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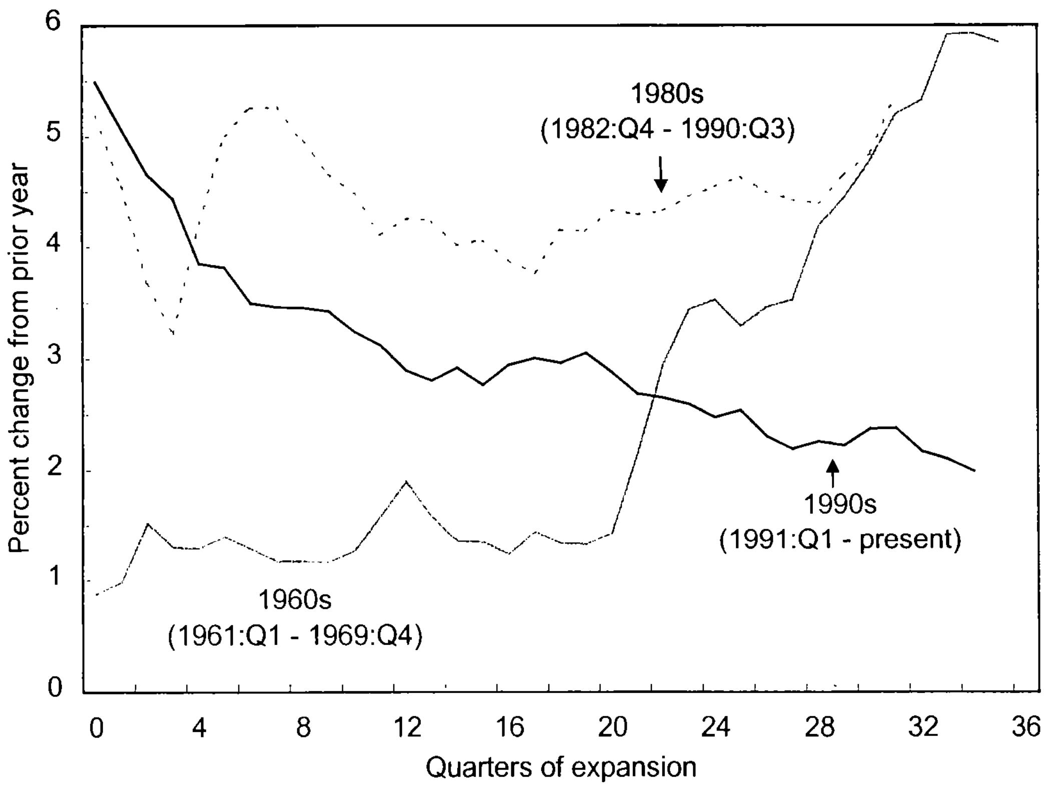
WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

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

October 22, 1999

CHART OF THE WEEK

Core Inflation in Three Long Expansions



The increase in the consumer price index for September announced this week was in line with market expectations and seems to have calmed financial market concerns that inflation might be heating up. In fact, this expansion has continued to show remarkably tame inflation (as measured by the consumer price index excluding the volatile food and energy components). By this point in the long 1960s expansion, for example, inflation was rising sharply.

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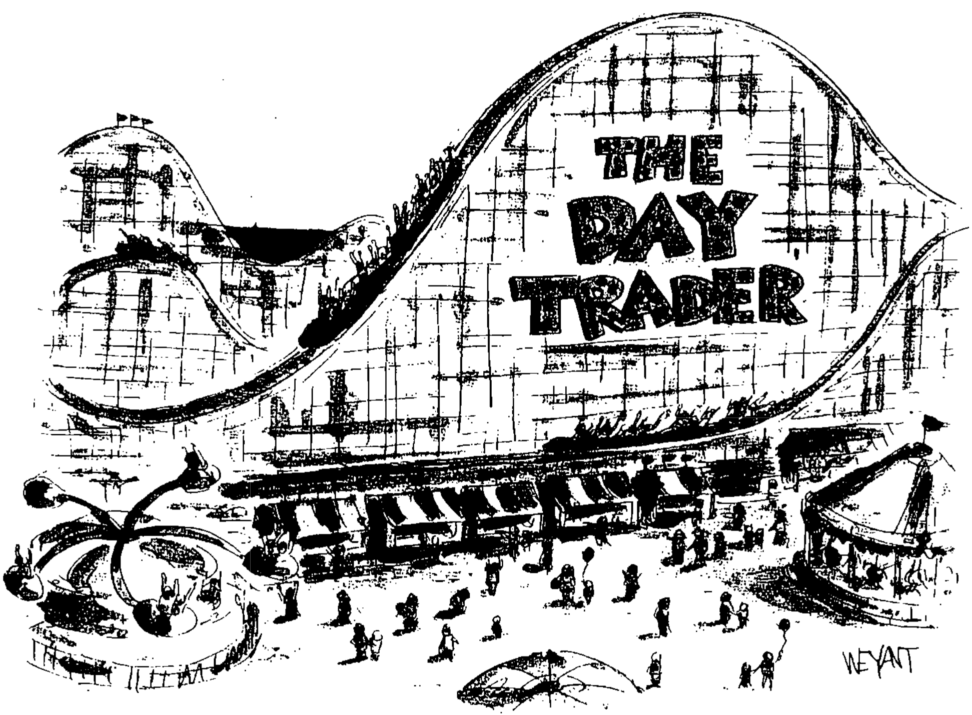
DEPARTMENTS



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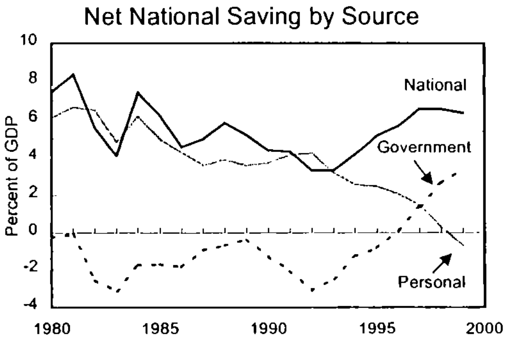
TREND

Have Americans Stopped Saving?

The fraction of disposable income that Americans save has been declining for the past two decades, and the personal saving rate is now negative. In the minds of some, this trend seems to indicate a crisis in personal saving, but a recent analysis of the saving data provides a somewhat more optimistic assessment.

Personal saving is just part of the story. Personal saving as measured in the National Income and Product Accounts (NIPA) has indeed declined precipitously since the early 1990s—falling by about 5 percentage points of GDP (see chart). But personal saving is just one part of national saving (which also includes the net saving of corporations and government). In contrast to personal saving, national saving has been on the rise, fueled in large part by improvements in the Federal budget balance.



Note: 1999 data based on first half

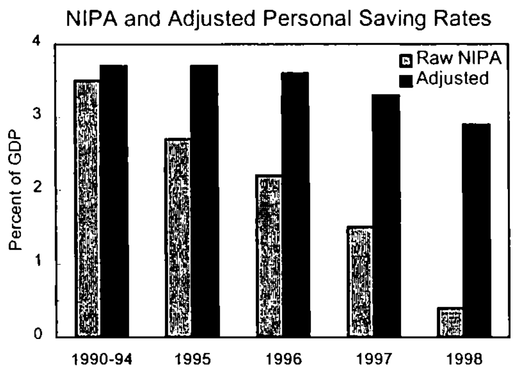
Measuring personal saving. In general, saving may be thought of as the part of current income that is laid aside for future use. The recent study suggests that some adjustments to the NIPA measure of personal saving might bring it more in line with this economic concept of saving. Among the most important are:

- Include changes in the stock of consumer durable goods. Expenditures on owner-occupied housing are included in personal saving, but purchases of other durables are not, even though they too represent assets that yield a stream of future benefits. Reclassifying the net accumulation of durable goods would add about 2 percentage points to both the household and national saving rates over the 1990s.

- Include contributions to social security and public pension and insurance funds. Contributions to and earnings from private pensions are included in personal saving and this adjustment would afford the same treatment to social security and public pensions. This adjustment would add about 1.7 percentage points to the personal saving rate, but it would subtract an equivalent amount from government saving (where such payments are currently credited).

- Adjust for the effect of inflation on assets. Households on balance earn more interest on savings accounts and other assets than they pay on loans. The study argues that the part of these net interest payments that simply compensates for inflation should not be included in saving. Since this adjustment has gotten smaller recently as inflation has declined, adjusted saving would not show as much of a decline as the official measure. The opposite adjustment would be required in sectors that are net payers of interest, hence national saving would be unchanged by the adjustment.

An adjusted measure of personal saving. By including the accumulation of durable goods and contributions to public pensions and by adjusting for inflation (along with some other technical adjustments), the authors compute an adjusted personal saving rate that fell only 0.8 percentage points in the 1990s, to just below 3 percent of GDP. This is a far more modest decline than that of the official NIPA measure (see chart).



What about the stock market? Capital gains are not included in the NIPA personal saving measure or in the adjusted measure reported above. Including them would result in a personal saving rate that has averaged nearly 35 percent since 1995 and has been trending *upward* since the mid-1990s. However, the question of whether capital gains should be treated as saving is tricky. For an individual household, capital gains represent increased future consumption opportunities, but for the economy as a whole it is only the gains associated with increases in the productivity of the underlying assets (as opposed, say, to a change in tastes that reduces the risk premium) that represent increased future consumption opportunities.

Conclusion. Some analysts have questioned whether the sharp decline in the NIPA personal saving rate provides an accurate picture of household saving behavior. One set of reasonable adjustments, for example, leads to a much smaller decline in the personal saving rate than is shown in the official measure. Except for the inclusion of the accumulation of durable goods, however, these adjustments mainly represent a reallocation of saving from business and government to personal saving and do not change measured national saving.

EYES ONLY

SPECIAL ANALYSIS

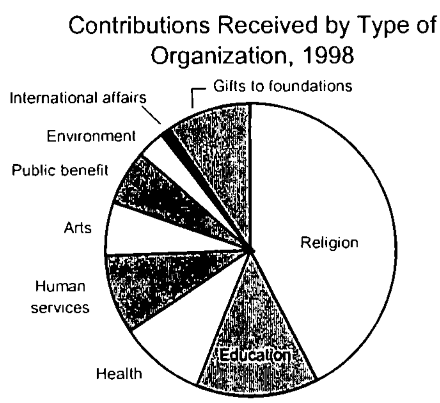
Recent Trends in Philanthropy

Charitable giving in 1998 reached an estimated $174.5 billion, or just over 2 percent of GDP (see upper chart). Giving has not been so large as a share of GDP since the early 1970s, and recent estimates of future giving suggest that contributions will continue to rise over the next 20 years as baby boomers age.

Sources of data. Data on giving come from a variety of sources. The data in the upper chart come from *Giving USA*, which combines data on giving by individuals, foundations, and corporations to make annual estimates of total giving. Individual giving (apart from bequests) is estimated from IRS data on charitable contributions by those who itemize and national survey data on giving by non-itemizers.

Who gives? Individuals accounted for an estimated 85 percent of all contributions in 1998 (77 percent of all giving was from living individuals and another 8 percent was from bequests). Other giving came from foundations (10 percent) and corporations (5 percent). About 70 percent of households contributed to charity last year, giving an average of $1,075. Contributions by individuals have increased 31 percent since 1995, while foundation giving has risen by about 50 percent.

Who gets? Religion is by far the single largest recipient category, with 44 percent of total contributions in 1998 (see lower chart). Several types of organizations have received substantial increases in donations since 1990. These include education (up 59 percent), environmental organizations (up 69 percent), public-benefit organizations such as civil rights groups and community development organizations (up 78 percent), and foundations (whose receipt of gifts is up 254 percent).



Characteristics of individual donors. Except for the richest, families at all levels of income are about equally generous. The average contribution in groups with annual income below $500,000 (representing 99.7 percent of families) was roughly 1.5 to 2 percent of income in 1994 (see chart on next page). The average

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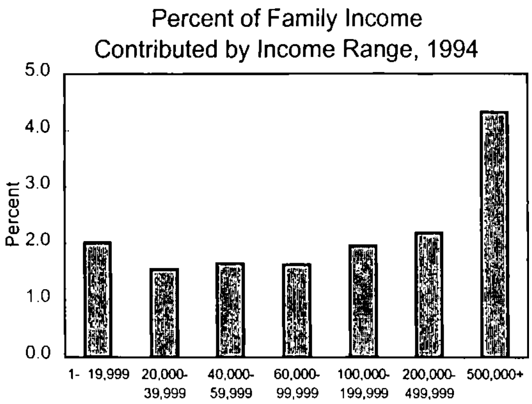


contribution of the richest 0.3 percent of donors, by contrast, was 4.3 percent of income.

Giving by net worth shows a different pattern. Those with the least net worth give the most in percentage terms, and this percentage declines as net worth increases. This is consistent with the highly skewed distribution of net worth and the relatively small net worth in much of the distribution. Households with high income or wealth do, however, provide a disproportionate share of individual contributions. For example, the 20 percent of families with incomes of $60,000 or more in 1994 gave 67 percent of all individual contributions that year. The 4.3 percent of families with incomes above $125,000 gave 46 percent of the total. Finally, elderly households (those with a head aged 65 or over) in every income group make larger contributions than their non-elderly counterparts.

A golden age of philanthropy? A new study estimates that levels of charitable bequests—one component of individual giving—will increase dramatically over the next 20 years, due in part to the aging of baby boomers. The study's lower-bound estimate of total charitable bequests over the period is $1.7 trillion (in 1998 dollars). Such estimates are inherently speculative, but if this estimate proves accurate, bequests over the next two decades will be an order of magnitude greater than the $176 billion in bequests over the past 20 years and would imply dramatic increases in total philanthropic giving.

Conclusion. The strong economy and stock market have helped create a resurgence in philanthropy since 1995. Projections show that increases in giving are likely to continue, and may accelerate as baby boomers age.

ARTICLE

Reviving Russia: What Is to Be Done?

Russia's economy is in dire straits, according to a new report, with falling production and declining productivity. Old industries have not been restructured, and market distortions make even new firms unproductive. The growth potential is great, however, since existing assets could be operated much more efficiently in many industries, and Russia has both an educated labor force and vast natural resources, including large and economically attractive energy reserves.

Russian GDP: falling from an already low level. The study's best estimate is that even in 1991, before major reforms, Russia had only 27 percent of the U.S. level of GDP per capita (all comparisons are to U.S. levels in 1995). A subsequent decline of 40 percent through 1997 brought GDP per capita down to 16 percent of the U.S. level (compared, for example, with Brazil's 23 percent). Even though significant unemployment has developed, most jobs have been "nominally" preserved despite the fall in output. Between 1991 and 1997, hours worked per capita fell from 90 to 83 percent of the U.S. level.

Average Labor Productivity by Sector, Russia 1997

Industry case studies. The study examined 10 industries in detail, finding that productivity was low across the board—nowhere more than 40 percent of U.S. levels and much lower than that in some cases (see chart). Specific results include the following:

- Steel. Large numbers of obsolete steel plants remain in operation as a legacy of the old Soviet industry. They are kept in operation with subsidized energy supplies and employ many "stranded" workers. Some relatively productive steel plants are aggressive exporters, but even these seem to maintain unneeded workers and have organizational problems and poor quality control.

- Retailing. Traditional Soviet retailers, *gastronoms*, were highly inefficient and are being driven out of business. They are being replaced by kiosks and outdoor wholesale markets that are also inefficient but are able to compete through tax and tariff evasion and the sale of counterfeit goods. More productive modern retailing formats (such as supermarkets) cannot compete, as they have to obey the law and pay taxes.

- Oil. Although some individuals may have become rich through oil, the development of the industry today is inhibited by government intervention and unstable tax polices. Oil exports are limited to ensure a subsidized supply to the military, agriculture, and traditional manufacturing. The industry suffers from poor drilling and maintenance practices and needs access to foreign capital.

- Software. Although this industry is relatively productive, growth is limited by widespread piracy and the lack of demand for its products in other sectors.

Across the 10 industries, persistent low productivity can be traced to three main factors: the retention of excess workers in old assets; the continued prevalence of inefficient organization in old companies; and the failure to make potentially profitable new investments.

What created these conditions? Three main causes of Russia's current difficulties can be distilled from the study:

- Structural shocks. Following reform, prices were liberalized and government spending was cut. Many existing industries were unable to meet the market test and collapsed. In particular, residential construction and heavy manufacturing were hard hit.

- An unstable political and economic environment. Large budget deficits led to high inflation followed by the 1998 financial crisis. In this environment, the cost of attracting both foreign and domestic investment became excessive.

- Barriers to restructuring and new investment. Government intervention and corruption slowed or stopped the restructuring of old firms and discouraged new productive activities. The energy sector has been forced to subsidize failing enterprises, and elaborate barter transactions distort the market, effectively giving government tax subsidies to unproductive companies. The lack of property rights, enforceable laws, and an appeal mechanism make it difficult for productive companies to prosper.

Russia's potential. The study argues that Russia should break out of its current economic mess by removing market distortions, especially in high-growth sectors. Once new jobs are created, workers can be moved out of old industries, and these too can be turned around. Nearly three-quarters of the old assets in Russia are economically viable and could achieve productivity levels that are up to 65 percent of U.S. levels. The example of Poland shows how a transition economy can grow. And even within Russia, the Novgorod region has grown since 1995 as the regional government sought out foreign investment, removed red tape, and made land available for new investors.

