)	94.99	0.4	2.9

International Comparisons [1]	**Real GDP growth** (percent change last 4 quarters)	**Unemployment rate** (percent)	**CPI inflation** (percent change in index last 12 months)
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1/ For unemployment data, rates approximating U.S. concepts as calculated by the U.S. Department of Labor, Bureau of Labor Statistics.
2/ Rate for unified Germany.

EYES ONLY

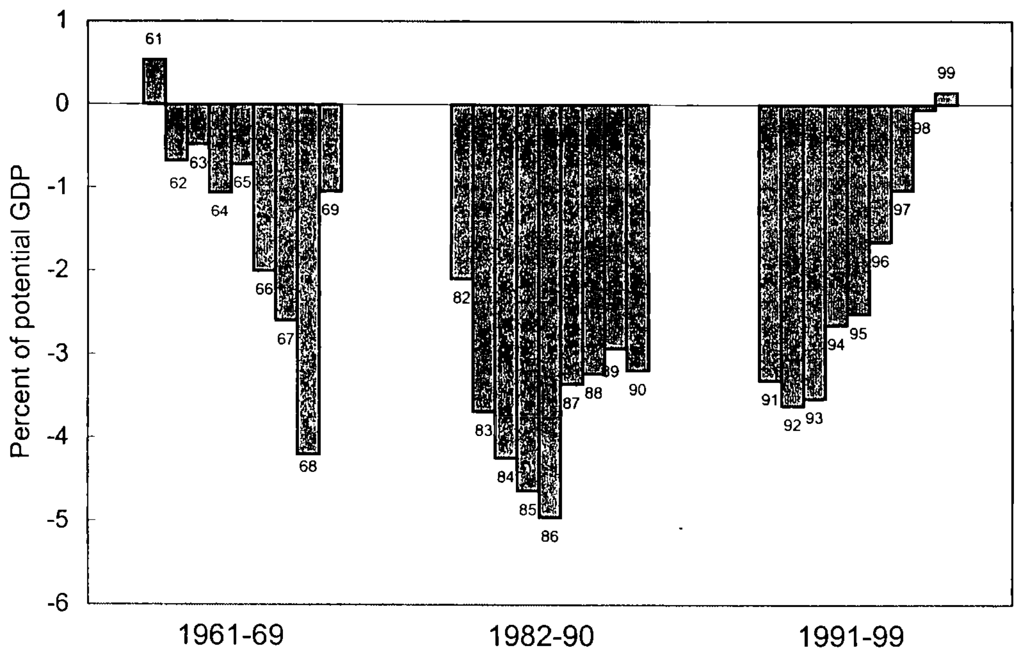
WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

Prepared by the Council of Economic Advisers
with the assistance of the Office of the Vice President

January 14, 2000

CHART OF THE WEEK

The Structural Budget Balance in Three Long Expansions



The structural budget balance has moved steadily from deficit to surplus over the last 7 years of this expansion. In the 1961-69 expansion, by contrast, the structural deficit grew larger until the 1968 tax increase; and the structural deficit was large throughout the 1982-90 expansion. (The structural deficit reflects adjustments to the deficit to remove cyclical and temporary factors; it measures what the deficit would be at full employment.) A Special Analysis in this Briefing discusses other indicators of fiscal restraint in this expansion.

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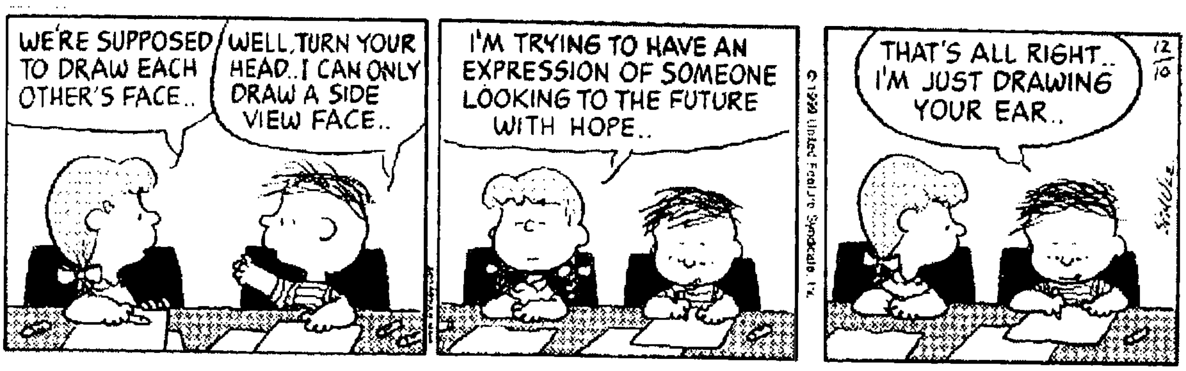


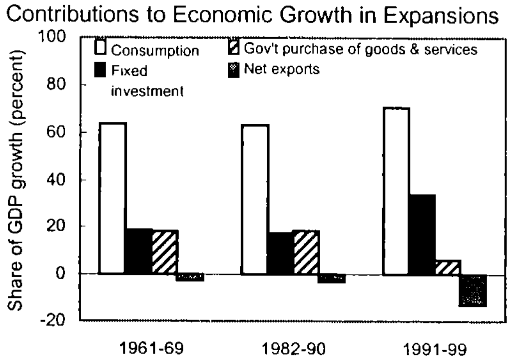
SPECIAL ANALYSIS

Fiscal Discipline and Economic Growth

As shown in the Chart of the Week, the decline in the structural budget deficit in this expansion has been unusual compared with what happened in the other two long expansions. This reflects an unusual decline in federal expenditures relative to GDP.

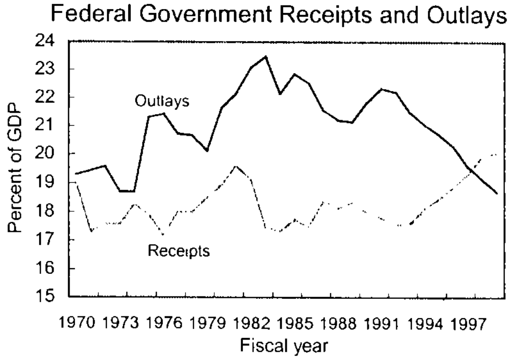
Contributions to growth. Growth in GDP can be disaggregated into the contributions of the major demand components: consumption, investment, government purchases, and net exports. In this expansion, the proportion of growth represented by consumption (the largest component of GDP) has been a little higher than in the other long expansions and the negative contribution of net exports has been larger (see upper chart). The difference that reflects fiscal discipline, however, is the relatively small contribution from government and the relatively large contribution from private fixed investment. Moreover, the modest contribution of government is entirely accounted for by growth in state and local spending: federal purchases of goods and services were smaller in 1999 than they were in 1991 after adjusting for inflation.