EYES ONLY

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

Cost Deters Low-Income Workers from Taking Health Insurance. Twenty percent of uninsured Americans have access to employer-sponsored health insurance but choose not to enroll, with the majority citing cost as the main reason, according to a recent study. The study reports that low-income workers with access to employer-sponsored coverage are far more likely to be uninsured than middle- and upper-income workers; 19 percent of people below the poverty line with access to employer-sponsored insurance are uninsured, compared with 5 percent of the overall population. One reason cost is a barrier to enrollment for low-income workers is that the employee share of premiums represents a higher percentage of their income than it does for higher income workers. In addition, the study finds that employee contributions tend to be higher in absolute dollars in firms that employ primarily low-wage workers.

Using Recreation Expenditures to Measure Living Standards. A new study examines trends in the share of household budgets spent on recreation—what it calls the quintessential luxury good—to suggest that the U.S. standard of living has risen by more than is implied by standard income and expenditure measures. Between 1972 and 1991, trends in recreational expenditure shares suggest that the standard of living rose by 3.6 percent per year, or twice the rate of growth in per capita expenditures. Over a broader sweep of time, the share of recreation in household expenditures has increased sharply, especially for lower income families. In 1888, less than 2 percent of the household budget was allocated for recreation; by 1991 recreation's share had risen to 6 percent as the proportion of income devoted to necessities fell. The study also suggests that consumption of recreation has become less concentrated by income class and that reasons for this may include cost-reducing and quality-improving technological change as well as government provision of goods such as parks.

Rising Immigrant Poverty: a Second Look. A recent study has gotten some attention with its conclusion that immigrant poverty is a growing problem in the United States. The study reports that in 1997, 21.6 percent of people living in poverty resided in an immigrant household (including children born here), up from 9.7 percent in 1979. The study argues that increases in the poverty rate for each new wave of immigrants partly explain the rise in immigrant-related poverty. There are several reasons to be cautious when interpreting this study. First, the number of people living in immigrant households more than doubled from 17.3 million in 1979 to 35.3 million in 1997, suggesting that most of the rise in the immigrant share of the poor may simply reflect overall growth in the immigrant population. Second, while the poverty rate for *recent* immigrants increased 5 percentage points from 1979 to 1989, it increased only 1 percentage point between 1989 and 1997. Meanwhile, the educational attainment of working-age people in immigrant households has not deteriorated since 1989. Instead, the share of people in immigrant households with less than a high school education has fallen from 40 percent in 1989 to 34 percent in 1997. Finally, since 1996, the poverty rate for immigrants has declined.

EYES ONLY

INTERNATIONAL ROUNDUP

Hunger in a World of Plenty. The latest estimates from the Food and Agriculture Organization of the United Nations show that the number of people going hungry in developing countries has declined by 40 million since the early 1990s. But 790 million people in developing countries, plus another 34 million in the industrialized and transitional economies, still do not have enough to eat. About two-thirds of the undernourished live in Asia and the Pacific, with India alone home to 204 million. In Somalia, over 70 percent of the population is undernourished, the highest concentration in the world. Surveys show that two out of five children in the developing world are stunted (low height for age), and one in three is underweight. Nearly half of these children live in South Asia, where half the children under 5 years old are underweight. Each year the number of undernourished people falls by 8 million—a rate too slow to reach the World Food Summit's goal of halving the number of hungry people in the world to 400 million by the year 2015. Indeed, the number of undernourished is growing in many parts of the world: between 1991 and 1996, the number going hungry rose in 59 out of 96 countries. The problem is especially severe in parts of sub-Saharan Africa, where little progress has been made against hunger thus far, and land degradation is expected to cause the situation to deteriorate in the future.

Effect of Privatization in the UK. In 1979 state-owned industries accounted for almost one-tenth of British GDP. Since then the British government has pursued a major program of privatization. A recent study has compared the performance of the newly privatized firms, state-owned firms, and publicly traded firms not subject to government control. It found that, while state-owned firms tended to deliver a much lower rate of return on net operating assets than the publicly traded firms, the newly privatized firms delivered returns near the average level of the publicly traded firms. The study also found significant changes in managerial accountability for financial performance. In those firms that had been privatized for at least 4 years, top managers were more likely to be fired for poor financial results than managers in state-owned firms.

Entrepreneurs and Growth. A recent study by the Global Entrepreneurship Monitor concludes that as much as one-third of the differences in national economic growth may be due to differences in entrepreneurial activity. The study identifies certain features of individual countries that are positively associated with business start-up activity: a young age structure within the working age population, involvement of women in entrepreneurial activities, high expected population growth, involvement in post-secondary or tertiary education, and a relatively high level of income inequality. A survey of experts on entrepreneurship in 9 major industrialized countries suggests that the U.S. entrepreneurial environment is typically perceived to be more favorable than other countries', especially in terms of social and cultural attitudes, availability of finance, and well-established commercial and professional support services.

EYES ONLY

RELEASES THIS WEEK

U.S. International Trade in Goods and Services

The goods and services trade deficit was $24.1 billion in August; it was $24.9 billion in July.

Housing Starts

Housing starts fell 3 percent in September to 1.618 million units at an annual rate. For the first 9 months of 1999, housing starts are 5 percent above the same period a year ago.

Consumer Price Index

The consumer price index increased 0.4 percent in September. Excluding food and energy, consumer prices rose 0.3 percent.

MAJOR RELEASES NEXT WEEK

Consumer Confidence—Conference Board (Tuesday)
Advance Durable Shipments and Orders (Wednesday)
Gross Domestic Product (Thursday)
Employment Cost Index (Thursday)

EYES ONLY

U.S. ECONOMIC STATISTICS

	1970-1993	**1998**	**1998:4**	**1999:1**	**1999:2**
Percent growth (annual rate)					
Real GDP (chain-type)	2.7	4.3	6.0	4.3	1.6
GDP chain-type price index	5.4	0.9	0.8	1.6	1.3
Nonfarm business (NFB) sector:					
Productivity (chain-type)	1.5	2.6	4.1	3.6	0.6
Real compensation per hour:					
Using CPI	0.6	2.5	2.0	2.9	1.5
Using NFB deflator	1.3	3.7	3.4	3.0	3.7
Shares of Nominal GDP (percent)					
Business fixed investment	10.9	11.0	11.0	11.0	11.2
Residential investment	4.5	4.3	4.5	4.6	4.7
Exports	8.2	11.3	11.3	10.9	11.0
Imports	9.2	13.0	13.1	13.2	13.7
Personal saving	5.2	0.3	-0.0	-0.5	-0.9
Federal surplus	-2.7	0.9	0.8	1.4	1.6

	1970-1993	**1998**	**July 1999**	**August 1999**	**September 1999**
Unemployment Rate (percent)	6.7**	4.5**	4.3	4.2	4.2
Payroll employment (thousands)					
increase per month			373	103	-8
increase since Jan. 1993					19409
Inflation (percent per period)					
CPI	5.8	1.6	0.3	0.3	**0.4**
PPI-Finished goods	5.0	0.0	0.2	0.5	1.1

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

New or revised data in **boldface**.

EYES ONLY

FINANCIAL STATISTICS

	1997	1998	August 1999	September 1999	Oct. 21, 1999
Dow-Jones Industrial Average	7441	8626	10935	10714	10298
Interest Rates (percent per annum)					
3-month T-bill	5.06	4.78	4.72	4.68	4.99
10-year T-bond	6.35	5.26	5.94	5.92	6.20
Mortgage rate, 30-year fixed	7.60	6.94	7.94	7.82	7.93
Prime rate	8.44	8.35	8.06	8.25	8.25

INTERNATIONAL STATISTICS

Exchange Rates	**Current level October 21, 1999**	**Percent Change from Week ago**	**Percent Change from Year ago**
Euro (in U.S. dollars)	1.081	0.1	N.A.
Yen (per U.S. dollar)	106.0	-0.9	-9.3
Major currencies index (Mar. 1973=100) (trade-weighted value of the U.S. $)	92.09	-0.3	-0.9

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	3.9 (Q2)	4.2 (Sep)	2.6 (Sep)
Canada	3.7 (Q2)	7.8 (Aug)	2.1 (Aug)
Japan	1.1 (Q2)	4.7 (Aug)	0.2 (Aug)
France	2.1 (Q2)	11.3 (Aug)	0.5 (Aug)
Germany	0.6 (Q2)	7.1 (Aug)[2]	0.6 (Aug)
Italy	0.8 (Q2)	12.1 (Apr)	1.7 (Aug)
United Kingdom	1.4 (Q2)	6.0 (Jun)	1.1 (Aug)

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 former West Germany. Using OECD standardized unemployment data, the unemployment rate for unified Germany for August was 9.2 percent.

EYES ONLY

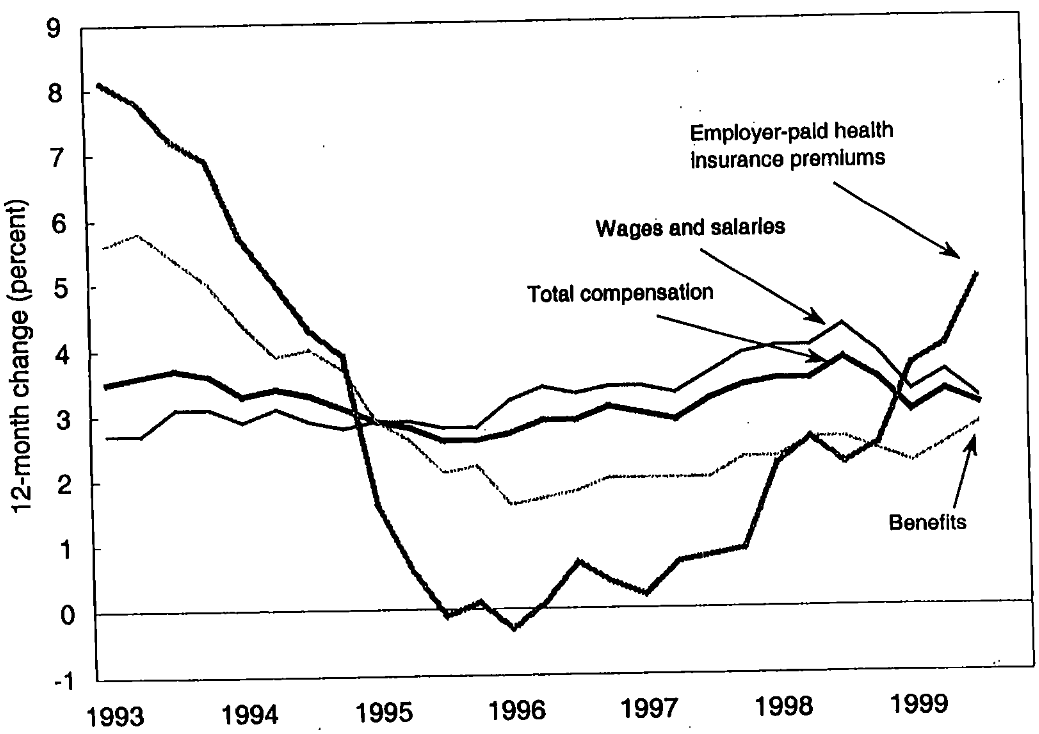
WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

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

October 29, 1999

CHART OF THE WEEK

Employment Cost Index for Private Industry



Over the 12 months ending in September, hourly compensation, measured by the employment cost index (ECI), rose 3.1 percent. As they have for the past several years, wages and salaries rose faster than benefits. However, employer-paid health insurance premiums continued to accelerate, rising 5.0 percent over the 12 months ending in September.

EYES ONLY

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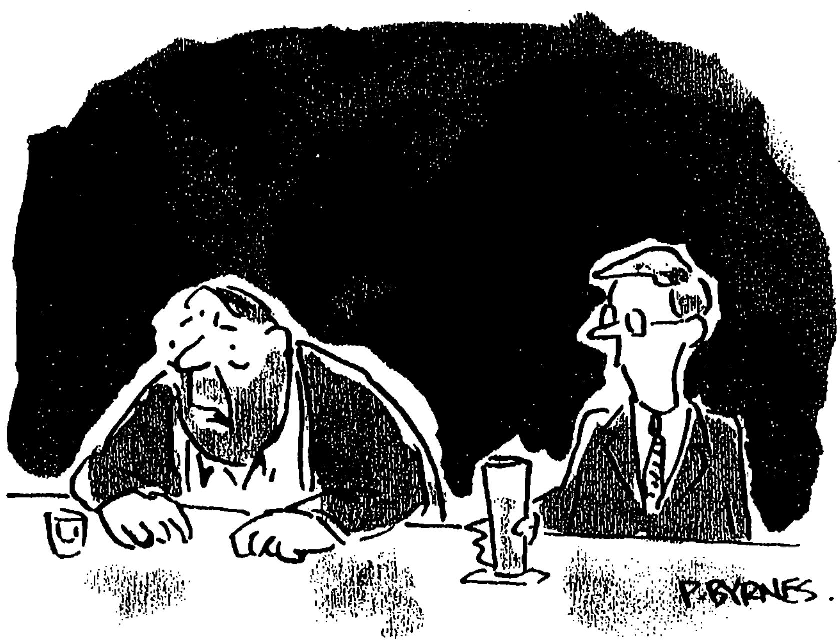


"I lost everything in the Beanie Baby crash of '99."

EYES ONLY

CURRENT DEVELOPMENT

GDP Scorecard: Third Quarter 1999

Real GDP is estimated to have grown at a 4.8 percent annual rate in the third quarter of 1999. Strong growth in consumption, investment in equipment and software, and an increase in stock building accounted for the gains. The price index for GDP increased 1.3 percent over the past four quarters, about the same as the year-earlier rate.

Component	Growth*	Comments
Total consumer expenditures	4.3%	Although down from an annual growth rate of 5.8 percent in the first half, this growth rate is still strong and exceeds the growth of real disposable income.
Equipment and software	21.7%	As usual, computer investment was strong, but industrial equipment—which had stagnated for the past year—sprang to life.
Nonresidential structures	-5.0%	Nonresidential structures investment has fallen for three consecutive quarters as industrial structures have been weak. However, office building continues to trend up.
Residential investment	-6.3%	The decline—the first in over 2 years—had been foreshadowed by housing starts. Starts are running high relative to their demographics and are not likely to grow further.
Inventories (change, billions of 1992 dollars)	$28.1	Despite a sizable increase from the second-quarter pace, inventories remain lean with respect to sales. In the fourth quarter, firms may build buffer stocks against Y2K problems.
Federal purchases	3.1%	A large increase in defense purchases offset a decline in nondefense purchases.
State & local purchases	3.4%	This growth rate is close to the average pace of the past 3 years.
Exports	12.4%	Exports had been fairly flat since mid-1997, the start of the Asian economic crisis. The gain in exports last quarter may indicate more rapid growth abroad, but it is too early to say.
Imports	17.2%	Large increases in imports of consumer and capital goods reflect the strength of domestic consumption and investment.

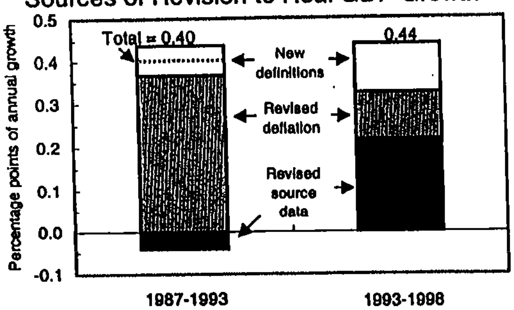
*Percent real growth in the third quarter at annual rates (except inventories). This advance estimate is subject to substantial revision, especially for exports, imports, and inventories, where the estimates are based on only 2 months of data.

SPECIAL ANALYSIS

Revisions Show Higher GDP Growth

The Commerce Department's benchmark revision—which incorporates information from the periodic economic censuses—shows higher real GDP growth for every year since 1978. In addition to bringing in new data sources, the benchmark revision provided an opportunity to change accounting definitions and to improve the consistency of the historical record.

Sources of Revision to Real GDP Growth*



* CEA estimates

On the product side. Over the 11 year period between 1987 and 1998, revisions to the annual rate of growth of real GDP averaged 0.4 percentage point. Since the first quarter of 1993, real GDP has grown at an average annual rate of 3.8 percent. Over the past 4 years real GDP grew at a 4.1 percent annual rate.

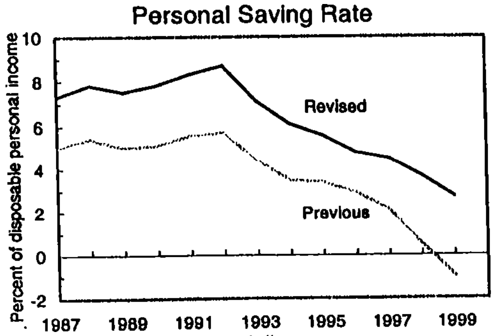
The revisions fall into three main categories (see upper chart):

- Source data. Incorporating new data from the economic censuses and other sources added about 0.2 percentage point per year to growth since 1993, but had little impact on prior years.

- Revised deflation methodology. For the 1987 to 1993 period, the largest component of the revision represents a change in how spending is adjusted for inflation. Most of the change in deflation methodology reflects extending the new methodology now used for the CPI to the years 1978-94 (this methodology was already in use for the post-1994 period).

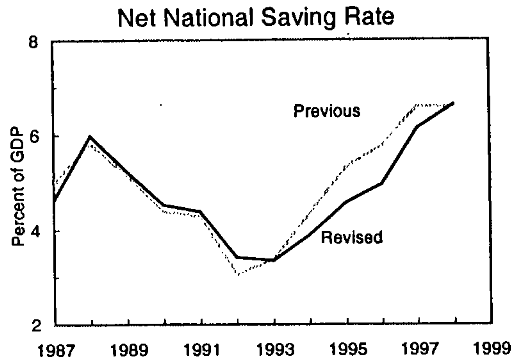
- New definitions. The most significant new definition is the inclusion of the purchase and development of computer software as investment, raising the *level* of GDP by about 1.9 percent by 1998. This change raises the *growth rate* of real GDP by an average of 0.1 percentage point per year.

Personal Saving Rate

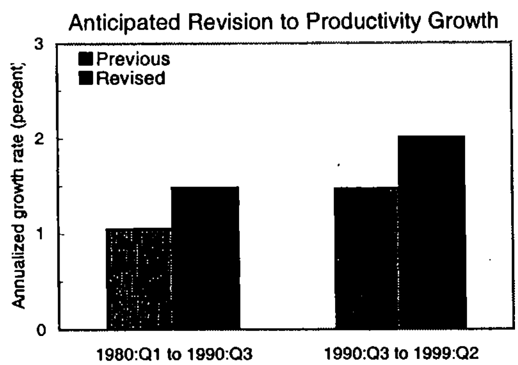


Note: 1999 data based on first half

On the income side. Pension plans for government employees were moved from the government to the household sector so that contributions to (and interest and dividends earned by) these pension plans are now classified as personal income, while the pension payments were removed from transfer income. This reclassification boosts the personal saving rate over most of the past decade (see lower chart on previous page), but it is offset by a decline in government saving. The personal saving rate still shows a marked decline but is no longer negative. New data boosted wages and salaries substantially in 1998, adding to income and saving.



With software now classified as investment, software depreciation is added to the income side of the accounts. Although the new procedure boosts gross saving, net saving as a share of GDP changed little (see upper chart).



Productivity. Clearing away the smoke from the new classifications and deflation procedures, new source data indicate that spending and income both grew a bit faster over the past 5 years than had been thought previously. This suggests an upward revision to productivity growth (see lower chart) that is likely to boost the estimated growth rate of potential output.

Budget implications? These revisions have limited implications for the budget outlook because many of them (such as the treatment of software) have little impact on Federal receipts and outlays. However, the small upward revision in the acceleration of output in the past few years hints at further growth that could have a modest positive impact on the budget surplus.

EYES ONLY

ARTICLE

Evaluating the Evidence on Job Stability

Recent research provides a fresh look at the question of whether job stability has been on the decline in the 1990s. This question achieved prominence in the popular press a few years ago and continues to resurface from time to time. The new research finds that, although instability may have increased for certain groups of workers through the mid-1990s, the earlier press accounts were more alarmist than the evidence seems to warrant.

Earlier evidence. Over the last several years numerous newspaper and magazine articles have worried about the "downsizing" of America and the loss of permanent jobs. In 1996, for example, the *New York Times* stated that "the notion of lifetime employment has come to seem as dated as soda jerks, or tail fins." The conclusions of these news reports generally suggest that there is a new reality in the U.S. labor market such that workers must anticipate more frequent job changes, are in constant fear of being laid off, and will be unable to retain a career job for much of their work life. Analysis in the 1999 *Economic Report of the President* called this picture into question, noting, for example, that job displacement had begun to decline from its 1993-95 peak. Nevertheless, the *Report* noted that the rate of job displacement in 1995-97 remained higher than it was in 1987-89 with a similar rate of unemployment.

Evidence from large corporations. Many popular accounts emphasize the experiences of workers in large firms and are frequently anecdotal or based on particular downsizing announcements. More systematic evidence, however, comes from a recent study that used actual payroll data from 51 large corporations that were the clients of a consulting firm to analyze what happened to employee tenure and the percentage of workers in long-term jobs in the 1990s. In fact, this study found that the average tenure of employees was longer in the mid-1990s (13.4 years) than it was in the early 1990s (12.6 years) and that the percentage of workers who have been with the same employer 10 or more years actually increased considerably in the 1990s. It found no evidence of a trend toward focusing on mid-career employees in the implementation of downsizing decisions. Rather, the retention rates for workers with 10 to 19 years of service were virtually identical in downsizing and growing firms.

This evidence is specific to large companies and may not be representative of all U.S. workers. For example, each of the firms surveyed has a defined benefit pension plan and all of the firms provide health insurance to their employees. However, this evidence provides some kinds of information about firm behavior that is not available in household surveys.

Evidence from household surveys. The advantage of household surveys is their representativeness, and the new research on job stability is largely based on such surveys. While there is still less than total agreement among all the new studies, there is some evidence that job instability showed small increases during the early to mid-1990s for certain workers—white males with long tenure, blacks, and young workers—but not the dramatic change reported in the press. For example, one study found some indication that more-tenured workers experienced a significant decline in job stability but less-tenured workers experienced gains. The authors do not, however, see this as part of a longer-term trend toward decreased job stability for the American workforce generally. Indeed, a different study that used data from two large household panel surveys found little change in overall job exit rates and concluded that any increase in instability that may have existed in an earlier period did not persist into the 1990s. This study also found little evidence of an *increase* in job *insecurity* as measured by involuntary terminations, a job ending in a spell of non-employment, or of job changes being accompanied by wage declines.

Conclusion. While there is some hard evidence to back up the stories in the popular press about changes in job stability, recent research offers a more tempered view. As one commentator noted, "where there was once anecdotal smoke, there is now some statistical fire—but not a raging conflagration." Finally, it is worth emphasizing that most of the studies on this topic have only used data through the mid-1990s. The continued strong economy should help to remove fuel from any remaining fires.

EYES ONLY

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

Dow Now Will Do Windows. For the first time in its history, the Dow Jones Industrial Average will include NASDAQ stocks, with Microsoft and Intel joining SBC Communications and Home Depot as new members of the 30 stock index. These four will replace Chevron, Goodyear, Sears, and Union Carbide, effective at the beginning of trading on Monday. The managing editor of the *Wall Street Journal*, whose editors select the component stocks of the Dow, said that these changes will make the index even more representative of the evolving U.S. economy. The *New York Times* noted that recently the Dow has grown more slowly than the Standard and Poor's 500 stock index, with which it competes for license fees from option and futures trading based on the indexes. The *Times* calculates that if the current changes had been made at the time of the last change of the Dow in 1997, the index subsequently would have grown faster than the S&P 500 and would have peaked at more than 12,800 this summer. The Dow is price-weighted (in contrast to most others, which are value-weighted). Hence, Microsoft is not the dominant stock in the index. Because a given percentage change in a stock with a high price moves the Dow more than the same change in a stock with a lower price, American Express has a bigger weight than Microsoft.

EITC Promotes Employment among Single Mothers. The EITC is responsible for large increases in the employment of single mothers since the mid-1980s, according to a recent study. Between 1984 and 1996, the proportion of single mothers who worked during the previous year increased by 9 percentage points (to 82 percent). The share of single mothers with young children who worked rose 14 percentage points (to 75 percent). The study found that over 60 percent of the overall increase was attributable to the EITC. Changes in welfare benefits and welfare waivers accounted for much of the rest, while other factors, including expansions of Medicaid and child care and changes in training programs, played a small role.

Creating a Living Downtown in Denver. In a report published last year, the Brookings Institution and Fannie Mae found that many American downtowns are experiencing population booms—especially those of New York, Denver, and Houston. A recent follow-up report, written by the Director of Denver's Community Planning and Development Agency, discusses that city's experience. The report cites a strong economy, population gains in the region, and a stock of low-cost buildings to be redeveloped as contributing to downtown Denver's growth. It also identifies certain public policies that may have helped, including policies to give definition and cohesion to Denver's downtown neighborhoods, such as the declaration of Lower Downtown ("LoDo") as an historic district in 1988. Downtown accessibility was improved through new roads leading to downtown and by free shuttle bus service linked to regional bus terminals. Regional amenities were added as well, including new cultural and sports venues, a convention center, and the parks along the South Platte River. The city also expanded police presence, worked to preserve old buildings, and sought developers to rehabilitate empty buildings.

EYES ONLY

INTERNATIONAL ROUNDUP

ILO Studies Trends in Commerce Sector. Stimulated by technology, evolving consumer demand, and trade liberalization, the number of jobs in the commerce sector (wholesale and retail trade) grew significantly worldwide during the 1990s, according to a new report by the International Labor Organization (ILO). In the 93 countries reviewed, the commerce sector created nearly 54 million jobs from 1990 to 1997. Of those, 40 million were added in Asian and Pacific countries (20 million in China alone), 6 million in industrialized countries, 6 million in Latin America, and 2 million in transition economies. Commerce-sector employment grew significantly faster than overall employment for the majority of countries studied from 1995 to 1997. This sector tends to have a relatively large proportion of female and part-time employees as well as high labor turnover rates. The report notes some evidence that the rise of multinational corporations may be putting local enterprises out of business (especially in developing countries), but it also cites the benefits of challenging local firms to boost their productivity.

Hong Kong Begins Selling Its Stock Portfolio. In August 1998, Hong Kong's government bought $15 billion worth of stock shares, arguing that this was necessary to foil speculators who were simultaneously shorting the stock market and selling currency (in hopes of driving up interest rates and driving down stock prices). More than a year after this intervention, share prices have increased substantially, and the government is now trying to sell some of its share-holdings packaged in a fund that tracks Hong Kong's benchmark Hang Seng Index. The authorities are reportedly enticing local investors with a discount on the market price of the stocks. Public reaction has included concern that unloading such a large portfolio could depress the market and doubt that the offer will be attractive to investors (because, some argue, the fund is heavily weighted toward poorly performing property stocks and local investors may prefer individual stocks to funds). A few expressed strong objections to the intervention itself, viewing it as a betrayal of Hong Kong's free-market principles.

Transportation Costs Hinder Economic Development in Africa. A lack of investment is weakening the capacity and efficiency of transport systems in sub-Saharan Africa, according to a recent study by the United Nations Conference on Trade and Development. IMF statistics show that for 31 out of 43 Sub-Saharan countries freight costs on imports were 50 percent higher than the average for all developing countries. Among the top 15 export products from Africa to the United States, African transport costs are higher than their competitors' for all but 3 products. The report argues that inadequate transport systems can adversely affect export performance and market development. High transport costs also lead to balance of payments problems, as many countries must import transportation services. The study found that for 20 out of 43 countries, payments for such imports absorbed over 20 percent of total foreign exchange earnings from exports. The report argues that private financing for transportation investment may sometimes be feasible, but the necessary infrastructure investment almost certainly requires public financing and development aid.

EYES ONLY

RELEASES THIS WEEK

Gross Domestic Product

According to advance estimates, real gross domestic product grew at an annual rate of 4.8 percent in the third quarter of 1999.

Employment Cost Index

The employment cost index for private industry workers rose 3.1 percent for the 12-month period ending in September.

Advance Durable Orders

Advance estimates show that new orders for durable goods decreased 1.3 percent in September, following an increase of 1.0 percent in August.

Consumer Confidence

Consumer confidence, as measured by The Conference Board, fell 4.1 index points in October, to 130.1 (1985=100).

MAJOR RELEASES NEXT WEEK

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

EYES ONLY

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**	**4.8**
GDP chain-type price index	**5.2**	**1.1**	**2.0**	**1.3**	**1.0**
Nonfarm business (NFB) sector:					
Productivity (chain-type)	1.5	2.6	3.6	0.6	N.A.
Real compensation per hour:					
Using CPI	0.6	2.5	2.9	1.5	N.A.
Using NFB deflator	1.3	3.7	3.0	3.7	N.A.
Shares of Nominal GDP (percent)					
Business fixed investment	N.A.	**12.5**	**12.6**	**12.6**	**12.8**
Residential investment	N.A.	**4.2**	**4.4**	**4.5**	**4.4**
Exports	8.2	**11.0**	**10.7**	**10.7**	**10.9**
Imports	9.2	**12.7**	**12.9**	**13.4**	**13.9**
Personal saving	N.A.	**2.6**	**2.2**	**1.8**	**1.5**
Federal surplus	N.A.	**0.5**	**1.1**	**1.3**	N.A.

	1970-1993	1998	July 1999	August 1999	September 1999
Unemployment Rate (percent)	6.7**	4.5**	4.3	4.2	4.2
Payroll employment (thousands)					
increase per month			373	103	-8
increase since Jan. 1993					19409
Inflation (percent per period)					
CPI	5.8	1.6	0.3	0.3	0.4
PPI-Finished goods	5.0	0.0	0.2	0.5	1.1

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

New or revised data in **boldface**.

EYES ONLY

FINANCIAL STATISTICS

	1997	1998	August 1999	September 1999	Oct. 28, 1999
Dow-Jones Industrial Average	7441	8626	10935	10714	10623
Interest Rates (percent per annum)					
3-month T-bill	5.06	4.78	4.72	4.68	4.96
10-year T-bond	6.35	5.26	5.94	5.92	6.12
Mortgage rate, 30-year fixed	7.60	6.94	7.94	7.82	7.96
Prime rate	8.44	8.35	8.06	8.25	8.25

INTERNATIONAL STATISTICS

Exchange Rates	**Current level October 28, 1999**	**Percent Change from**	
		Week ago	**Year ago**
Euro (in U.S. dollars)	1.052	-2.7	N.A.
Yen (per U.S. dollar)	105.1	-0.8	-10.6
Major currencies index (Mar. 1973=100) (trade-weighted value of the U.S. $)	92.65	0.6	-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	4.1 (Q3)	4.2 (Sep)	2.6 (Sep)
Canada	3.7 (Q2)	7.8 (Aug)	2.1 (Aug)
Japan	1.1 (Q2)	4.7 (Aug)	0.2 (Aug)
France	2.1 (Q2)	11.3 (Aug)	0.5 (Aug)
Germany	0.6 (Q2)	7.1 (Aug) 2/	0.6 (Aug)
Italy	0.8 (Q2)	12.1 (Apr)	1.7 (Aug)
United Kingdom	1.8 (Q3)	6.0 (Jun)	1.1 (Aug)

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 former West Germany. Using OECD standardized unemployment data, the unemployment rate for unified Germany for August was 9.2 percent.

EYES ONLY

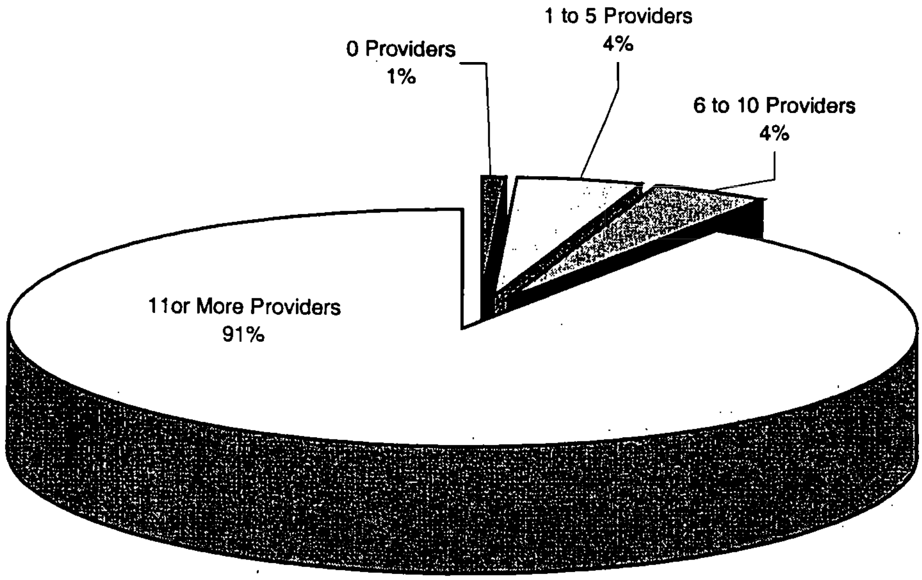
WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

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

October 15, 1999

CHART OF THE WEEK

Percent of Population with Local Internet Access



Over 90 percent of the U.S population live in counties that have access to 11 or more local Internet Service Providers (ISP), while less than 1 percent have no local access to an ISP. Without regard to population, 247 mostly rural counties, nearly 8 percent of the total, have no local ISPs while 55 percent of all counties have 11 or more.

EYES ONLY

CONTENTS

"I've consolidated all our bills into one missed payment."

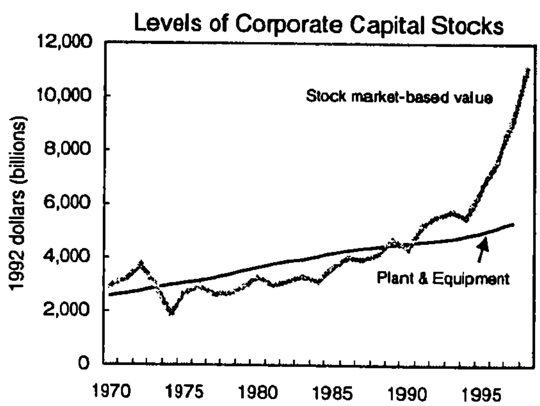
EYES ONLY

SPECIAL ANALYSIS

Intangible Capital and the Stock Market

Recent research based on stock market valuations suggests that over the last decade U.S. businesses have accumulated large quantities of intangible capital that raise productive capacity but are not accounted for in standard measures of the capital stock. Intangible capital includes the value of intellectual property, organizational structure, management expertise, and past investments in job training. According to a measure of capital based on stock market valuation, growth in the total capital stock including intangible capital has been more rapid than that in plant and equipment alone. Such rapid growth in the capital stock would imply faster trend labor productivity growth than one would expect based on the more limited measure of capital. However, the stock market-based method of measuring business capital has yet to be the subject of careful study and remains controversial.