Contributions to Economic Growth in Expansions



Federal expenditures and revenues. Total federal expenditures, which include Social Security and other transfers in addition to purchases of goods and services, fell from 22.3 percent of GDP in 1991 to 19.0 percent in 1999 (see lower chart). This decline of 3.3 percentage points is more than twice the decline of 1.3 percentage points during the 1982-90 expansion. Moreover, the decline in spending in the 1980s was associated with a decline in revenues (as a share of GDP), whereas the decline in the current expansion occurred during a period of rising revenues. This contradicts the view that increases in government revenue simply invite a corresponding increase in spending.

Federal Government Receipts and Outlays



Analysis. Budget deficits can be useful in stimulating the economy when private demand is weak. And arguably they served that role in the early stages of the 1960s and 1980s expansions. However, fiscal restraint was applied too late to prevent a sharp rise in inflation later in the 1960s expansion. It was never a feature of the 1980s expansion, and the combination of loose fiscal policy and tight monetary policy was associated with relatively high real interest rates and declining saving and investment. In the current expansion, by contrast, fiscal discipline has allowed monetary policy to accommodate strong growth with low inflation. Interest rates have been lower than they would have been without fiscal discipline, and investment has flourished.

SPECIAL ANALYSIS

Bugs Bunny Online: Not a Mickey Mouse Merger

America Online (AOL) and Time Warner agreed to merge this week in a stock deal that combines an older media franchise with one of the better known players in the new world of the Internet. In this "merger of equals," AOL is far smaller than Time Warner in terms of revenue ($1.5 billion versus $6.7 billion in the third quarter of 1999). Nevertheless, with its higher market value, AOL was able to offer to buy out Time Warner shareholders while leaving AOL shareholders with 55 percent of the shares in the new AOL Time Warner.

AOL's dilemma. AOL is an Internet service provider (ISP) that also supplies its own content to more than 20 million members of its America Online service. Most AOL customers dial in on an ordinary phone line to receive relatively slow "narrowband" access. Broadband access that increases the speed at which consumers can download their favorite news, music, and movie clips from the Web is now becoming available in two ways: through the local cable company's wire using a cable modem, and through the local phone company's wire using a digital subscriber line (DSL) service. AOL had been seeking at Federal, state, and local levels "open access" to provide its content over a broadband pipe, but it had been notably unsuccessful in persuading the largest cable company–AT&T–to open up its lines on terms acceptable to AOL.

Enter Time Warner. Time Warner is a multimedia company that is involved in many different ventures, including publishing, music and film production, and TV production for various cable networks such as its subsidiaries CNN and HBO. Time Warner also operates a number of cable systems throughout the country that serve approximately 13 million subscribers. Time Warner has upgraded about 85 percent of its systems to offer high speed broadband Internet access, but it still has relatively few broadband customers.

The plan. By merging, the combined company expects to realize synergies between the two operations. With its large customer base and expertise in marketing Internet services, AOL should be able to expand the number of Time Warner cable customers who purchase broadband access. The new company will also benefit from marketing Time Warner content to existing AOL subscribers.

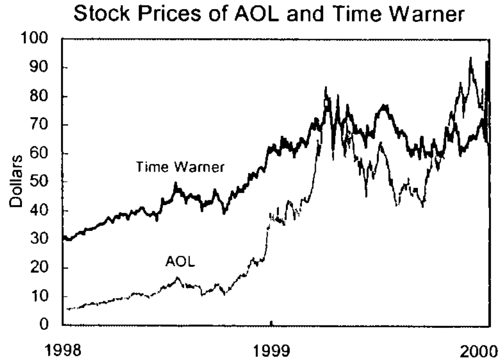
Competition and Internet access issues. The merger will not solve all of AOL's broadband access issues, since Time Warner's systems still represent only a fraction of the nation's total cable consumers. Thus, it is not surprising that the two companies have said that they are "committed to ensuring consumer choice of ISPs and content," because AOL will still need broadband access for customers not served by Time Warner. It is far from clear, however, whether AOL Time Warner will actively push for legislation in this area.

Despite its large size, the new company will still face competition. In its existing dial-in business, AOL faces competition from many other national and regional Internet service providers, and there are a number of other providers of broadband access through wires owned by other cable and phone companies. With respect to content, Time Warner will still have to compete with other providers of news, information, music, and movies as it does today, and the companies have said nothing to suggest that they intend to restrict the sales of that content to a single distribution provider like AOL.

The proposed merger will be reviewed by the antitrust authorities, but there appear at first blush to be relatively few markets where the merger might substantially reduce competition under traditional antitrust guidelines. The FCC may review the merger under the Telecommunications Act of 1996. And incumbent phone companies may have an increased desire to seek relief or revisit the Act.

Stock market valuations. Over the past 2 years, both companies' stock prices have risen sharply, but the percentage gain has been much larger for AOL stock (see chart). In part at least, this difference reflects investor expectations that AOL's business has much more potential for earnings growth than Time Warner's. The terms of the merger call for AOL to pay a large premium to Time Warner's shareholders relative to its pre-merger value. For this deal to benefit AOL shareholders as well, the synergies from combining the two companies would have to be substantial. However, the historical results from previous mergers suggest that shareholders in acquiring firms tend not to benefit from mergers. And the initial market reaction to the AOL Time Warner deal was a 13 percent decline in the value of AOL stock during the two trading days following the announcement.

Stock Prices of AOL and Time Warner



Future expectations. After the announcement of this merger, other Internet and media companies have seen their stock prices rise in anticipation of further mergers, but the shape of any future deals is less clear. AOL's leading role as both an ISP and a content provider is unusual in the online world, and other media and Internet companies may need to find a different model to use before attempting to blend traditional media with the Internet.

EYES ONLY

ARTICLE

Fishery Business

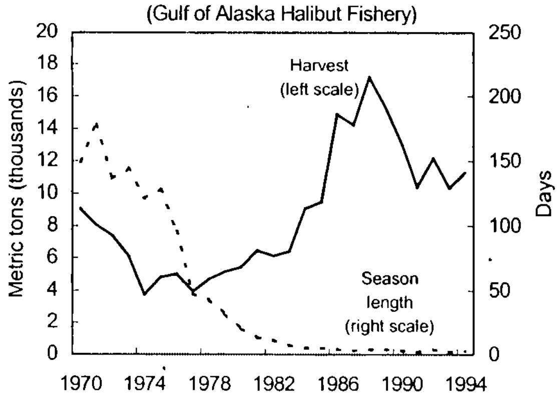
Over-fishing continues to be a problem for most fisheries in the United States, according to a recent report from the National Research Council (NRC). The report, which was requested in the Sustainable Fisheries Act of 1996, confirms the efficacy of individual quotas for some fisheries as a tool for addressing this problem, and it recommends lifting the moratorium on introducing new quota programs that was imposed by the Act.

The over-fishing problem. Fisheries are a common property resource, and without effective management over-fishing is likely to occur. This is because individual fishers' decisions about how intensively to fish are unlikely to take into account the full costs of these decisions in depleting the fish stock and possibly even killing off a species.

Traditional management strategies. Some fishery managers have tried to prevent over-fishing by imposing an annual limit on the catch. This limit, called the total allowable catch (TAC), is set at a level designed to guarantee the sustainability of the fishery, and the season usually ends once this limit is reached. This creates an additional problem, however, as each fishing crew tries to beat the rest of the fleet and capture as large a fraction of the TAC as possible. The "derbies" that result can be quite wasteful; fishers over-invest in gear and purchase ever-larger boats, making the derbies even more frenetic.

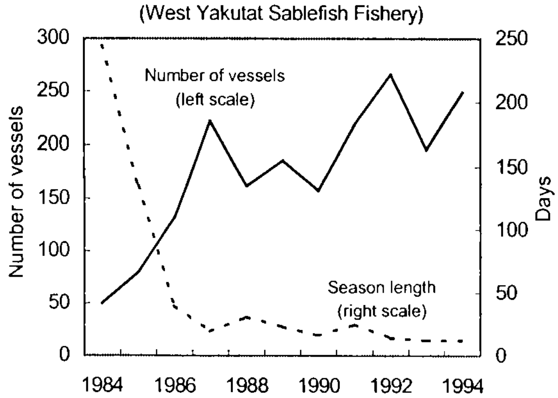
Harvest and Season Length

(Gulf of Alaska Halibut Fishery)



Number of Vessels and Season Length

(West Yakutat Sablefish Fishery)



Inefficiency. When this process significantly shortens the fishing season, consumers' access to certain species of fresh fish is restricted and fishers' work efforts are concentrated in a short, intense season. In the central Gulf of Alaska halibut fishery, for example, the season collapsed from a high of over 170 days in 1971 to 2 days in 1991, while the total catch more than quadrupled from 1974 to 1988 (see upper chart). In the West Yakutat sablefish fishery, the number of vessels increased almost fourfold in only 4 years in the mid-1980s as the number of days fell sharply (see bottom chart). Shorter seasons have also been associated with higher accident rates, because, with a season of only a few days, the decision to sit out bad weather is often tantamount to sitting out the season.

A possible solution. A potentially more efficient approach for some fisheries is to allocate shares of the TAC through individual quotas and allow fishers to trade these quotas in an open market. Under a quota system, each fisher has a right to a specified share of the TAC in each year, and each can catch this share in the cheapest manner possible without having to worry about the behavior of competitors. The incentives to concentrate production in the early portion of the season and to over-invest in capital disappear. Overall efficiency is improved further when the quotas are transferable, because less efficient fishers have an incentive to sell their rights to more efficient fishers.

Experience with individual quotas. The NRC report finds that individual quotas have been used extensively around the world, with very promising results. New Zealand first introduced a program in 1986 and at least 7 other countries now employ individual quotas. The creation of each of the four U.S. programs underway before the moratorium was imposed arose, in part, out of a concern over the build-up of fishing capital. In two of these (the surf clam/ocean quahog fishery and the wreckfish fishery) over-harvesting has ceased, and there is evidence that the total quantity of capital has subsequently fallen. In the Alaskan halibut and sablefish fisheries, the annual harvest did not exceed the target in the first 2 years of the quota program, after doing so by an average of 6 percent over the previous 17 years.

Conclusion. The moratorium on new individual quota programs imposed by the Sustainable Fisheries Act of 1996 runs through October 1, 2000. In recommending that the Congress lift this moratorium and allow regional fisheries to use individual quotas, the NRC report emphasizes that the quotas are not a panacea applicable to all fisheries. But it also concludes that past experience has repeatedly demonstrated the effectiveness of individual quotas in matching harvesting and processing capacities to the resource, slowing the race to fish, providing consumers with a better product, and reducing wasteful and dangerous fishing.

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

The Gender Pay Gap in Top Corporate Jobs. Between 1992 and 1997, about 2.5 percent of high-level executives in U.S. corporations were women. According to a recent study, these women earned about 45 percent less than their male counterparts. As much as three quarters of this gender gap can be explained by the fact that women tend to manage smaller companies and are less likely to be CEOs, chairs, or company presidents. Taking into account that female executives also tend to be younger and have less seniority than males reduces the unexplained gender gap to just 5 percent. While the absence of a significant conditional gender gap implies that women and men who hold similar jobs in firms of similar size receive fairly equal compensation, it does not rule out the possibility of discrimination in terms of gender segregation or promotion.

Children's Life Prospects Diverge. The number of children under age 6 with particularly bright futures and the number with particularly dim futures both rose between 1976 and 1996, according to a recent study. Looking at both "risk factors" and "opportunity factors" in young children's environments that are associated with negative and positive adult outcomes, the study found that the share of young children with particularly good prospects rose from 9 percent to 26 percent. Most of this growth resulted from having mothers who are now more educated and more likely to delay childbearing. The proportion of children with poor prospects—having a teen or unmarried mother, having a mother without a high school degree or living in poverty—rose from 8 percent to 12 percent. Applying this analysis to children in cities and suburbs, the study found increases in both good and bad prospects in both cities and suburbs. But it also found that in 1996 half of all children with poor prospects lived in central cities, while two-thirds of all children with good prospects lived in suburbs.

Manufacturing Increasingly Relies on Temporary Workers. The manufacturing sector increased its use of temporary help workers in the 1990s, according to a recent study. The study argues that because the official BLS data count these temporary workers as service sector not manufacturing employees, the number of jobs generated in manufacturing has been underestimated, manufacturing productivity has been overstated, and the decline in manufacturing hours has been overestimated. Not counting these workers in manufacturing explains, in part, the apparent flatness of manufacturing employment in the 1990s. While official data suggest that the expansionary period between 1992 and 1997 generated only 550,000 manufacturing jobs, accounting for the temporary workers implies that, in fact, as many as 1,060,000 new jobs were created. The decline in manufacturing hours between 1989 and 1997 also disappears once temporary help workers are taken into account. The study finds that excluding temporary help workers raises manufacturing productivity (and lowers service sector productivity), but it does not account for much of the gap between the high rate of growth in manufacturing productivity and the low rate in services. Nor does it change the rate of growth of productivity for the nonfarm sector as a whole.

EYES ONLY

INTERNATIONAL ROUNDUP

European Commission to Create Food Safety Authority. In a White Paper published this week, the European Commission unveiled plans to create an independent European Food Authority, with the aim of restoring public confidence in European food policy after a series of food alerts and crises in recent years. The intention is that the Authority will be guided by the best science and work closely with national scientific bodies. It will be independent of industrial and political interests and open to public scrutiny. Its main tasks will be disseminating independent scientific information on all aspects of food safety, operating a rapid alert system, and communicating with consumers on issues of food safety and health. The White Paper envisions the Authority beginning operations in 2002, once the necessary legislation is adopted.