The stock market as a measuring stick. The premise of this research is that the stock market accurately measures the true productive capacity of businesses, and therefore provides a better yardstick for capital accumulation than standard measures based on past investments in plant and equipment. Economic theory argues that, at least over longer periods of time, the market value of a business should equal its replacement cost—including the cost of replacing its intangible capital. One implication of this theory is that the doubling of the stock market value of nonfinancial corporate businesses over 1990-1997 implies an equally large increase in their productive capital stock, well above the 17 percent increase based on investments in plant and equipment alone (see chart). If total capital accumulation has in fact been faster than previously thought, this should have a positive effect on labor trend productivity growth.



Intangible capital and the IT revolution. Why might the stock of intangible capital have grown so rapidly in the 1990s? A number of explanations have been put forward. One is that businesses have intensified efforts at increasing efficiency and productivity. A second is that the explosion in information technologies has led to a surge in investment in intangible capital—including investments in computer software (not currently counted as business capital), the creation of new products and services, and the redesign of production processes and management strategies. In this view, businesses have invested considerable resources in order to take advantage of the opportunities provided by the IT revolution. Investors perceive that these investments will pay off and this is

EYES ONLY

showing up in stock market valuations. One piece of evidence supporting the connection between information technologies and the accumulation of intangible capital is the fact that stock price gains in high tech firms have outpaced those in the rest of the economy, suggesting that these firms have been accumulating intangible capital at a rapid rate.

Intangible capital or a market bubble? There have doubtless been sizable increases in intangible capital over the last decade, but there remains considerable controversy over whether the huge increase in stock market valuation over this period implies a one-for-one increase in the capital stock. At least a portion of the runup in stock prices may reflect changes in perceptions of risk or excessive optimism on the part of investors regarding future earnings, with no positive implications for the capital stock and productivity growth. It is difficult to measure and evaluate the different variables—including perceptions of risk and profitability—that factor into stock market prices. Indeed, economists have a mixed record of perceiving the underlying determinants of stock values. Irving Fisher, one of the founders of financial economics, claimed that "Stock prices have reached what looks like a permanently high plateau," just 2 weeks before the stock market crash of 1929. For 1999, a balanced view of the stock market and intangible capital is likely somewhere between the two extremes, with some but not all of the increase in stock market valuation representing real gains to productive capacity.

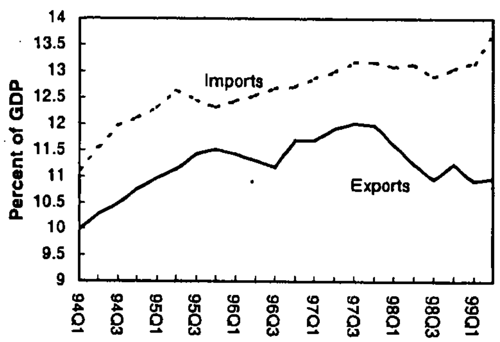
SPECIAL ANALYSIS

Recent Patterns of Trade and Growth

Between the onset of the Asia crisis in the third quarter of 1997 and the second quarter of this year, the U.S. trade deficit widened from 1.2 percent of GDP to 2.7 percent of GDP. Most of this increase reflects depressed export growth.

Recent trends. From 1994 through 1997, the trade deficit remained fairly constant as a percentage of GDP (see upper chart). The trade deficit has widened substantially over the last year and a half. About two-thirds of this widening owes to export sluggishness, with only a third attributable to increases in imports.

U.S Exports and Imports as a Percent of GDP



Are U.S. exports competitive? If export weakness reflects weak demand abroad, then it is reasonable to expect that it can be reversed as the rest of the world recovers. A longer-term decline in competitiveness, by contrast, could be more difficult to reverse.

U.S. and Other Nations' Exports to Non-U.S. Markets

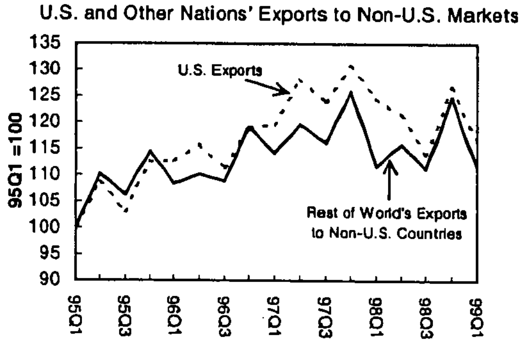
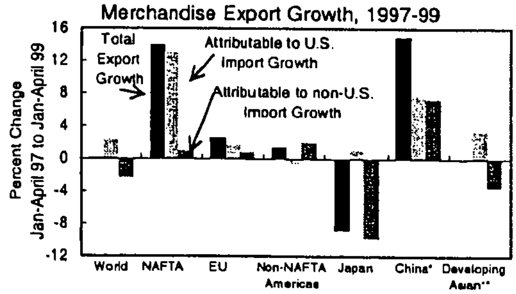


Chart derived from import data

The middle chart compares the performances of U.S. exports with the rest of the world's exports to all non-U.S. markets. U.S. exports appear to have tracked global market movements rather closely. U.S. exports were indeed hit hard in 1998, but so were those of other countries. Despite the contraction in exports in 1998, the market share of U.S. exports in the first quarter of 1999 remained higher than in the mid-1990s.

Contribution of U.S. Import Growth to Non-U.S. Merchandise Export Growth, 1997-99



* Includes Hong Kong; ** Thailand, Korea, Indonesia, Malaysia, Philippines
Chart derived from import data.

Support for growth. As shown in the lower chart, the United States has been a critical source of support for the rest of the world's exports since 1997. Total non-U.S. exports were virtually unchanged over this period. However, excluding the growth in U.S. trade, world exports fell by 2.3 percent: Increases in U.S. imports completely offset decreases in imports in the rest of the world. As seen in the chart, growth in U.S. imports were particularly important for export growth in the other NAFTA

EYES ONLY

countries, the European Union, China, and other developing Asian countries. In contrast, U.S. imports contributed little to export growth in the non-NAFTA Americas and Japan.

EYES ONLY

ARTICLE

From Learning to Earning

It has long been debated how schooling improves economic well-being. Is it because students who are smart to begin with get more schooling, and employers are willing to pay for such "smarts?" Or do employers value what students learn in school? Three recent studies provide new evidence on the relative contribution of "aptitude" (the ability to learn) and "achievement" (what people learn in school) to economic well-being. The studies, combined with earlier research, provide strong evidence that how much students learn in school affects how much they earn.

Background. Starting in the late 1950s, economists developed the theory of human capital, which is a function of both endowments (e.g., genetic factors) and investment (e.g., schooling and student effort). Empirical research using data on identical twins, along with other methods, supported the importance of investment in education by showing that higher levels of schooling lead to higher wages, controlling for initial aptitude. But other research argued that aptitude was the primary determinant of economic success. The 1966 "Coleman Report," for example, found that school quality (as measured by factors such as school expenditures) had little effect on the amount students learn—and so presumably little effect on future earnings. Others have argued that educational credentials are "signals" that enable employers to sort job applicants by ability, but that ability is largely determined by heredity or by very early environmental influences. In this vein, the 1994 book *The Bell Curve* claimed that innate aptitude largely determines economic outcomes.

New research. Because so much controversy remains about the relative importance of aptitude and achievement, the new studies reexamine the issue using new methods. These studies take special care to separate the effects of aptitude and achievement when estimating the effect of schooling on test scores and economic outcomes. Together, they suggest that an additional year of schooling raises future wages by 2 to 4 percent, after controlling for aptitude.

- Using national survey data, one study finds, surprisingly, that gains in students' test scores between the 10th and 12th grades are almost uncorrelated with students' 10th grade scores. This implies that increases in cognitive ability (measured by test scores) are likely to reflect learning rather than initial aptitude. The study then uses data on the students' wages 10 years later to estimate the effect of test-score gains on future earnings.

- A second study finds that—holding education level constant—those who score higher on the Armed Forces Qualification Test (AFQT), a test of cognitive skills, earn higher wages. On the other hand, holding AFQT scores constant, those with more education also earn higher wages. This implies that employers care about worker's aptitude and their achievement.

- A third study uses the fact that most states require children to enter first grade when they reach a certain age by a particular date. This has the effect of dividing children of the same general age, and presumably the same cognitive ability, into two groups. One group, born in the months before the cut-off date, starts school earlier, while the group born in the months after the cut-off date begins school at a later age. Using national data, the study finds that those in the earlier-starting group actually earn higher average wages as adults (2.7 percent higher). Part of the reason for the difference in wages may be that early exposure to schooling increases cognitive skills which in turn translates into higher wages. This is evidence that schooling (and school timing) affects outcomes—not just innate ability.

Implications. The studies present new evidence that enhancing student achievement can yield significant benefits, regardless of aptitude. This evidence highlights the potential impact of policies that increase the quantity or quality of schooling. It also casts doubt on the claim made in *The Bell Curve* that "For many people, there is nothing they can learn that will repay the cost of the teaching." It should be noted, however, that cognitive test scores explain only a modest amount of the overall variation in wages. Most of the variation can be attributed to factors other than cognitive skills or to cognitive skills not measured by conventional tests. For example, employers say they want workers who are not only skilled, but are also reliable, creative, confident, and honest.

EYES ONLY

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

Job Loss among Older Americans. A report based on the Health and Retirement Study finds that a late-career job loss has large and lasting effects on subsequent employment. Nearly 40 percent of American men who lose their jobs at age 55 do not return to work within a year and over 25 percent do not returned to work after 2 years. Of those who do return to work after suffering a late career job loss, roughly 20 percent will no longer be working after 1 year, with this figure rising to about 30 percent after 2 years. Combining the difficulties in finding and keeping a job, the report estimates that among 55-year-old job losers, only half are working at age 56, compared to 95 percent of 56-year olds who have not suffered a recent job loss.

Internet Economy Flying High. In 1998, Internet-related businesses generated over $300 billion of revenues and 1.2 million jobs in the United States, as estimated by one study. While the Internet economy has created thousands of startups, major firms still play a significant role, with employment in the top 15 companies accounting for nearly one-third of the jobs. Many of these jobs, such as web design and Internet consulting, did not exist just 5 years ago and companies have had to design jobs to meet the challenges of the Internet economy. Although online companies engaging in commerce are expected to operate with fewer employees, the study found that the ratio of revenues to employees was about the same for online companies and their "brick-and-mortar" counterparts selling similar products in 1998. Evidently, Internet commerce, which is estimated to make up about one-third of all Internet revenues, has yet to yield sizable gains in efficiency over more traditional methods.

Good and Bad News in Housing. The physical adequacy of the housing stock has improved significantly over the past few decades, particularly for households in the lowest income quintile, according to a recent study by the Federal Reserve Bank of New York. Today, with only around 2 to 3 percent of housing units rated "severely inadequate" there is little difference in the physical adequacy of the units occupied for different income quintiles. This contrasts with 1975, when 12 percent of the lowest income quintile's housing stock was rated severely inadequate. However, housing affordability remains a problem. The lowest income quintile is spending an average of 60 percent of family income on housing, compared to about 40 percent in the mid-1970s. This increase can be attributed to slow growth in family income compared with that of housing costs. Additionally, as discussed in a recent HUD report, the number of rental units affordable to struggling households (those with income at or below 30 percent of the area median) has decreased by 5 percent between 1991 and 1997. Because the number of renters who are struggling has increased, the gap between struggling families and the number of affordable units has grown since 1991.

EYES ONLY

INTERNATIONAL ROUNDUP

Market Incentives for Developing an AIDS Vaccine. Although developing an effective HIV vaccine now appears scientifically feasible, a recent World Bank paper argues that privately funded investment in developing such a vaccine remains far too low. Of the $300 million spent worldwide on R&D on HIV vaccines in 1998, less than $50 million was privately funded. In contrast, some $2 billion annually is spent on research for AIDS *treatment*, much of it by the private sector. A forthcoming World Bank study finds that most biotechnology firms and vaccine makers do not consider the potential developing country market in making R&D investment decisions regarding an AIDS vaccine, despite the fact that 90 percent of HIV infections are in the developing world. The firms cited lower-than-expected uptake of other vaccines since the 1970s as evidence that there may not be an adequate market for an HIV vaccine. A possible mechanism for encouraging vaccine development is long-term market assurances, whereby governments and other donors would establish a fund dedicated to purchasing an AIDS vaccine satisfying specific medical criteria.

Mundell Wins Nobel. Columbia University Professor Robert A. Mundell won the Nobel Prize in Economic Sciences this week. The Royal Swedish Academy of Sciences cited Mundell's research on optimal currency zones, which was influential in the establishment of the European Monetary Union. This work showed that regional economic disturbances may require movement of labor from high- to low-unemployment regions. In other work, Mundell analyzed how the potency of monetary and fiscal policy depended on the degree of international capital mobility and whether exchange rates are fixed. For example, if capital moves easily, then a fiscal expansion has less effect on output with floating exchange rates than with a fixed exchange rate because in the former case the resulting appreciation of the exchange rate causes net exports to fall.

Reforming the International Financial Architecture. A report sponsored by the Council on Foreign Relations analyzes the factors that lead to banking, currency, and debt crises, and proposes recommendations for crisis prevention and resolution. The report emphasizes market-based incentives and fair burden-sharing across and within economies as guiding principles for financial reforms. For emerging economies with fragile financial structures, the report recommends adopting nondiscriminatory taxes to discourage short-term capital inflows and argues against pegged exchange rates. Collective-action clauses on sovereign bond contracts should be implemented to promote private-sector burden-sharing. The report calls for leaner agendas and a clearer division of labor between the IMF and the World Bank, and recommends that the IMF avoid large-scale lending during crises and provide more favorable lending terms to countries adopting "good" policies. The major themes are reasonably consistent with recent G-7 proposals, although this report focuses more on restructuring international lending institutions.

EYES ONLY

RELEASES THIS WEEK

Industrial Production and Capacity Utilization
****Embargoed until 9:15 a.m., Friday, October 15, 1999****

The Federal Reserve's index of industrial production decreased 0.3 percent in September. Capacity utilization fell 0.4 percentage point to 80.3 percent.

Producer Price Index
****Embargoed until 8:30 a.m., Friday, October 15, 1999****

The producer price index for finished goods rose 1.1 percent in September. Excluding food and energy, producer prices rose 0.8 percent.

Retail Sales

Advance estimates show that retail sales rose 0.1 percent in September following an increase of 1.5 percent in August. Excluding sales in the automotive group, retail sales rose 0.6 percent following an increase of 0.9 percent.

MAJOR RELEASES NEXT WEEK

Consumer Prices (Tuesday)
Housing Starts (Tuesday)
U.S. International Trade in Goods and Services (Wednesday)

EYES ONLY

U.S. ECONOMIC STATISTICS

	1970-1993	1998	1998:4	1999:1	1999:2
Percent growth (annual rate)					
Real GDP (chain-type)	2.7	4.3	6.0	4.3	1.6
GDP chain-type price index	5.4	0.9	0.8	1.6	1.3
Nonfarm business (NFB) sector:					
Productivity (chain-type)	1.5	2.6	4.1	3.6	0.6
Real compensation per hour:					
Using CPI	0.6	2.5	2.0	2.9	1.5
Using NFB deflator	1.3	3.7	3.4	3.0	3.7
Shares of Nominal GDP (percent)					
Business fixed investment	10.9	11.0	11.0	11.0	11.2
Residential investment	4.5	4.3	4.5	4.6	4.7
Exports	8.2	11.3	11.3	10.9	11.0
Imports	9.2	13.0	13.1	13.2	13.7
Personal saving	5.2	0.3	-0.0	-0.5	-0.9
Federal surplus	-2.7	0.9	0.8	1.4	1.6

	1970-1993	1998	July 1999	August 1999	September 1999
Unemployment Rate (percent)	6.7**	4.5**	4.3	4.2	4.2
Payroll employment (thousands)					
increase per month			373	103	-8
increase since Jan. 1993					19409
Inflation (percent per period)					
CPI	5.8	1.6	0.3	0.3	N.A.
PPI-Finished goods	5.0	0.0	0.2	0.5	1.1

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

New or revised data in **boldface**.
PPI data **embargoed until 8:30 a.m., Friday, October 15, 1999.**

EYES ONLY

FINANCIAL STATISTICS

	1997	1998	August 1999	September 1999	Oct. 14, 1999
Dow-Jones Industrial Average	7441	8626	10935	10714	10287
Interest Rates (percent per annum)					
3-month T-bill	5.06	4.78	4.72	4.68	4.88
10-year T-bond	6.35	5.26	5.94	5.92	6.17
Mortgage rate, 30-year fixed	7.60	6.94	7.94	7.82	7.85
Prime rate	8.44	8.35	8.06	8.25	8.25

INTERNATIONAL STATISTICS

Exchange Rates	**Current level October 14, 1999**	**Percent Change from**	
		Week ago	**Year ago**
Euro (in U.S. dollars)	1.080	0.7	N.A.
Yen (per U.S. dollar)	107.0	-0.7	-10.3
Major currencies index (Mar. 1973=100) (trade-weighted value of the U.S. $)	92.33	-0.2	-0.9

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	3.9 (Q2)	4.2 (Sep)	2.3 (Aug)
Canada	3.7 (Q2)	7.8 (Aug)	2.1 (Aug)
Japan	1.1 (Q2)	4.7 (Aug)	0.2 (Aug)
France	2.1 (Q2)	11.3 (Aug)	0.5 (Aug)
Germany	0.6 (Q2)	7.1 (Aug) 2/	0.6 (Aug)
Italy	0.8 (Q2)	12.1 (Apr)	1.7 (Aug)
United Kingdom	1.4 (Q2)	6.0 (Jun)	1.1 (Aug)

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 former West Germany. Using OECD standardized unemployment data, the unemployment rate for unified Germany for August was 9.2 percent.

EYES ONLY

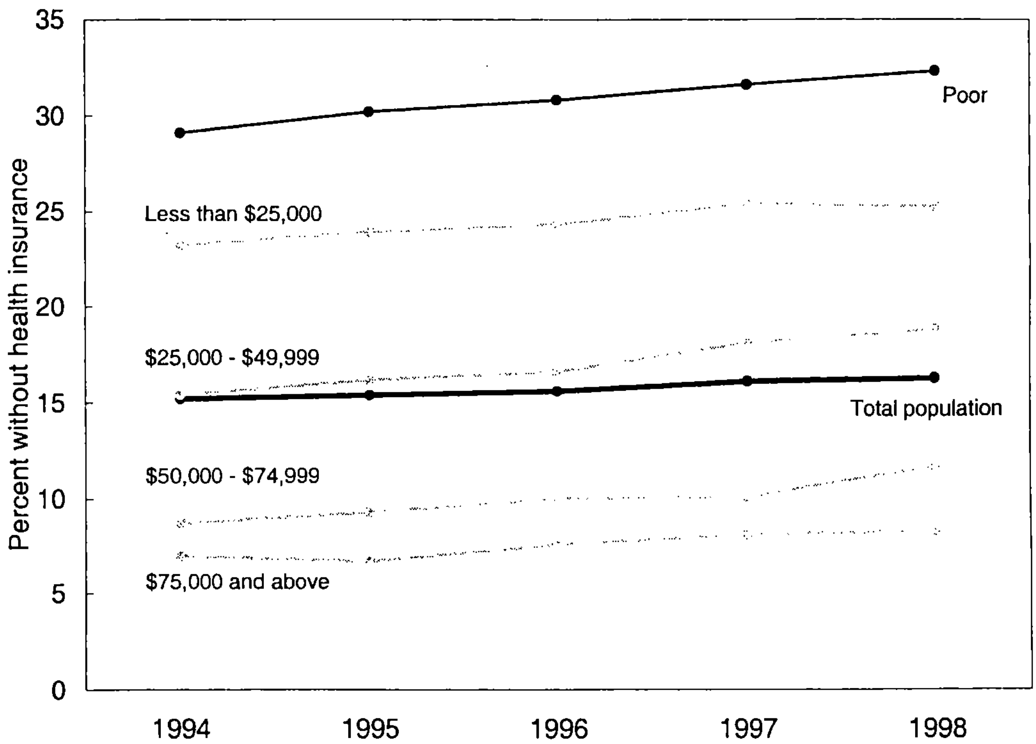
WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

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

October 8, 1999

CHART OF THE WEEK

Lack of Health Insurance Coverage by Income Group



The latest data on health insurance coverage show an increase in the share of people without health insurance from 16.1 percent in 1997 to 16.3 percent in 1998. Among the four income groups shown in gray, the two middle income groups experienced the largest increases in the share of people without health insurance. While health insurance coverage increased among households with less than $25,000 in income, the proportion of people living in poverty and without health insurance went up to 32.3 percent.

EYES ONLY

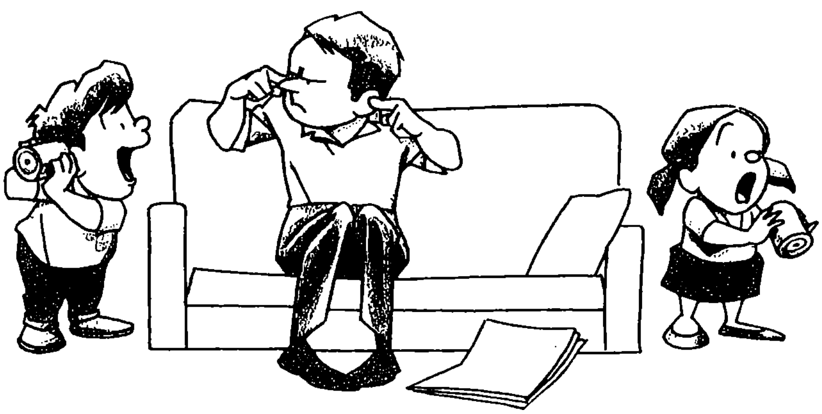
CONTENTS

TREND

SPECIAL ANALYSIS

ARTICLE

DEPARTMENTS



"But we're playing *cell* phone! It's *supposed* to be annoying."

EYES ONLY

TREND

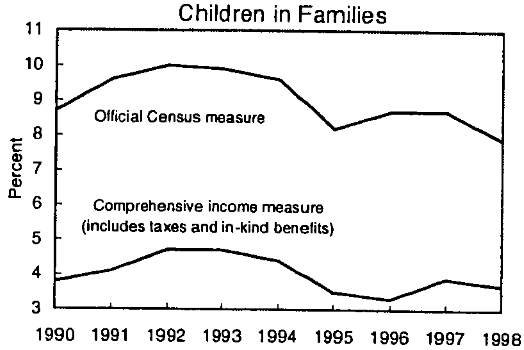
Extreme Child Poverty and the Income of Single Mothers

Based on their analysis of income and poverty data through 1997, the Children's Defense Fund (CDF) and the Center on Budget and Policy Priorities (CBPP) this summer reported disturbing trends in extreme child poverty and the income of female-headed households with children. However, a new Department of Health and Human Services analysis shows that these trends did not continue in 1998.

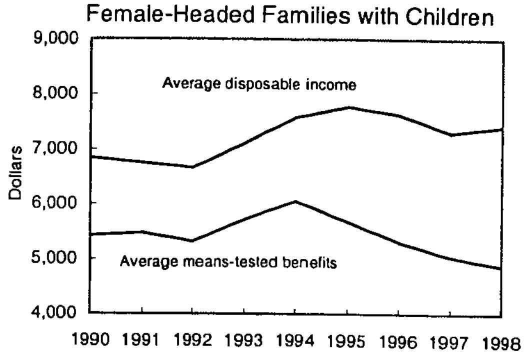
Background. The CDF report focused on extreme poverty (household income less than half the poverty threshold). While official Census data showed no change from 1996 to 1997 in the proportion of children living in extreme poverty, CDF used a comprehensive definition of income that includes the effects of in-kind benefits, such a food stamps (but not medical care), and taxes. Under this definition, the proportion of children living in extreme poverty jumped from 3.3 percent in 1996 to 3.9 percent in 1997. The difference between the Census and CDF findings appears to reflect a decline in in-kind benefits (mainly food stamps) between 1996 and 1997 for this group. This point was further emphasized in the CBPP report, which found that means-tested cash and in-kind benefits received by poor female-headed families with children fell substantially between 1995 and 1997, contributing to a decrease in disposable income for this group.

Extreme Child Poverty. The HHS analysis of the latest poverty data shows that the extreme poverty rate for children in families decreased between 1997 and 1998 under both the official and the comprehensive measures (see upper chart). However, the drop in the Census measure was much larger (from 8.7 to 7.9 percent, or over 550,000 children). The decline in the comprehensive measure from 3.9 to 3.7 percent (a drop of just over 100,000 children) was not statistically significant, and this measure remains higher than it was in 1995. Nevertheless, the new data provide a less discouraging picture of the trend in extreme child poverty than the one based on 1997's data.

Extreme Poverty Rates for Children in Families



Income and Benefits for Bottom Fifth of Female-Headed Families with Children



Female-headed households. The trend toward lower disposable income for the poorest fifth of female-headed households with children reported by the CBPP was also halted in 1998. The HHS analysis shows that the average means-tested benefits received by this group continued to decline in 1998 (see lower chart on previous page). However, earnings and other income increased by more than enough to offset the decline in benefits, leading to an increase in average disposable income (the comprehensive definition of income). As a result, the comprehensive measure of the poverty rate for female-headed families declined slightly between 1997 and 1998.

Conclusion. Trends since 1995 in extreme child poverty and in income and poverty among low-income female-headed households with children are being used by some groups as indicators for assessing welfare reform. The latest data show that the disturbing trends in last year's data have been arrested. And the increase in earnings and other income for those most likely to have been affected by welfare reform is encouraging. Still, child poverty rates remain high and receipt of in-kind benefits like food stamps continues to decline.

SPECIAL ANALYSIS

An Alternative to Stricter Medicaid Asset Limits

A recent article in the *Weekly Economic Briefing* cited new evidence that Medicaid rules could encourage transfers of assets to other family members by people who anticipate that they will enter nursing homes. Meanwhile, the market for private long-term care insurance is developing slowly, with less than 5 percent of total long-term care costs paid for by such insurance. This follow-up suggests that the transfer issue could become more important in coming years, and examines an approach that some states have taken to create positive incentives for individuals to purchase long-term care insurance as an alternative to imposing more stringent Medicaid qualification limits.

Increasing asset transfers may put more pressure on Medicaid. The shift from defined-benefit to defined-contribution pension plans will increase the number of retirees with non-annuity pension wealth that might potentially be transferred to other family members. Significant asset transfers could affect Medicaid costs, which have skyrocketed for many years and in 1996 consumed over 20 percent of state budgets, rivaling the cost of education.

Partnership programs offer an interesting alternative. A 1988 initiative established partnerships between state Medicaid programs and private long-term care insurance companies. Partnership programs were first introduced in four states (California, New York, Connecticut, and Indiana). At least 11 other states considered similar programs shortly thereafter, but provisions of the 1993 Omnibus Budget and Reconciliation Act have discouraged implementation. The four existing Partnership programs, which were granted waivers to continue, vary in structure, but all offer benefits to pay for long-term care costs while providing Medicaid asset protection. Key features of these plans include:

- a minimum daily benefit whose value is adjusted for inflation;
- portability of long-term care benefits (but a residence requirement in the issuing state for initial purchase and for Medicaid asset protection);
- retention of some or all assets above the state Medicaid limit (without changing the income limits).

This last feature means that individuals still contribute toward their nursing home care, but it reduces the incentive to transfer assets.

Early indicators are encouraging. Preliminary evaluations suggest that partnership programs have successfully attracted middle-income-and-asset households—exactly those who might otherwise transfer their assets in order to qualify for Medicaid. In New York, partnership insurance accounts for 20 percent of all long-term care policies active in the state. In addition, partnership policies may represent a more affordable long-term care option for some people. In Connecticut, for example, it is only necessary to purchase an amount of insurance equal to the amount of assets an individual wishes to protect. These early indicators suggest that partnership policies may present a viable way to address the transfer problem.

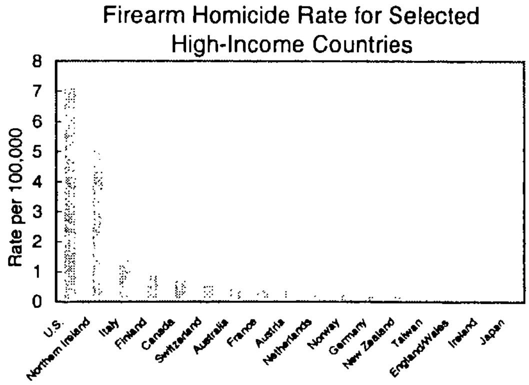
Policy implications. Partnership programs are consistent with Administration goals of increasing long-term care insurance coverage, expanding Medicaid eligibility, and encouraging partnerships between Medicaid and qualified elderly housing. However, even in states that have partnership programs, few people purchase long-term care insurance. For example, a survey of non-partnership long-term care insurance purchasers in California found that 80 percent did not know about the program. The Administration's proposed national long-term care education campaign can help increase public awareness of these programs.

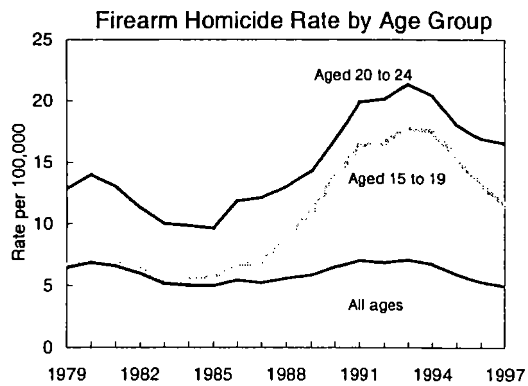
Conclusion. The Administration has proposed a major initiative to address the Nation's long-term care needs. Some version of partnership programs may offer additional encouragement for using private long-term care insurance rather than simply transferring assets to qualify for Medicaid.

ARTICLE

The Costs of Gun Violence

The medical costs of treating gunshot injuries are large, and approximately half of these costs are borne by taxpayers. But gun violence also imposes economic and social costs that go well beyond these direct medical expenditures.





Incidence of gun violence. The United States leads the developed world in the incidence of gun violence (see upper chart). The rates shown in the chart (for years in the early 1990s) imply total firearm homicides of about 6 per year in New Zealand, 25 in Japan, 36 in England, 179 in Germany, 214 in Canada, and over 18,000 in the United States. Gun violence exacts its highest toll among younger people. Roughly 75 percent of gunshot victims are under 30 years old. And while the homicide rates among older age groups have fallen since 1979, homicide among those aged 15 to 24 ballooned in the early 1990s and has remained high despite recent declines (see lower chart).

Medical costs. One recent study estimates that total gunshot-related medical costs in 1994 were $2.3 billion, or $17,000 for each of the 130,000 gunshot injuries in that year. Non-fatal gunshot injuries, three-quarters of which are inflicted in assaults, accounted for a disproportionate share of total medical costs. Eighty-five percent of total medical costs from gunshots were incurred in treating hospitalized gunshot survivors, and the average lifetime cost of treating a hospitalized gunshot survivor was $35,000. Costs for hospitalized gunshot victims who survive their injuries are higher because the majority of medical treatment costs are incurred in the years after a patient's discharge from the hospital, reflecting the magnitude of follow-up treatment costs from gun violence.

Taxpayer share of costs. Because approximately 80 percent of discharged gunshot victims do not have private insurance, taxpayers incur a large share of the medical costs of gun violence. While government programs are the primary payers for 40 to 50 percent of hospitalized gunshot injury cases generally, the government pays an even greater share of the costs of more expensive gunshot injuries requiring hospitalization. For example, government programs are the primary payer of acute-care costs for approximately 63 percent of spinal cord injuries due to gunshots and 89 percent of spinal injury cases after initial hospitalization. In addition, hospitals may shift some of the losses they incur treating gunshot victims to privately insured patients.

Costs to hospitals. Gunshot wounds can impose a large burden on the hospital system. At one major trauma center in Northern California, for example, gunshot injuries accounted for about 1 percent of injury-related admissions, but they accounted for as much as 9 percent of trauma service admissions and 14 percent of trauma service hospital stays between 1990 and 1992. This trauma center estimated that reimbursement for firearm-related admissions was only 37 percent of total charges.

Additional costs. While large in absolute terms, direct medical costs are only a small part of the overall cost of gun violence. For example, one frequently cited study estimated that the value of output lost due to victims' reduced labor force participation is roughly 10 times greater than the direct medical costs. In addition, fear of gun violence can impose social costs. A recent study that used survey data to estimate how the public values reductions in gun violence estimated that, collectively, Americans would be willing to pay $24 billion for a 30 percent reduction in gun violence. This estimate implies a total cost per gun injury of $750,000 (or about forty times the estimated medical cost noted above).

Conclusion. While the medical costs of gun violence are significant, these costs represent only a small fraction of the total financial burden imposed by endemic gun violence in the United States. High levels of youth firearm violence are particularly costly because they can be associated with high levels of lifetime follow-up medical costs for survivors and many years of lost labor market activity associated with both injuries and death.

EYES ONLY

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

Fed Holds the Line but Adopts a Bias toward Tightening. On Tuesday, the Federal Open Market Committee voted to leave its target for the federal funds rate unchanged. Although it noted that strengthening productivity growth has been fostering favorable trends in unit costs and prices, the FOMC also observed that the pool of available workers willing to take jobs was shrinking and that it would have to be especially alert in the months ahead to possible inflationary pressures. Accordingly, it adopted a directive that was biased toward a possible firming of policy going forward—though committee members emphasized that this did not signify a commitment to near-term action. Indeed, several times in the past, the FOMC has adopted a bias toward tightening without raising rates in the near term.