China to Shut Down Steel Plants. China has announced plans to close its small steel plants, which may result in the loss of thousands of jobs. Small smelters and mills with annual production capacities below 100,000 tons are to be closed, affecting more than 2,500 plants. Plants that rely on small and backward steel blast furnaces and converters will also be closed. According to the *China Daily*, most of the plants in question are low-technology operations that waste resources and generate serious pollution. The plan will allow the government to obtain better control of steel output. China's goal is to achieve a 10 percent reduction of steel output this year in order to alleviate a current steel market glut. The plant closures will be enforced with strict measures, including denying designated plants raw materials, power supplies, credit, environmental licenses, and markets for their steel.

Russia's Health Crisis. Russia is in the midst of a health crisis, with deaths currently exceeding births by about 700,000 a year. Some experts estimate that without immediate policy measures, Russia's population is on track to drop to 80 million in 50 years from about 150 million today. Drug-resistant tuberculosis, AIDS, and cardiovascular disease are rampant. Some estimate that over 10 million Russians will be infected with HIV by 2005. The death rate from cardiovascular disease in Russia is higher than the death rate in the United States from all causes combined. Alcohol abuse poses additional concerns. In 1996, over 35,000 Russians died from unintentional alcohol poisoning; the comparable U.S. figure is 300. The experiences of countries like Thailand and Uganda in successfully lowering HIV infection rates show the positive impact when diverse government ministries, NGOs, and grassroots community groups join forces to raise local awareness. However, it has been argued that Russia's leadership has done little to promote "healthy lifestyles" domestically.

EYES ONLY

RELEASES THIS WEEK

Industrial Production and Capacity Utilization

****Embargoed until 9:15 a.m., Friday, January 14, 2000****

The Federal Reserve's index of industrial production increased 0.4 percent in December. Capacity utilization rose 0.1 percentage point to 81.3 percent.

Consumer Price Index

****Embargoed until 8:30 a.m., Friday, January 14, 2000****

The consumer price index rose 0.2 percent in December. Excluding food and energy, consumer prices rose 0.1 percent. For the 12-month period ending in December, consumer prices rose 2.7 percent; excluding food and energy, consumer prices rose 1.9 percent.

Retail Sales

Advance estimates show that retail sales increased 1.2 percent in December following an increase of 1.1 percent in November. Excluding sales in the automotive group, retail sales rose 1.4 percent following an increase of 0.7 percent.

Producer Price Index

The producer price index for finished goods rose 0.3 percent in December. Excluding food and energy, producer prices rose 0.1 percent. For the 12-month period ending in December, producer prices rose 3.0 percent; excluding food and energy, producer prices rose 0.9 percent.

MAJOR RELEASES NEXT WEEK

Housing Starts (Wednesday)
U.S. International Trade in Goods and Services (Thursday)

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U.S. ECONOMIC STATISTICS

	1970-1993	**1998**	**1999:1**	**1999:2**	**1999:3**
Percent growth (annual rate)					
Real GDP (chain-type)	3.0	4.6	3.7	1.9	5.7
GDP chain-type price index	5.2	1.1	2.0	1.3	1.1
Nonfarm business (NFB) sector:					
Productivity (chain-type)	1.7	3.1	2.7	0.6	4.9
Real compensation per hour:					
Using CPI	1.0	3.9	2.8	1.2	2.1
Using NFB deflator	1.5	4.7	2.9	2.9	4.4
Shares of Nominal GDP (percent)					
Business fixed investment	11.4	12.5	12.6	12.6	12.7
Residential investment	4.5	4.2	4.4	4.5	4.4
Exports	8.2	11.0	10.7	10.7	10.8
Imports	9.2	12.7	12.9	13.4	13.8
Personal saving	6.6	2.6	2.2	1.8	1.5
Federal surplus	-2.8	0.5	1.1	1.3	1.4

	1970-1993	**1999**	**October 1999**	**November 1999**	**December 1999**
Unemployment Rate (percent)	6.7**	4.2**	4.1	4.1	4.1
Payroll employment (thousands)					
increase per month			284	222	315
increase since Jan. 1993					20367
Inflation (percent per period)					
CPI	5.8	**2.7**	0.2	0.1	**0.2**
PPI-Finished goods	5.0	**3.0**	-0.1	0.2	**0.3**

**Figures beginning 1994 are not comparable with earlier data.

New or revised data in **boldface**.
CPI data **embargoed until 8:30 a.m., Friday, January 14, 2000**.

EYES ONLY

FINANCIAL STATISTICS

	1998	1999	November 1999	December 1999	Jan. 13, 2000
Dow-Jones Industrial Average	8626	10465	10810	11246	11582
Interest Rates (percent per annum)					
3-month T-bill	4.78	4.64	5.07	5.20	5.25
10-year T-bond	5.26	5.65	6.03	6.28	6.63
Mortgage rate, 30-year fixed	6.94	7.43	7.74	7.91	8.18
Prime rate	8.35	8.00	8.37	8.50	8.50

INTERNATIONAL STATISTICS

Exchange Rates	**Current level January 13, 2000**	**Percent Change from**	
		Week ago	**Year ago**
Euro (in U.S. dollars)	1.027	-0.5	-12.2
Yen (per U.S. dollar)	106.1	0.9	-6.5
Major currencies index (Mar. 1973=100) (trade-weighted value of the U.S. $)	92.80	0.2	1.2

International Comparisons [1]	**Real GDP growth** (percent change last 4 quarters)	**Unemployment rate** (percent)	**CPI inflation** (percent change in index last 12 months)
United States	4.3 (Q3)	4.1 (Dec)	**2.7** (Dec)
Canada	4.2 (Q3)	6.9 (Nov)	2.1 (Nov)
Japan	1.0 (Q3)	4.6 (Nov)	-1.2 (Nov)
France	2.9 (Q3)	10.7 (Nov)	0.9 (Nov)
Germany	1.3 (Q3)	9.0 (Nov)[2]	1.0 (Nov)
Italy	1.2 (Q3)	12.1 (Apr)	2.0 (Nov)
United Kingdom	1.8 (Q3)	5.9 (Sep)	1.4 (Nov)

U.S. CPI data **embargoed until 8:30 a.m., Friday, January 14, 2000**.

1/ For unemployment data, rates approximating U.S. concepts as calculated by the U.S. Department of Labor, Bureau of Labor Statistics.

2/ Rate for unified Germany.

EYES ONLY

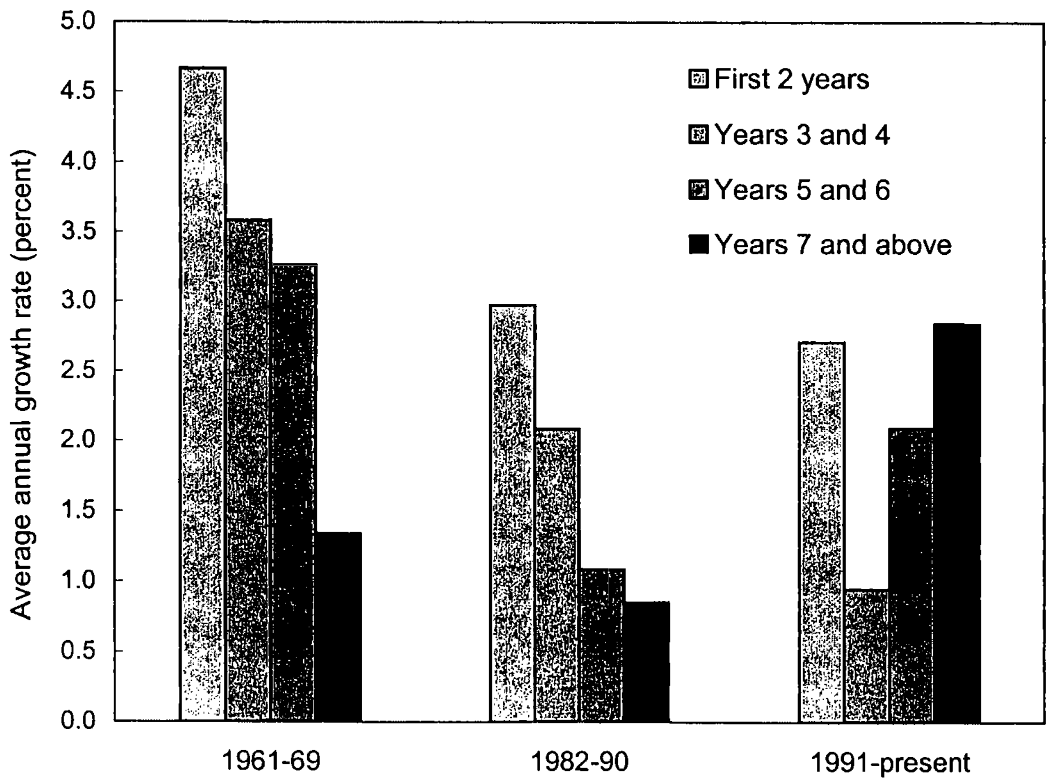
WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

Prepared by the Council of Economic Advisers
with the assistance of the Office of the Vice President

January 7, 2000

CHART OF THE WEEK

Growth in Nonfarm Output per Hour During Expansions



Productivity growth tends to be strong in the early stages of an expansion as idle resources are put back to work. But the rate of growth of productivity tends to fall as the expansion matures. While this was true of the other two long postwar expansions, it has not been true in the current expansion, with nonfarm productivity growth strongest in the later years. A Special Analysis in this Briefing examines possible reasons for this acceleration.

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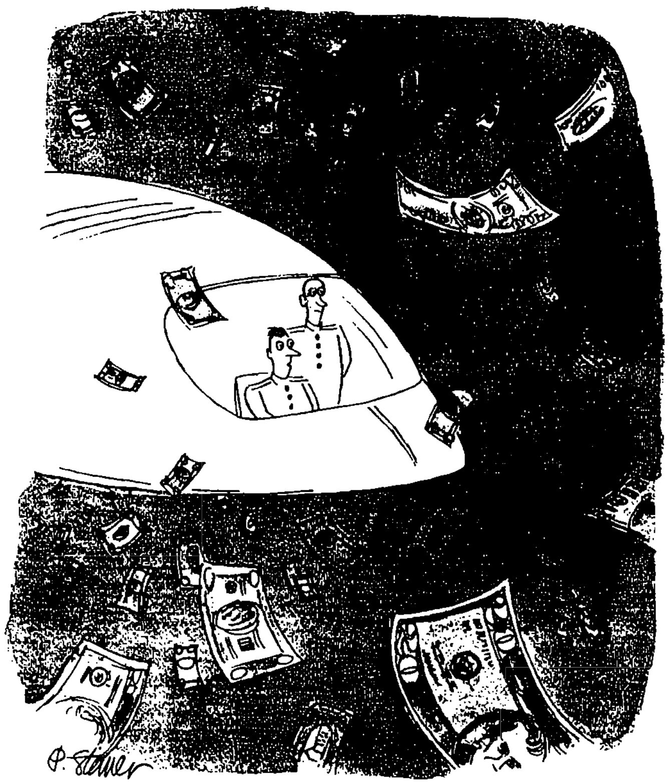


"Captain, it looks like we've entered cyberspace."

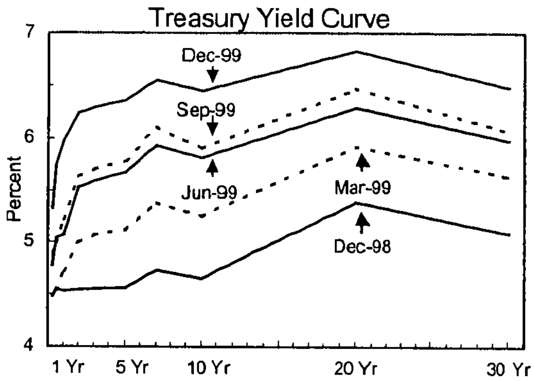
EYES ONLY

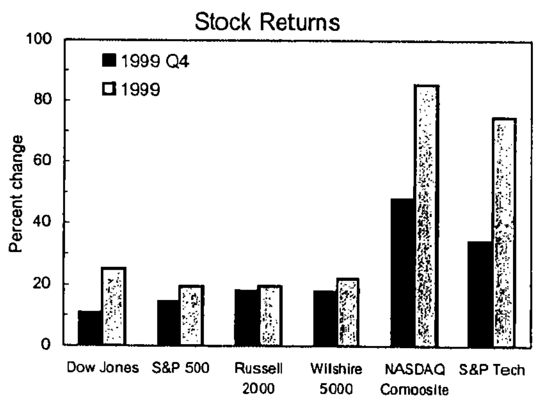
FINANCIAL MARKET UPDATE

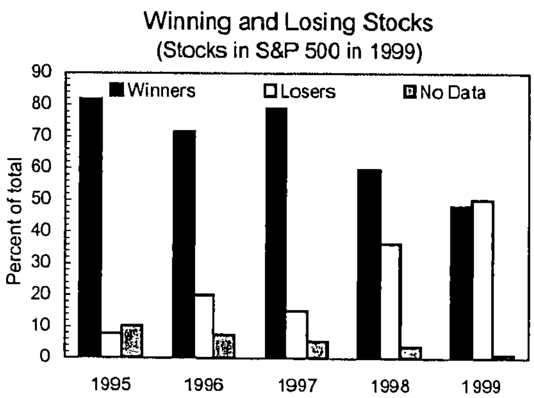
Fourth Quarter 1999

Stock prices soared in the last quarter of 1999, led by technology companies. All major indexes closed out 1999 at record highs. The Federal Reserve raised its target lending rate in November but made no further move in December. Market concerns about future rate hikes have kept yields on long-term Treasuries near 2-year highs.