Telecom Consolidation Continues. This week, MCI Worldcom announced plans to acquire Sprint in a deal that would combine the second and third largest long distance companies. If the merger is completed, the new company's share of the long distance market would be approximately 36 percent, compared with 43 percent for AT&T. Separately, the FCC announced approval of the merger between local carriers SBC and Ameritech, but it attached a list of 30 conditions to ensure that the combination would not harm consumers. One provision requires SBC to enter at least 30 local phone markets outside of its region or face almost $1.2 billion in fines. Another provision imposes a "most-favored nation" clause covering terms SBC may negotiate with other phone companies. To enter outside of its region, SBC may need to lease network elements from other phone companies, and this clause requires SBC to make similar terms available to entrants in its own region. Although such provisions could benefit new entrants in SBC's region, these provisions may also make it less likely that SBC will aggressively seek to enter other regions. If SBC knows that a "good" deal outside its region will reduce revenues within its region, then it may not seek terms that would lead it to price more aggressively outside of its own region.

Survey Examines How Families Use the EITC. Over half of EITC beneficiaries planned to use their refund to improve their long-term economic well-being by saving, moving to a safer neighborhood, paying tuition, or purchasing or repairing a car, according to a recent study of low-income Chicago families. Almost all families receive the EITC as an annual, lump-sum tax refund check. This allows credit-constrained low-income families to move beyond current consumption by using the EITC to make extraordinary types of purchases or expenses. The study found that families who had access to financial institutions were more likely to use their refund for their long-term economic improvement. Making ends meet was also an important use of the EITC for almost one-half of the sample. The authors observe that the EITC allows families to do what they otherwise could not; without it, almost 90 percent either could not meet their top priority use of the EITC refund, would have to spend a lesser amount, or would be forced to delay their top priority.

INTERNATIONAL ROUNDUP

World Bank Launches New Global Poverty Initiative. The World Bank has released new findings on global poverty to mark the beginning of an expanded anti-poverty strategy that combines the efforts of the Bank, the IMF, and client governments. The Bank reports that poverty numbers, which dropped worldwide in the mid-1990s, have risen following the Asian financial crisis. Of the world's 6 billion people, 3 billion live on less than $2 per day and 1.3 billion live on less than $1 per day. The Bank notes that, under current trends, the international community will fall short of its goal of halving the world's poverty rate by 2015. Moreover, concerns about corruption, violence, powerlessness, and insecure livelihood remain widespread among the world's poor. To battle poverty, the new initiative combines plans for faster, broader debt relief with a strategy to balance macroeconomic and financial reforms with human, structural, and social concerns. The enhanced strategy will be introduced first in countries that are eligible for the Heavily Indebted Poor Countries (HIPC) initiative. In addition, the HIPC program was strengthened during the World Bank/IMF annual meetings last week when developed countries pledged a new infusion of cash into the program, which is now expected to help 36 countries.

China to Offer Foreign-Investment Tax Breaks. Beginning January 1, China will offer tax breaks and other preferences for foreigners investing in poorer regions. China is one of the largest recipients of foreign direct investment (FDI) in the world, but FDI fell almost 10 percent in the first half of 1999 from a year earlier, exacerbating the slowdown in economic growth. Also, inland areas have developed much less rapidly than coastal areas in recent years. The new regime addresses these concerns by allowing foreign enterprises in the poor central and western provinces to receive a preferential tax incentive for 3 years. China's government also announced several other incentives for technology transfer to poor regions, including a business-tax exemption for transferring advanced technology into the country and an import-tariff exemption for equipment and parts used by foreign investors for technological innovation.

Outlook for Global Steel Market Brightens. Global market conditions for steel are improving briskly, following 2 years of economic turmoil, according to a report from the International Iron and Steel Institute. Last year, global demand fell from its 1997 peak, but the report argues that strong consumption growth in the second half of 1999 should more than recoup the loss, and it projects continued strong consumption growth of about 3 percent next year. Growth in Asia (especially Korea and China) should lead the recovery, with Brazil and other South American countries expected to follow in 2000. In 1998, trade flows showed some massive surges as producers redirected sales from weak to buoyant markets. Trade balances in steel declined sharply in some major trading countries (the EU and the United States), as Japan and Korea increased exports in response to weak home markets. The report estimates, perhaps optimistically, that the EU's balance will improve, but not by enough to offset the earlier decline, while the U.S. balance in steel should return to near pre-1998 levels.

EYES ONLY

RELEASES THIS WEEK

Employment and Unemployment

****Embargoed until 8:30 a.m., Friday, October 8, 1999****

In September, the unemployment rate was unchanged from August at 4.2 percent. Nonfarm payroll employment decreased by 8,000.

Leading Indicators

The composite index of leading indicators fell 0.1 percent in August, after increasing 0.3 percent in each of the prior three months.

MAJOR RELEASES NEXT WEEK

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

EYES ONLY

U.S. ECONOMIC STATISTICS

	1970-1993	1998	1998:4	1999:1	1999:2
Percent growth (annual rate)					
Real GDP (chain-type)	2.7	4.3	6.0	4.3	1.6
GDP chain-type price index	5.4	0.9	0.8	1.6	1.3
Nonfarm business (NFB) sector:					
Productivity (chain-type)	1.5	2.6	4.1	3.6	0.6
Real compensation per hour:					
Using CPI	0.6	2.5	2.0	2.9	1.5
Using NFB deflator	1.3	3.7	3.4	3.0	3.7
Shares of Nominal GDP (percent)					
Business fixed investment	10.9	11.0	11.0	11.0	11.2
Residential investment	4.5	4.3	4.5	4.6	4.7
Exports	8.2	11.3	11.3	10.9	11.0
Imports	9.2	13.0	13.1	13.2	13.7
Personal saving	5.2	0.3	-0.0	-0.5	-0.9
Federal surplus	-2.7	0.9	0.8	1.4	1.6

	1970-1993	1998	July 1999	August 1999	September 1999
Unemployment Rate (percent)	6.7**	4.5**	4.3	4.2	**4.2**
Payroll employment (thousands)					
increase per month			**373**	**103**	**-8**
increase since Jan. 1993					**19409**
Inflation (percent per period)					
CPI	5.8	1.6	0.3	0.3	N.A.
PPI-Finished goods	5.0	0.0	0.2	0.5	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, October 8, 1999**.

EYES ONLY

FINANCIAL STATISTICS

	1997	1998	August 1999	September 1999	Oct. 7, 1999
Dow-Jones Industrial Average	7441	8626	10935	10714	10537
Interest Rates (percent per annum)					
3-month T-bill	5.06	4.78	4.72	4.68	4.70
10-year T-bond	6.35	5.26	5.94	5.92	6.05
Mortgage rate, 30-year fixed	7.60	6.94	7.94	7.82	7.82
Prime rate	8.44	8.35	8.06	8.25	8.25

INTERNATIONAL STATISTICS

Exchange Rates	**Current level October 7, 1999**	**Percent Change from**	
		Week ago	**Year ago**
Euro (in U.S. dollars)	1.072	0.7	N.A.
Yen (per U.S. dollar)	107.7	0.8	-13.1
Major currencies index (Mar. 1973=100) (trade-weighted value of the U.S. $)	92.51	-0.1	-0.9

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	3.9 (Q2)	**4.2** (Sep)	2.3 (Aug)
Canada	3.7 (Q2)	7.7 (Jul)	2.1 (Aug)
Japan	1.1 (Q2)	4.9 (Jul)	0.2 (Aug)
France	2.1 (Q2)	11.3 (Jun)	0.5 (Aug)
Germany	0.6 (Q2)	7.1 (Jul) 2/	0.6 (Aug)
Italy	0.8 (Q2)	12.1 (Apr)	1.7 (Aug)
United Kingdom	1.4 (Q2)	6.1 (May)	1.1 (Aug)

U.S. unemployment data **embargoed until 8:30 a.m., Friday, October 8, 1999.**

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 former West Germany. Using OECD standardized unemployment data, the unemployment rate for unified Germany for July was 9.1 percent.

EYES ONLY

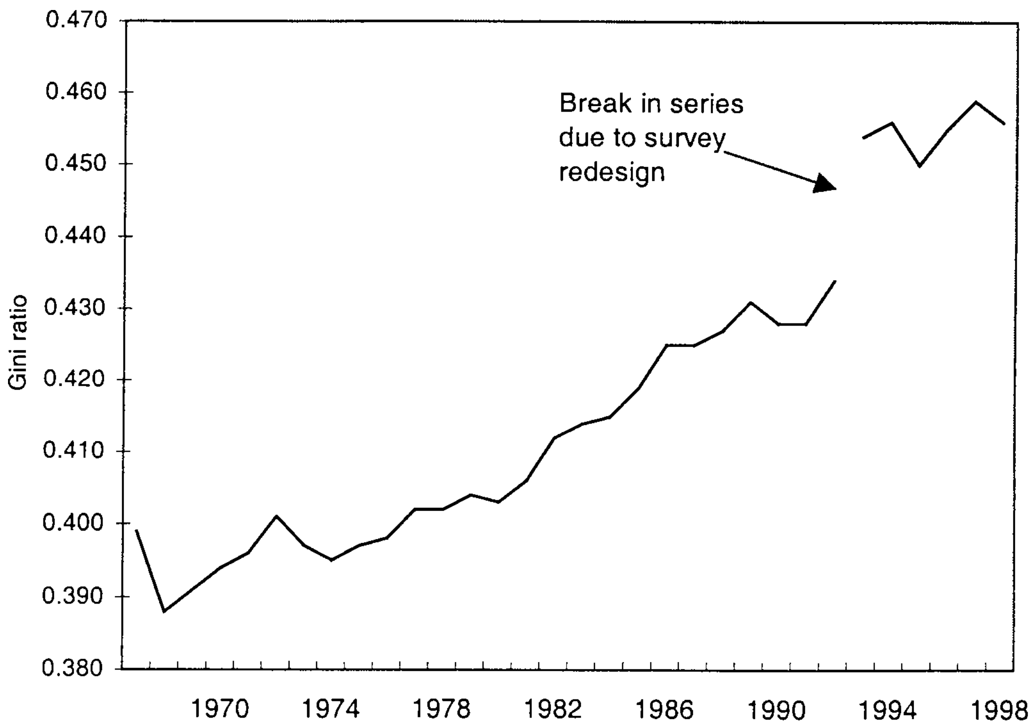
WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

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

October 1, 1999

CHART OF THE WEEK

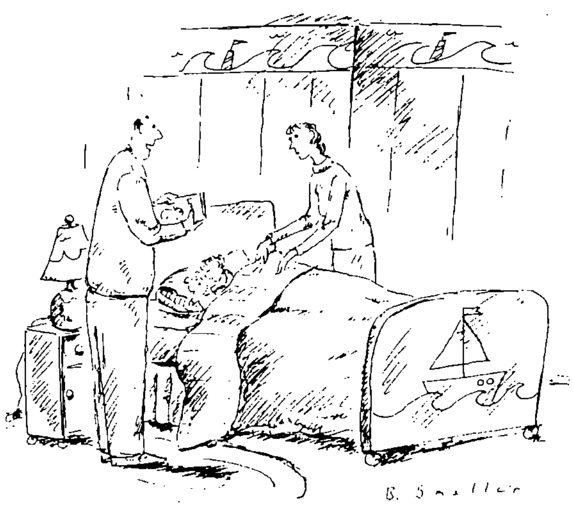
Income Inequality Has Stopped Increasing



The latest income and poverty statistics show that the Gini ratio (a measure of income inequality) fell slightly in 1998. After two decades of rising inequality, this measure has shown no significant change since 1993. (The break in the series reflects a change in data reporting that increased the measured income of the highest income households by substantially more than their actual income increased.)

EYES ONLY

CONTENTS

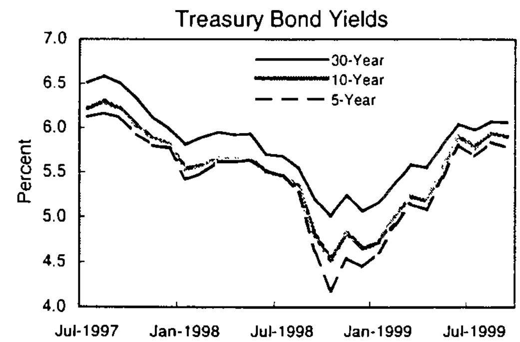


"Of course he looks peaceful—he's lived his entire life in a bull market."

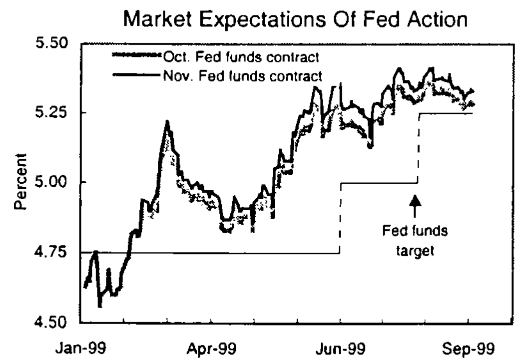
FINANCIAL MARKET UPDATE

Third Quarter, 1999

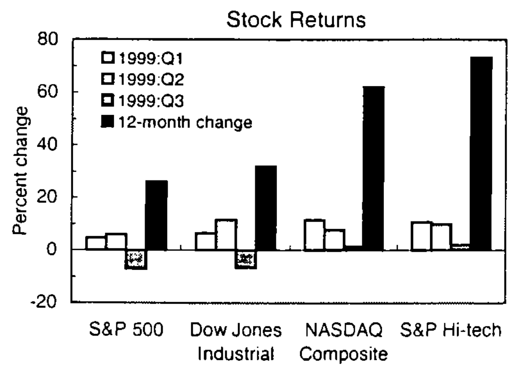
In August the Fed again raised its Federal funds target by ¼ point. Interest rates this quarter have remained near levels reached in June, and growth in stock prices has stalled.



Interest rates. Yields on Treasury securities are at their highest levels since late 1997 (see upper chart). Expectations for future rate hikes at the next FOMC meeting and beyond remain muted, with Fed funds futures contracts trading close to the current target (see middle chart).



There appears to be less apprehension over Y2K issues than earlier this quarter. One measure of the perceived risk is the premium that people are willing to pay to have access to liquidity in early January. One such measure, the spread between December and January Fed funds futures contracts, has recently retreated to under 5 basis points after widening to over 15 in July, suggesting that market anxiety over the availability of liquidity may have eased somewhat. The Fed's decision to make discount window credit readily available from October to April may have also helped dampen any tendency for money markets to tighten.



Stock prices. The major indexes were nearly flat this quarter, following sizeable gains in each of the first two quarters (see lower chart). Technology stocks grew slowly, while the Dow and the S&P 500 actually lost ground. Notwithstanding the stock market's recent sluggishness, the major indexes have all recorded strong growth over the last 12-month period.

EYES ONLY

CURRENT DEVELOPMENT

Y2K Inventory Building Could Make GDP More Volatile

As a precautionary move against possible Y2K disruptions, many businesses may advance their purchases of raw materials. This could cause an uneven pattern of GDP growth over the next few quarters.

Survey evidence. A survey just published by the National Association of Purchasing Management sheds light on how much precautionary inventory building is likely in manufacturing. Of the purchasing managers surveyed, 38 percent plan to acquire extra inventories because of Y2K concerns in commodities comprising 22 percent of their total inventories. Among the managers who anticipated the acquisition of precautionary stocks, an average extra 18-day supply of materials was expected, with the median manager beginning stockbuilding in October.

Impact on GDP. These survey results imply that precautionary stockbuilding by manufacturers will add about ½ percentage point to the annual rate of real GDP growth in the third and fourth quarters. The effect on first quarter GDP will depend on whether or not Y2K disruptions appear. If Y2K disruptions become evident after January 1, these buffer stocks of raw materials will prevent output from falling further than would happen otherwise. But if the disruptions do not appear, the overhang of these excess stocks would depress first-quarter GDP growth by about 1½ percentage points at an annual rate.

Conclusion. Although large enough to be noticed, these effects are small relative to normal fluctuations. The effect would be larger, however, if precautionary hoarding occurs elsewhere as well. For example, utilities may advance purchases of coal and oil, and consumers may hoard groceries and gasoline.

EYES ONLY

SPECIAL ANALYSIS

E-Commerce (Re)discovers the Distribution System

Much has changed in American retailing between the introduction of the mail order catalogue and the electronic commerce (e-commerce) of today. Among large retailers providing an extensive selection of consumer goods, however, one important element of their operations that appears to be unchanged is the need to operate an efficient warehouse distribution system.

Montgomery Ward and Sears. Montgomery Ward began mail order distribution of a wide variety of consumer goods in 1872, but by 1900, mail order sales at Sears exceeded those at Montgomery Ward. As Sears made an increasingly wide variety of consumer goods available through its mail order operation (ranging from jewelry and clothing to hardware and furniture), its sales expanded from less than $1 million in 1895 to more than $37 million by 1905.

Distribution problems caused by success. The increasing success in selling merchandise, however, left Sears with the problem of how to distribute efficiently all of the goods ordered through its catalogue. Initially, Sears had relied on manufacturers to ship orders directly to consumers, but delays and duplicated orders increased costs and hurt the company's reputation with its customers. To solve its distribution problem, Sears built a large, mechanized warehouse designed to centralize shipping in one location.