Interest Rates. Treasury rates increased over the past 3 months at all maturities (see top chart). In November, when the Federal Reserve raised its federal funds target rate 25 basis points to 5½ percent, it cited the shrinking pool of available workers and the potential inability of production to keep pace with demand. Signaling a commitment to help smooth the year-2000 transition, the Fed made no further move in December despite continued concerns about increasing inflationary pressures. However, federal funds futures rates rose at the end of December, indicating that the market expects the Fed to raise rates again in February.







Stock prices. The Standard and Poor's 500 index grew a robust 15 percent in the fourth quarter, but technology-based indexes performed even better, illustrating the strength of the technology sector relative to the market as a whole (see middle chart). In particular, the NASDAQ significantly out-performed other major indexes, gaining 48 percent in the fourth quarter alone and 86 percent for 1999.

Concentrated gains. Although the broad indexes showed strong growth, gains were more concentrated than in previous years. For example, in 1999 the S&P 500 grew about 20 percent, yet fewer than half of all stocks in the index realized any gains (see bottom chart). In contrast, over 70 percent of these stocks saw price increases in 1996, even though the index as a whole grew at about the same rate as in 1999.

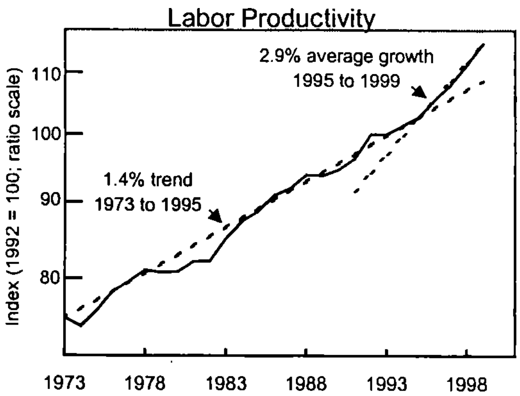
Happy New Year? Stock prices have been volatile this week. After falling sharply in the first few days, the Dow recouped some its losses and the S&P 500 stabilized. Technology stocks were particularly hard hit, however, with the NASDAQ falling over 8 percent through Thursday.

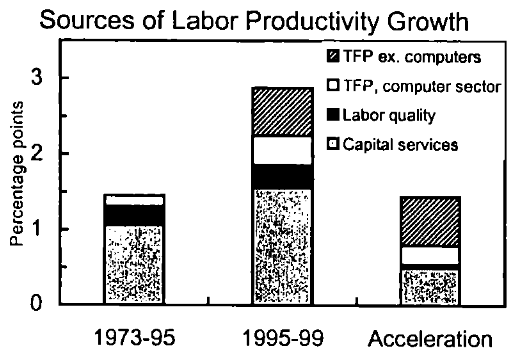
EYES ONLY

SPECIAL ANALYSIS

Accounting for the Surge in Productivity Growth

Labor productivity trended upward at an average annual rate of 1.4 percent from 1973 to 1995, but it has since accelerated to a 2.9 percent annual clip over the past 4 years (see upper chart). CEA analysis finds that half of this acceleration is accounted for by an increase in capital—especially computer capital—and by productivity growth in the computer-producing sector.





More capital per worker. Labor productivity increases when workers have more capital to work with. Partly because business investment as a share of GDP has been above its long-term average since 1995, capital services per hour have grown faster since 1995 as well. Analysis of preliminary data indicates that this capital deepening accounted for 1.5 percentage points of annual labor productivity growth during the 1995-99 period, up from 1.1 percentage points during the 1973-95 period (see lower chart). Thus, the increase in capital services per hour accounts for about a third of the 1.5 percentage point increase in annual productivity growth. Most of this gain from capital deepening is accounted for by investment in computers and software.

Computer quality. Besides their role in capital deepening, computers enter GDP directly as a flow of new investment. Hence, productivity growth in the production of computers contributes directly to overall productivity growth. Productivity growth has been particularly rapid in the computer-producing sector, as reflected in the rapid decline in computer prices. Price declines for computers, which had been running at a 15 percent average annual rate before 1995, fell at a 27 percent annual rate thereafter, indicating an acceleration in computer quality after 1995. Improved computer quality added an estimated 0.25 percentage point to the post-1995 productivity acceleration.

Work force quality. The American work force has become better educated, and, since about 1980, the average worker has had more work experience. However, nothing dramatically new happened to the index of labor composition after 1995, and the estimated contribution of work force quality to productivity growth of 0.3 percentage point per year since 1995 is only slightly above the pre-1995 pace.

Total factor productivity. According to these estimates, the combined effects of capital deepening, changing labor composition, and rising computer quality account for about half of the post-1995 acceleration in productivity. The residual, called total factor productivity (TFP), reflects all the other factors that affect productivity growth. These may include cyclical influences and new efficiencies from the use of the Internet, especially for business-to-business transactions.

Outlook. Can the factors that account for the more rapid pace of labor productivity growth since 1995 be sustained? Of course we cannot know for sure, but current trends are positive and Administration policies are supportive.

- Capital deepening. The growth rate of capital services per hour increased in 4 of the past 5 years, reaching 5.4 percent in 1999—a rate that implies a 1.8-percentage-point per year contribution of capital deepening to labor productivity growth. For 2000, the pace of capital deepening is likely to increase further, because the level of investment is already very high. Projections over the longer run are more speculative, but the level of nominal investment is expected to remain high relative to nominal output. Pursuing a budget policy of debt reduction also promotes investment.

- Computers. The pace of computer price declines has been particularly rapid over the past 4 years and may not be sustainable. However, the contribution of computers to productivity growth would still be important even if the rate of price declines slowed to the longer term rate of about 20 percent per year.

- Work force quality. The trend toward a more educated work force seems likely to continue with the Administration's policy of promoting human capital investment, and the average age of the work force will continue to rise through at least 2008, when the leading edge of the baby-boom generation retires. But these factors are not expected to accelerate, and the contribution of labor composition to productivity is not likely to change much from its historical average of 0.3 percentage point per year.

- Total factor productivity. This is the most difficult factor to forecast since it is a residual reflecting a wide variety of factors.

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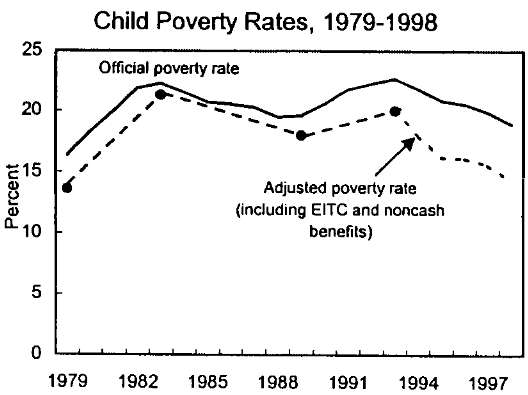
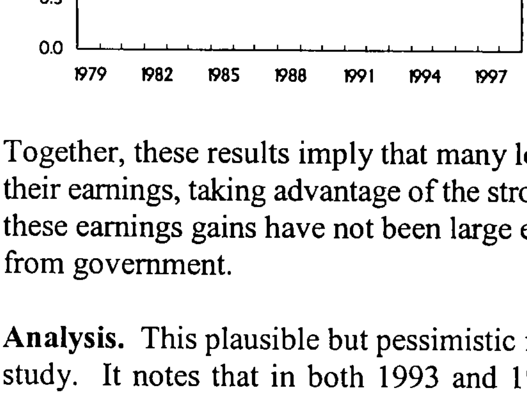
SPECIAL ANALYSIS

Recent Changes in the Safety Net and Child Poverty

Since 1993, the number of poor children has fallen by 2.3 million. However, a new study from the Center on Budget and Policy Priorities finds that the average poor child in 1998 was worse off than the average poor child in 1994. The study attributes this result to sharp declines in the number of poor children receiving cash assistance and food stamps. This conclusion must be interpreted cautiously, however, in light of the changing composition of the families who remain poor.

Trends in the child poverty rates. The official child poverty rate, which is based on a measure of income that includes earnings and cash assistance but excludes other benefits such as the EITC and food stamps, has declined sharply, from 22.7 percent in 1993 to 18.9 percent in 1998 (see upper chart). This is the lowest rate since 1980. The study finds that the decline is even sharper using a broader income measure that includes the EITC and noncash benefits such as food stamps.





The child poverty gap. To examine trends in the depths of poverty, the study focuses on a different statistic, the "child poverty gap," which measures the *amount* by which poor children's family income falls short of the poverty threshold. The study finds that, in 1998, the per child gap before taking into account government benefits and taxes was $2,489—the lowest it has been since 1979 (see lower chart). The net effect of taxes and transfers is to shrink the gap. However, the study finds that the post-tax-and-transfer gap per child has risen in recent years and, at $1,604 in 1998, was the largest on record and $149 higher than it was in 1994.

Together, these results imply that many low-income families with children boosted their earnings, taking advantage of the strong economy and welfare reform—but that these earnings gains have not been large enough to offset reductions in net transfers from government.

Analysis. This plausible but pessimistic interpretation is the one emphasized in the study. It notes that in both 1993 and 1995, 57 percent of poor children (before counting benefits based on income) received AFDC, while by 1998, only 41 percent of poor children received TANF. Child participation in the food stamp program also shows a downward trend: between 1995 and 1998, the number of children receiving food stamps declined by almost 27 percent while the number of poor children fell 10 percent.

While the data clearly show that the average child poverty gap has widened (based on the comprehensive, post-tax-and-transfer-income measure), the interpretation of this finding is difficult because the composition of the poor population has changed. The data do not track individuals over time, and the strong economy and policy initiatives such as EITC and minimum wage have been successful in helping many families escape poverty since 1993. To the extent that those who have escaped poverty had incomes closer to the poverty threshold to begin with than those left behind, the per child gap could have increased with no individual families becoming worse off. However, the narrowing of the pre-tax-and-transfer gap suggests that remaining poor families may in fact have both increased their earnings and experienced some decline in benefits.

Conclusion. Further research is required to learn more about how much of the change in the child poverty gap reported in the study reflects compositional effects and how much reflects changes in receipt of government benefits. Even so, the study highlights the plight of families where parents face the greatest barriers to employment, such as limited work experience, a disability, or difficulty in finding child care. This points to the importance in fighting poverty of continued efforts to ensure that low-income families receive the benefits for which they are eligible, and for finding innovative ways to reduce child poverty.

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

Children without Health Insurance Are Enrolled in Other Programs. Almost three-quarters of all low-income children without health insurance live in families that participate in other government programs, such as the National School Lunch, WIC, Food Stamp and Unemployment Compensation Programs. This finding by the Urban Institute suggests a new possibility for identifying uninsured children and encouraging their families to enroll them for Medicaid or CHIP coverage. Several localities are building outreach efforts around the National School Lunch Program, which serves the families of an estimated 60 percent of all low-income uninsured children. Programs already in existence include sending informational flyers to parents and positioning trained volunteers at schools to answer questions and help complete applications. Concerns such as the need to protect the privacy of lunch program applicants and the fact that Medicaid and CHIP programs require more information than the National School Lunch Program, still need to be addressed.

Enrollment of Foreign Students in U.S. Colleges Nears Half a Million. The number of foreign students attending colleges and universities in the United States increased 2 percent in the last school year to a record total of nearly 491,000, according to a recent study. China supplied the most students (10.4 percent), followed by Japan and Korea. Although foreign students compose only 3 percent of America's total higher education population, they contribute more than $13 billion dollars to the U.S. economy in money spent on tuition, living expenses, and related costs. With over three-quarters of that funded by overseas sources, higher education now ranks as the country's fifth largest service sector export, according to the study.

Survey Finds Grandparents Play Active Role in Families. Most grandparents regularly interact with their grandchildren, according to a survey of over 800 grandparents aged 50 and over. The survey, sponsored by the American Association of Retired Persons, found that more than 8 in 10 grandparents had talked with a grandchild on the telephone or had seen a grandchild in person in the previous month. It also found that 11 percent of grandparents are caregivers: 3 percent are raising a child and 8 percent provide day care on a regular basis. Roughly a third of the African American grandparents surveyed are caregivers—compared with roughly a fifth of the white grandparents. Grandparents spent a median of $489 per year for gifts, clothes, outings, tuition, and other purchases for their grandchildren. Among activities engaged in with grandchildren in the past month, the most frequently reported were eating together at home (72 percent) or eating out (65 percent). Other activities with responses in roughly the 40 to 55 percent range included watching a television comedy, having grandchildren stay overnight, shopping for clothes, engaging in exercise or sports, watching educational television, and going to religious services. Asked to rate their relationship with a grandchild on a scale of 0 to 10 (excellent), the mean answer was 8.7.