Centralized distribution and Wal-Mart. A similar approach was adopted by Wal-Mart to lower the distribution costs for consumer goods sold through its stores. Like Sears, Wal-Mart built centralized distribution centers to handle merchandise delivered from factories. Truckload shipments to the distribution center from suppliers are divided up for shipment to individual stores. To determine what needs to be shipped to each store, Wal-Mart uses computerized inventory equipment to keep track of which items need to be reordered, thereby increasing revenues from its shelf space. Attention to the details affecting the cost of distributing goods allowed Wal-Mart to became an effective, low-cost competitor to other mass merchants, including, ironically, the department stores operated by Sears.

E-commerce vendors. Some of the leading firms involved in today's electronic commerce have rediscovered the virtues of centralized distribution centers long employed by traditional merchants. Initially, it might have been thought that e-commerce vendors would be able to use the Internet to avoid investing in the infrastructure of traditional merchants. Recently, however, several prominent e-commerce firms like Amazon.com and Barnesandnoble.com have announced plans to create new warehouse distribution centers to hold inventory and fill the orders they receive over the Internet. Thus, even in the virtual world of Internet retailing, efficient distribution centers appear to be just as important today as they were to earlier large retailing firms at the turn of the century.

EYES ONLY

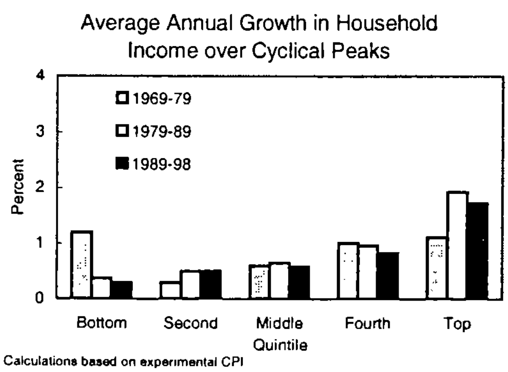
ARTICLE

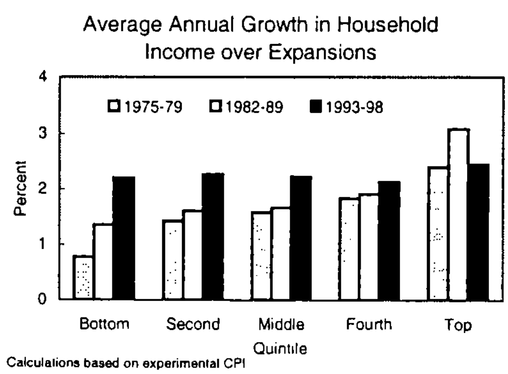
Measuring Income and Poverty

The latest statistics on income and poverty show excellent progress since 1993. Median family income adjusted for inflation is at an all-time high and the poverty rate is lower than it has been at any time since 1979. In some ways, the gains would be even more impressive if the official measures better reflected methodological improvements in measuring inflation and poverty.

Adjusting for inflation. The Census Bureau currently uses a variant of the official consumer price index to adjust its historical money income series for inflation. This variant, the CPI-U-X1, incorporates revisions to the treatment of homeownership made by the Bureau of Labor Statistics in 1983 into the CPI for the earlier 1967-82 period. This year the BLS has introduced another experimental variant, the CPI-U-RS, which incorporates most of the other improvements in its methodology made over the 1978-98 period into the CPI for that period. Using this index to adjust for inflation would add 0.2 percentage point to the average annual growth rate of income since 1993.

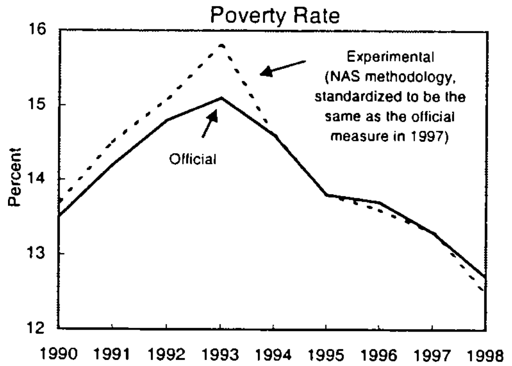
Trends and cycles in the growth of household income. Officially, real median household income did not surpass its 1989 level until 1998, and the average income of the bottom fifth of the distribution has barely edged above its 1989 level. Using the experimental CPI, median household income is now 5.5 percent higher than it was in 1989 and the average income of each fifth of the distribution has surpassed its 1989 level. Nevertheless, income grew most slowly at the bottom of the distribution in both the 1979-89 and 1989-98 periods (see upper chart).





A hopeful sign that the stagnation of median income and the rise in inequality that characterized the 1973-93 period may be over can be seen in the growth of income since 1993. In each fifth of the distribution, growth in real income exceeded 2 percent per year (using the experimental CPI) and growth was fairly uniform across the distribution (see lower chart). The strength and balance of this expansion surpass those of the other two expansions shown in the chart (except for the growth in the richest fifth in the 1982-89 expansion).

A better measure of poverty? In addition to its official calculation of the poverty rate, the Census Bureau has begun to publish an experimental measure that incorporates improvements recommended in a 1995 National Academy of Sciences (NAS) report. The chart compares the official poverty rate with the experimental measure based on the NAS methodology (standardized to be the same as the official rate in 1997). The experimental measure shows a larger decline than the official measure both between 1997 and 1998 and since 1993. In part, this reflects the fact that the alternative measure reflects the EITC while the official measure does not.



Conclusion. Improving Federal statistics is an ongoing process, and the statistical agencies are cautious about making changes. However, the incorporation of improved methodologies is critical to achieving an accurate picture of the economy and in the case of the income and poverty numbers would strengthen the evidence that the strong economy is raising income and reducing poverty.

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

Ethnic Gap in College Graduation. While native-born Hispanics and blacks have increased high school graduation rates, they have made little progress in closing the gap between their college graduation rates and those of non-Hispanic whites and Asians. Moreover, the share of Hispanics in the school-age population is growing. This share is expected to double from 1990 levels, reaching 20.8 percent in 2015. Researchers at the Rand Corporation have estimated that despite the increase in the share of minorities, the educational attainment of those 25 years and older will grow, in part because older, less-educated people will be replaced by younger more-educated cohorts. Nevertheless, the college graduation gap between Hispanics and blacks, on the one hand, and non-Hispanic whites, on the other, is projected to grow between 1990 and 2015. The report argues that the nation as a whole may suffer if this increasingly large population is not provided with the tools needed to succeed in a changing economy.

Transactions Services Compose a Significant Portion of Banks' Revenue. A substantial percentage of banks' revenue comes from transactions services, according to a study by the Federal Reserve Bank of New York. Transactions services include the safekeeping, administering, reporting on and transferring of money in deposit accounts, the transfer of money related to credit cards, as well as securities processing. Revenue from transactions services comes from fees (such as ATM surcharge fees, deposit account and credit card fees, and hidden fees such as the fee the merchant pays for accepting a debit or credit card). But it also comes from foregone interest on deposit accounts and high interest rates on credit cards, which substitutes for higher explicit fees. All told, transactions services contribute as much as $59.2 billion, or 42.2 percent, to the combined operating revenue of the 25 largest bank holding companies. The study concludes that transactions services constitute a significant activity of banks, and that lending activities contribute less revenue than is commonly believed.

A Shrinking Portion of the Safety Net. General Assistance (GA) programs, which are financed by states and localities, provide income or in-kind support to people ineligible for Federal cash assistance (such as SSI or TANF). A recent study notes that these programs have contracted considerably over the last decade, continuing a trend that began in the 1980s. State GA programs for able-bodied adults without dependent children, which traditionally provide the only source of cash support for these individuals, have suffered the sharpest cutbacks. In 1989, 25 states provided GA for this group, while in 1998 only 13 states provided such assistance. In Michigan, for example, 82,000 recipients lost benefits when the state terminated its GA program for able-bodied adults without dependent children in 1991. GA programs for disabled, elderly, and unemployed individuals suffered moderate cutbacks between 1989 and 1998, and states have also restricted benefits to immigrants.

EYES ONLY

INTERNATIONAL ROUNDUP

Mergers Drive FDI in 1999. Cross-border mergers and acquisitions (M&As) were the driving force behind a record volume of foreign direct investment (FDI) by the developed countries in 1998, according to UNCTAD's *World Investment Report 1999*. FDI outflows from developed nations rose 46 percent to $595 billion in 1998, as cross-border M&As shot up 74 percent to $411 billion. These developments underscore the emergence of an international production system through FDI with transnational corporations (TNCs) at its core. 60,000 TNCs account for an estimated 25 percent of global output. Sales by foreign affiliates of TNCs grew by 17.5 percent to reach $11 trillion in 1998, and such sales have consistently exceeded the value of world exports ($7 trillion in 1998), making international production globally more important than trade in delivering goods and services to foreign markets. The large FDI outflows by developed countries did not translate into commensurate FDI inflows for developing countries, as inflows declined 4 percent in 1998, compared with a 68 percent increase in inflows to developed countries.

Investment in Knowledge Increasing in OECD. OECD countries spend roughly as much on intangible, knowledge-based investments as on machinery and equipment, according to the new OECD report, *OECD Science, Technology, and Industry Scoreboard 1999*. Knowledge-based investment, defined as spending on research and development, software, and public education, averaged 8 percent of GDP across the OECD in 1995. Between 1985 and 1995, investment in knowledge grew 2.8 percent per year on average in OECD countries (slightly higher than GDP growth), with growth the highest in Nordic countries, Japan, and the United States. U.S. investment in knowledge grew 3.1 percent per year, far outpacing physical investment, which grew 1.9 percent per year. Knowledge-based industries, which include high and medium technology manufacturing, finance, insurance, communications, and some other services, composed more than 50 percent of OECD business value-added in the mid-1990s, up from 45 percent in the mid-1980s. The U.S. knowledge-based industry had the second highest relative share of real business value-added of all OECD countries (after Germany) in 1996, although its growth was actually slightly below the OECD average from 1985 through 1996.

The WTO and Developing Countries. At a joint conference on "Developing Countries and the Millennium Round" held by the WTO and the World Bank in Geneva last week, economists and policymakers pointed to significant gains for developing countries from further liberalization of trade in agriculture, manufactured goods, and services. However, they also emphasized that the gains are not automatic, and that full realization of the potential gains requires that the next WTO round reflect the capacities and concerns of these countries. More progress should be made in areas where many developing countries have a special interest, such as agriculture and construction services, and negotiations should be sensitive to the special needs of the developing countries, as they might not have the technical capacity or regulatory framework to implement WTO commitments.

EYES ONLY

RELEASES THIS WEEK

NAPM Report on Business

****Embargoed until 10:00 a.m., Friday, October 1, 1999****

The Purchasing Managers' Index rose 3.6 percentage points in September to 57.8 percent. (A reading above 50 percent indicates that the manufacturing economy is generally expanding.)

Gross Domestic Product

According to revised estimates, real gross domestic product grew at an annual rate of 1.6 percent in the second quarter.

Advance Durable Orders

Advance estimates show that new orders for durable goods rose 0.9 percent in August, following an increase of 4.0 percent in July.

Consumer Confidence

Consumer confidence, as measured by The Conference Board, fell 1.8 index points in September, to 134.2 (1985=100).

MAJOR RELEASES NEXT WEEK

Leading Indicators (Tuesday)
Employment (Friday)

EYES ONLY

U.S. ECONOMIC STATISTICS

	1970-1993	1998	1998:4	1999:1	1999:2
Percent growth (annual rate)					
Real GDP (chain-type)	2.7	4.3	6.0	4.3	**1.6**
GDP chain-type price index	5.4	0.9	0.8	1.6	**1.3**
Nonfarm business (NFB) sector:					
Productivity (chain-type)	1.5	2.6	4.1	3.6	0.6
Real compensation per hour:					
Using CPI	0.6	2.5	2.0	2.9	1.5
Using NFB deflator	1.3	3.7	3.4	3.0	3.7
Shares of Nominal GDP (percent)					
Business fixed investment	10.9	11.0	11.0	11.0	11.2
Residential investment	4.5	4.3	4.5	4.6	4.7
Exports	8.2	11.3	11.3	10.9	11.0
Imports	9.2	13.0	13.1	13.2	13.7
Personal saving	5.2	0.3	-0.0	-0.5	-0.9
Federal surplus	-2.7	0.9	0.8	1.4	1.6

	1970-1993	1998	June 1999	July 1999	August 1999
Unemployment Rate (percent)	6.7**	4.5**	4.3	4.3	4.2
Payroll employment (thousands)					
increase per month			281	338	124
increase since Jan. 1993					19403
Inflation (percent per period)					
CPI	5.8	1.6	0.0	0.3	0.3
PPI-Finished goods	5.0	0.0	-0.1	0.2	0.5

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

New or revised data in **boldface**.

EYES ONLY

FINANCIAL STATISTICS

	1997	1998	August 1999	September 1999	Sept. 30, 1999
Dow-Jones Industrial Average	7441	8626	10935	10714	10337
Interest Rates (percent per annum)					
3-month T-bill	5.06	4.78	4.72	4.68	4.74
10-year T-bond	6.35	5.26	5.94	5.92	5.90
Mortgage rate, 30-year fixed	7.60	6.94	7.94	7.82	7.70
Prime rate	8.44	8.35	8.06	8.25	8.25

INTERNATIONAL STATISTICS

Exchange Rates	**Current level September 30, 1999**	**Percent Change from** Week ago	Year ago
Euro (in U.S. dollars)	1.064	2.2	N.A.
Yen (per U.S. dollar)	106.8	2.5	-21.8
Major currencies index (Mar. 1973=100) (trade-weighted value of the U.S. $)	92.56	-0.2	-4.4

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	3.9 (Q2)	4.2 (Aug)	2.3 (Aug)
Canada	3.7 (Q2)	7.7 (Jul)	2.1 (Aug)
Japan	1.1 (Q2)	4.9 (Jul)	-0.1 (Jul)
France	2.1 (Q2)	11.3 (Jun)	0.5 (Aug)
Germany	0.6 (Q2)	7.1 (Jul)[2]	0.6 (Aug)
Italy	0.8 (Q2)	12.1 (Apr)	1.7 (Aug)
United Kingdom	1.4 (Q2)	6.1 (May)	1.1 (Aug)

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 former West Germany. Using OECD standardized unemployment data, the unemployment rate for unified Germany for July was 9.1 percent.

EYES ONLY

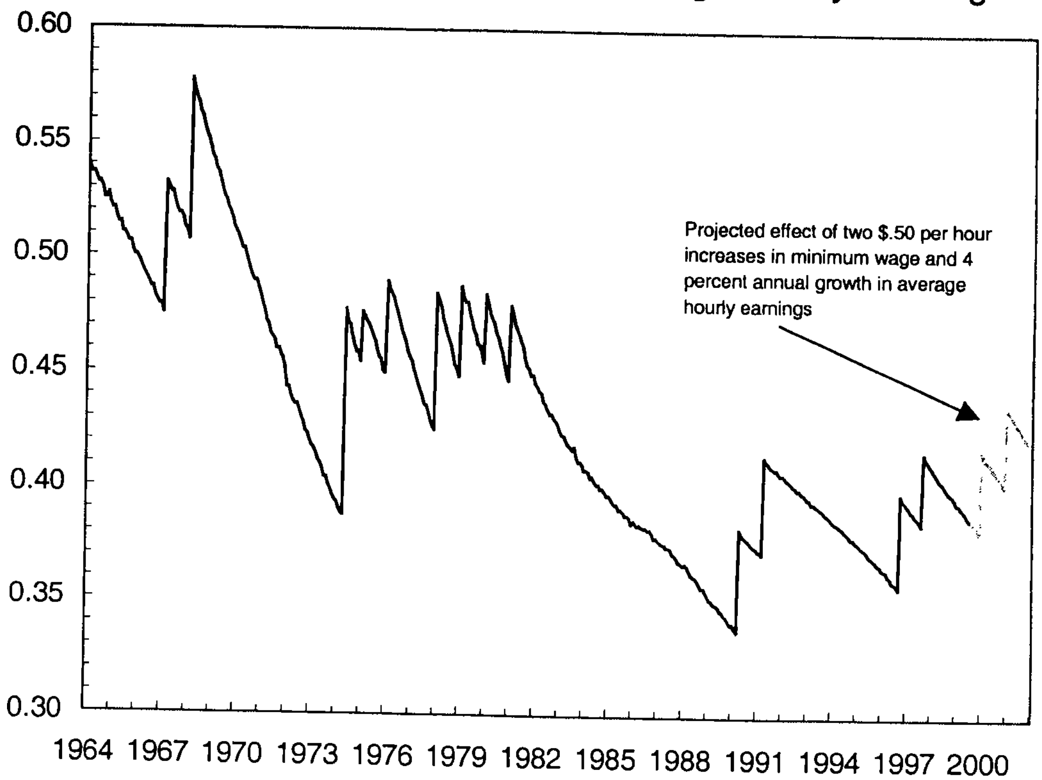
WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

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

September 24, 1999

CHART OF THE WEEK

Ratio of the Minimum Wage to Average Hourly Earnings



Between the late 1960s and the late 1980s, the minimum wage fell from over 55 percent of average hourly earnings to less than 35 percent of average hourly earnings. Increases in the minimum wage in the 1990s twice pushed this ratio to about 40. The chart shows that two $.50 per hour increases in 2000 and 2001 (along with 4 percent annual growth in average hourly earnings) could push the ratio above recent peaks—though it would start to decline again with continued growth in average hourly earnings.