INTERNATIONAL ROUNDUP

International Mergers Increase as Regulation Becomes More Complex. Last year was a record year for mergers and acquisitions, with more than $1.7 trillion in announced deals recorded in the United States, $1.2 trillion in Europe, and $162 billion in Asia. However, at the same time that mergers, particularly cross-border mergers, are rapidly increasing, merger control laws are becoming more numerous and complex. A survey of 99 international jurisdictions found that 28 countries and the European Union have substantially revised and strengthened existing competition laws in the past 3 years, and that 41 countries have instituted new merger control regulations in the past decade. The proliferation of regimes means that obtaining clearance for mergers and acquisitions worldwide is becoming increasingly complex, as companies must comply with merger notification requirements in different jurisdictions, each with its own rules, time frames, thresholds, and policy aims.

EU and Mexico Reach Trade Agreement. At the end of November 1999, Mexico and the European Union agreed on the terms of a free trade area (FTA) between the two regions, although both partners must still approve the agreement. The agreement will include an FTA covering industrial and agricultural goods, a preferential agreement in services, an agreement covering investments, rules on competition and intellectual property, and an effective dispute settlement system. The agreement may help bolster the share of Mexico's imports coming from the EU. (This share had declined from an average of 14 percent in 1990-92 to 9 percent in 1998.) At the same time, the agreement may allow Mexico to decrease its dependence on U.S. markets, currently the destination for roughly 80 percent of Mexican merchandise exports. Anecdotal evidence suggests that the proposed free trade agreement is already stimulating foreign direct investment in Mexico. For instance, the Nissan-Renault automobile alliance recently announced a joint venture of $400 million in Mexico over the next 7 years.

Debt-for-Health Swap for Sub-Saharan Africa. Of the estimated 34 million people living with HIV/AIDS in the world today, 23 million live in sub-Saharan Africa. Infection rates approach a quarter of the adult population in several countries in the region and top 10 percent in many others. A shortage of funds hinders efforts to slow the spread of the epidemic and reduce its impact. Recent international debt relief programs, such as the Cologne Debt Initiative, may free up resources to address social problems, and a recent study argues that HIV/AIDS prevention should be placed at the top of the agenda for sub-Saharan Africa. The study reviews various debt-for-development swap programs since 1987 and recommends using the debt relief savings to establish a "counterpart fund" in debtor countries, with a top priority of implementing HIV/AIDS prevention programs. The study states that even with a modest amount of funding, the effect on HIV/AIDS prevention could be significant. For example, Uganda launched a national campaign against HIV/AIDS with less funding than what could be available to most other sub-Saharan countries through debt relief, and it has successfully reduced the HIV/AIDS prevalence rate among Uganda's teenagers from 28 percent in 1992 to 10 percent in 1996.

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RELEASES THIS WEEK

Employment and Unemployment

****Embargoed until 8:30 a.m., Friday, January 7, 2000****

In December, the unemployment rate was unchanged from November at 4.1 percent. Nonfarm payroll employment rose by 315,000.

NAPM Report on Business

The Purchasing Managers' Index fell 0.7 percentage point to 55.5 percent in December. (A reading above 50 percent indicates that the manufacturing economy is generally expanding.)

MAJOR RELEASES NEXT WEEK

Producer Prices (Thursday)
Retail Sales (Thursday)
Industrial Production and Capacity Utilization (Friday)
Consumer Prices (Friday)

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U.S. ECONOMIC STATISTICS

	1970-1993	1998	1999:1	1999:2	1999:3
Percent growth (annual rate)					
Real GDP (chain-type)	3.0	4.6	3.7	1.9	5.7
GDP chain-type price index	5.2	1.1	2.0	1.3	1.1
Nonfarm business (NFB) sector:					
Productivity (chain-type)	1.7	3.1	2.7	0.6	4.9
Real compensation per hour:					
Using CPI	1.0	3.9	2.8	1.2	2.1
Using NFB deflator	1.5	4.7	2.9	2.9	4.4
Shares of Nominal GDP (percent)					
Business fixed investment	11.4	12.5	12.6	12.6	12.7
Residential investment	4.5	4.2	4.4	4.5	4.4
Exports	8.2	11.0	10.7	10.7	10.8
Imports	9.2	12.7	12.9	13.4	13.8
Personal saving	6.6	2.6	2.2	1.8	1.5
Federal surplus	-2.8	0.5	1.1	1.3	1.4

	1970-1993	1999	October 1999	November 1999	December 1999
Unemployment Rate (percent)	6.7**	**4.2****	**4.1**	**4.1**	**4.1**
Payroll employment (thousands)					
increase per month			**284**	**222**	**315**
increase since Jan. 1993					**20367**
Inflation (percent per period)					
CPI	5.8	N.A.	0.2	0.1	N.A.
PPI-Finished goods	5.0	N.A.	-0.1	0.2	N.A.

**Figures beginning 1994 are not comparable with earlier data.

New or revised data in **boldface**.
Employment and unemployment data **embargoed until 8:30 a.m., Friday, January 7, 2000**.

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FINANCIAL STATISTICS

	1998	1999	November 1999	December 1999	Jan. 6, 2000
Dow-Jones Industrial Average	8626	10465	10810	11246	11253
Interest Rates (percent per annum)					
3-month T-bill	4.78	4.64	5.07	5.20	5.25
10-year T-bond	5.26	5.65	6.03	6.28	6.57
Mortgage rate, 30-year fixed	6.94	7.43	7.74	7.91	8.15
Prime rate	8.35	8.00	8.37	8.50	8.50

INTERNATIONAL STATISTICS

Exchange Rates	**Current level January 6, 2000**	**Percent Change from**	
		Week ago	**Year ago**
Euro (in U.S. dollars)	1.032	3.0	-11.3
Yen (per U.S. dollar)	105.2	2.8	-6.7
Major currencies index (Mar. 1973=100) (trade-weighted value of the U.S. $)	92.62	-0.5	1.3

International Comparisons [1]	**Real GDP growth** (percent change last 4 quarters)	**Unemployment rate** (percent)	**CPI inflation** (percent change in index last 12 months)
United States	4.3 (Q3)	**4.1** (Dec)	2.6 (Nov)
Canada	4.2 (Q3)	7.2 (Oct)	2.1 (Nov)
Japan	1.0 (Q3)	4.7 (Oct)	-1.2 (Nov)
France	3.0 (Q3)	11.0 (Sep)	0.9 (Nov)
Germany	1.3 (Q3)	9.0 (Oct)[2]	1.0 (Nov)
Italy	1.2 (Q3)	12.1 (Apr)	2.0 (Nov)
United Kingdom	1.8 (Q3)	5.9 (Aug)	1.4 (Nov)

U.S. unemployment data **embargoed until 8:30 a.m., Friday, January 7, 2000**.

1/ For unemployment data, rates approximating U.S. concepts as calculated by the U.S. Department of Labor, Bureau of Labor Statistics.

2/ Rate for unified Germany.