EYES ONLY

CONTENTS

"Gentlemen, it's time we gave some serious thought to the effects of global warming."

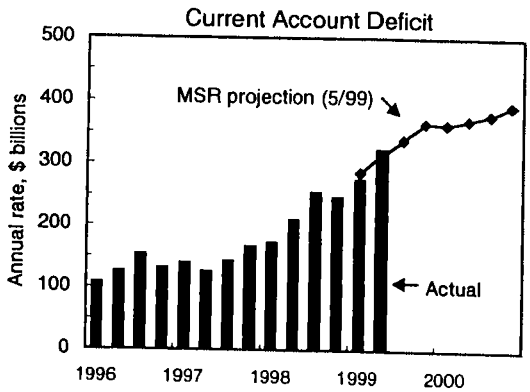
EYES ONLY

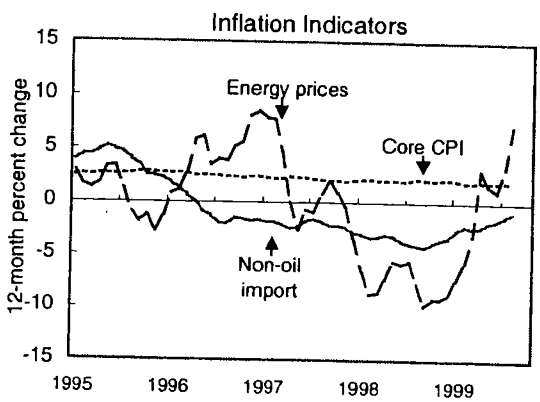
MACROECONOMIC UPDATE

Third Quarter Should Be Strong

Labor market and consumption indicators point to an acceleration of GDP in the third quarter.

Output and demand. Production-worker hours appear to be growing at a 3½ percent annual rate in the third quarter, enough to support about 4 percent real GDP growth. Consumption, which constitutes two-thirds of GDP, appears to be growing at about a 4 percent rate. In addition, orders for capital goods appear strong, and stockbuilding probably will boost third-quarter demand.





Leakage abroad. Some of this robust demand is being met with imports. Over the past year, nominal imports have increased substantially more than exports, a consequence of stronger growth here than among our trading partners and a legacy of a rising dollar from 1995 to 1998. The second-quarter erosion of the current-account deficit had been anticipated in the unpublished detail underlying the Mid-Session Review projection, and the deficit is expected to widen further over the next year-and-a-half (see upper chart).

Inflation. The rate of core consumer price inflation has been well contained at only 1.9 percent for the 12 months through August—down from 2.2 percent during the year-earlier period (adjusted for consistent methodology). However, two of the factors holding down inflation over the past year (falling energy and non-oil import prices) are no longer playing that role (see lower chart). Energy prices have skyrocketed since February, while import prices stopped falling in April. Although rising energy prices may get passed through to prices of other core items, surveys of inflation expectations have remained stable.

EYES ONLY

SPECIAL ANALYSIS

Hot Economy, Cool Emissions?

Historically, U.S. carbon dioxide (CO_2) emissions have grown about ¾ percent for every 1 percent increase in real GDP. In 1998, however, CO_2 emission increased only 0.4 percent while GDP grew 3.9 percent. CEA analysis suggests that this slow emissions growth in 1998 can be explained by the strong contribution to growth of high-tech (low emissions) industries and a warm winter. Improvements in technology do not appear to have been unusually large.

Factors influencing emissions. In general, a variety of factors besides growth in aggregate output can affect carbon dioxide emissions, notably the following:

- Structural change. The U.S. economy continues to experience a shift in output away from traditionally energy-intensive manufacturing sectors towards service and high-tech industries.

- Weather. Colder winters increase the demand for heating fuels and hotter summers increase the demand of electricity for cooling. Because heating on a cold day is more energy-intensive than cooling on a hot day, on balance, a warmer year tends to reduce energy use.

- Energy prices. Sharp energy price increases stimulate energy efficiency and reduce CO_2 emissions while sharp energy price decreases can result in higher energy consumption and CO_2 emissions.

- Technological change. Technological improvements can result in reducing the energy consumption necessary to generate a unit of output. Higher energy prices can accelerate the diffusion of more energy-efficient technologies, and government programs aimed at promoting energy efficiency may also facilitate technology diffusion.

What happened in 1998. Output in non-high-tech industries grew just 2.2 percent in 1998—less than the 3.9 percent increase in aggregate GDP and less than the 3.0 percent per year long-term trend rate of growth for this group of industries. This slow growth reflected not only the longer-term shift toward a more high-tech and service economy but also the weakness of several energy-intensive industries, such as steel. Weather, too, played a role in moderating energy use. The 1998 winter was 11 percent warmer than the previous winter. The 1998 summer was also warmer than the previous year's, but the increased emissions from more summer cooling were less than the reduced emissions from less winter heating. Finally, residential energy prices changed little between 1997 and 1998.

In CEA's statistical model of how structural change, weather conditions, and energy prices influenced U.S. CO_2 emissions over the 1962-1998 period, predicted levels of CO_2 emissions were on average within 1 percent of actual emissions. The level of 1998 emissions predicted by the model was very close to (0.1 percent lower than) actual 1998 emissions. This suggests that omitted variables such as short-term technological change were not important determinants of the 1998 decline in emissions.

Conclusion. The continuing transition towards a less energy-intensive high-tech economy and a mild winter resulted in slow CO_2 emissions growth in 1998. Short-term technological improvements did not appear to have a significant effect.

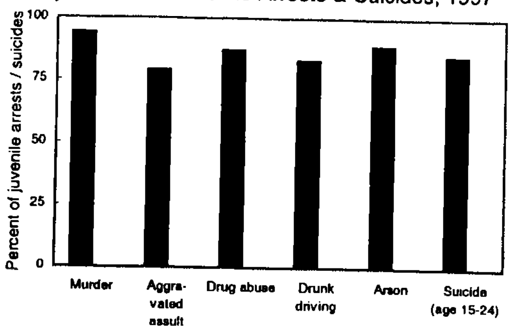
EYES ONLY

ARTICLE

"Reviving Laertes:" Recent Studies of Boys' Development

After a decade of influential studies on the development of girls, including the 1992 report *How Schools Shortchange Girls* and the 1994 book *Reviving Ophelia*, several recent studies have focused on boys. One important reason not to neglect the development of Ophelia's brother is that socially costly problems of crime and violence remain overwhelmingly problems of boys and men.

Boys' Share of Juvenile Arrests & Suicides, 1997



Crime and suicide. Juveniles arrested for property and violent crimes are overwhelmingly boys (see chart). Male students are substantially more apt to fight at school or to carry a weapon than female students in high school. And the suicide rate of young men aged 15 to 24 is more than five times that of young women that age.

The economic costs of crime and violence arise not only from the financial costs to victims but also from the loss of productive work arising from time spent in criminal activity and premature death. For example, the Justice Department's 1999 national report on juvenile offenders and victims estimates that the cost of a youth's dropping out of high school for a life of crime and drug abuse is between $1.7 and $2.3 million (in present value terms). This figure includes drug treatment and rehabilitation costs, medical costs, criminal justice costs, and victim costs, as well as the value of lost wages and output.

Insights from beyond the dismal science. One sociological insight into boys' greater involvement in crime and violence comes from *Raising Cain*, a recent book co-authored by a professor of public health at Harvard and a child psychologist. The book concludes that above and beyond the role of biology, differences between boys and girls are amplified by a culture that supports emotional development for girls and discourages it for boys. In particular, stereotypical notions of masculine toughness limit boys development of a full range of emotional resources, mitigating an "emotional literacy" needed to read and understand their emotions and those of others. The result, it argues, is that many boys are left to manage conflict, adversity, and change with a limited emotional repertoire, in turn leading to a higher propensity toward conflict and violence.

Conclusion and implications. Recently, researchers have shown an interest in the problems of boys. Besides crime and violence, these include school performance and, to some extent, self-esteem (see box on next page). In the future, the new research, combined with more standard economic analysis of the role of factors like family income and poverty status, might help in the design of policies to address problems such as the higher average crime rates and lower average educational attainment of African American boys relative to other boys.

Addressing the problems of boys is also one way to improve the future outcomes of men. With respect to fatherhood, for example, preliminary evidence finds that "emotionally illiterate" boys are more likely to become uninvolved fathers when they are adults. In addition, results from the 1999 National Survey of American Attitudes on Substance Abuse suggest the importance of healthy father-son relationships. It finds in two-parent families that a teenager whose relationship with the father is fair or poor is 68 percent more likely to smoke, drink, and use drugs than one whose relationship is average.

Developmental Differences between Boys and Girls

Besides findings on criminal and violent behavior, recent research has re-examined two other aspects of possible differences in boys' and girls' development that were raised in the earlier research on girls.

- School performance. Boys are more than twice as likely as girls to have a learning disability and two to three times more likely to have an attention deficit problem. From grade school to graduate school, females earn higher grades, on average—even in mathematics and sciences. In high school, girls now equal or outnumber boys in science classes, on average, except for physics. Differences in standardized test scores are small, with females scoring higher in writing ability and reading achievement and males scoring higher in science and mathematics (a gap that is shrinking). Men are a minority of college students (45 percent in 1995) and earn less than half of bachelor's and master's degrees.

- Self-esteem. *Raising Ophelia* argued that girls suffer a severe drop in self-esteem at adolescence, while boys gain in self-assurance as they age. Subsequent, more comprehensive research has revealed a less dramatic gap in self-esteem between genders. For example, a 1997 report found that girls had the advantage over boys in terms of future plans, teachers' expectations, and everyday experiences in school and in the classroom, with minority boys the most likely to feel discouraged about the future and the least interested in getting a good education. A recent study of self-esteem summarizes over 150 previous findings and concludes that males score higher on standard measures of self-esteem than females, but that the differences are small.

EYES ONLY

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

Beige Book Reports Continued Overall Strength. All Federal Reserve district economies continue to exhibit overall strength, with most experiencing moderate-to-brisk rates of growth, according to the Fed's latest summary of commentary on current economic conditions. Retail sales are generally up in most districts, with back-to-school sales meeting or exceeding retailers' expectations in many cases. Vehicle sales remain robust, with some dealers unable to meet demand for popular models. Industrial activity is on the rise in most parts of the country, with orders and production both up. In some cases, resurgent Asian demand is contributing to this rise in activity. Although commentary from most district reports continues to highlight widespread labor shortages, several districts have noted a slackening in the demand for labor. There are few reports of acceleration in nominal wages and salaries, although some districts note a substantial upswing in the cost of health-care benefits. While price pressures at the consumer level remain mostly calm, numerous districts report significant increases in some materials prices. Home sales and construction remain elevated, but many districts have begun to notice a slowdown. The recent drought has worsened crop and livestock conditions in the East and parts of the Midwest.

Many Workers Know Little about Their Pensions. A recent study found that a large percentage of Americans are unaware of basic details concerning their pensions. Only half of the study's respondents correctly identified their pension type. Fewer than half (43 percent) knew, within a year, the eligible date for their early retirement and only 40 percent knew, within a year, the date for normal retirement. According to company data, two-thirds of the respondents will be able to take early retirement by age 55, yet less than half of them think they will be able to do so. Respondents were also confused about the value of their pensions. The researchers expressed concern that many respondents approaching retirement may not be reacting to the correct information, and may be making their decisions based on a faulty understanding of their retirement programs.

Is the Stock Market Undervalued? The authors of the new book *Dow 36,000* argue that the stock market is currently *undervalued* and that the Dow will rise to 36,000 within 3 to 5 years (compared with today's level of less than 10,500). They cite a study showing that over periods of 20 or more years, a well-diversified equity portfolio is no riskier than an investment in bonds. In their view, investors are catching on fast and will continue to bid up stock prices until the "equity premium"—the excess of stock returns over bond returns—disappears. Although the large size of the equity premium historically (an average of 6.6 percent from 1926-1997, by one estimate) has been a puzzle to most economists, the authors' argument that it will fall to zero has been greeted with skepticism. To the extent that many investors are concerned about short-term fluctuations in stock prices, they may rationally demand some risk premium to compensate for the risk they are taking.

EYES ONLY

INTERNATIONAL ROUNDUP

Bank of Japan Asserts Its Independence. The Bank of Japan announced on Tuesday that, despite the recent strengthening of the yen, it would not increase Japan's money supply. The announcement, which came immediately after the latest Monetary Policy Meeting, emphasized the central bank's independence and that its policies were never determined in consultation with outside bodies. This announcement was widely seen as rebuking the Ministry of Finance, which reportedly was urging actions to prevent the yen from climbing. An implication of the Bank's announcement is that any intervention in the foreign exchange market would be "sterilized," so that any change in the supply of yen due to the intervention would be offset by other operations in order to keep the money supply unchanged. Foreign exchange interventions are generally more effective if the central bank allows the supply of currency to change. The Ministry of Finance has reportedly been seeking support from other countries for a coordinated intervention in the foreign exchange market. The Bank's announcement appears to make such intervention more difficult. It also seems to have been the cause of an immediate sharp rise in the yen and a sharp drop in the Japanese stock market when it opened the next day.

China Considers Liberalizing Trade in Grains. In a paper for a recent OECD workshop on agriculture, the Vice Director-General of the Chinese State Development Planning Commission urged China to modify its long-held policies supporting a high level of self-sufficiency in grain supply. The paper cites a number of problems associated with that policy, including ecological damage; high costs, which reduce benefits to farmers and increase costs to the government and consumers; and adverse consequences for trade relations, as current self-sufficiency policies oblige the government to impose high protective tariffs that violate WTO rules. The paper recommends that China's grain self-sufficiency decline to 90 percent within the next 30 years and advocates a number of adjustments to current Chinese protective trade policies, including lowering import tariffs and eliminating the state monopoly on grain imports and exports.

OECD Assesses Implementation of Jobs Strategy. Countries that have taken substantial steps to implement the OECD's Jobs Strategy have seen employment gains, according to a new OECD assessment. The report finds, however, that youth, older workers, and the low-skilled still face poor employment prospects and a low quality of available jobs in most OECD countries. It finds that countries that have been more successful in achieving a smooth transition from school to work for those with poor qualifications focus on providing them with recognized vocational qualifications and reinsertion programs for school drop-outs. The report also notes several adverse consequences of policies that had tended to increase incentives for early retirement in many countries. While recent pension reforms have typically addressed these incentives by strengthening the link between lifetime contributions and pension benefits, most OECD countries still have other programs, such as unemployment insurance or disability benefits, with adverse employment incentives.

EYES ONLY

RELEASES THIS WEEK

U.S. International Trade in Goods and Services

The goods and services trade deficit rose to $25.2 billion in July from $24.6 billion in June.

MAJOR RELEASES NEXT WEEK

Consumer Confidence—Conference Board (Tuesday)
Advance Durable Shipments and Orders (Wednesday)
Gross Domestic Product (Thursday)
NAPM Report on Business (Friday)

EYES ONLY

U.S. ECONOMIC STATISTICS

	1970-1993	1998	1998:4	1999:1	1999:2
Percent growth (annual rate)					
Real GDP (chain-type)	2.7	4.3	6.0	4.3	1.8
GDP chain-type price index	5.4	0.9	0.8	1.6	1.5
Nonfarm business (NFB) sector:					
Productivity (chain-type)	1.5	2.6	4.1	3.6	0.6
Real compensation per hour:					
Using CPI	0.6	2.5	2.0	2.9	1.5
Using NFB deflator	1.3	3.7	3.4	3.0	3.7
Shares of Nominal GDP (percent)					
Business fixed investment	10.9	11.0	11.0	11.0	11.2
Residential investment	4.5	4.3	4.5	4.6	4.7
Exports	8.2	11.3	11.3	10.9	11.0
Imports	9.2	13.0	13.1	13.2	13.7
Personal saving	5.2	0.3	-0.0	-0.5	-0.9
Federal surplus	-2.7	0.9	0.8	1.4	1.6

	1970-1993	1998	June 1999	July 1999	August 1999
Unemployment Rate (percent)	6.7**	4.5**	4.3	4.3	4.2
Payroll employment (thousands)					
increase per month			281	338	124
increase since Jan. 1993					19403
Inflation (percent per period)					
CPI	5.8	1.6	0.0	0.3	0.3
PPI-Finished goods	5.0	0.0	-0.1	0.2	0.5

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

EYES ONLY

FINANCIAL STATISTICS

	1997	1998	July 1999	August 1999	Sept. 23, 1999
Dow-Jones Industrial Average	7441	8626	11052	10935	10319
Interest Rates (percent per annum)					
3-month T-bill	5.06	4.78	4.55	4.72	4.69
10-year T-bond	6.35	5.26	5.79	5.94	5.87
Mortgage rate, 30-year fixed	7.60	6.94	7.63	7.94	7.76
Prime rate	8.44	8.35	8.00	8.06	8.25

INTERNATIONAL STATISTICS

Exchange Rates	**Current level September 23, 1999**	**Percent Change from Week ago**	**Percent Change from Year ago**
Euro (in U.S. dollars)	1.042	-0.0	N.A.
Yen (per U.S. dollar)	104.2	-0.9	-23.6
Major currencies index (Mar. 1973=100) (trade-weighted value of the U.S. $)	92.79	-0.3	-4.6

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	3.9 (Q2)	4.2 (Aug)	2.3 (Aug)
Canada	3.7 (Q2)	7.7 (Jul)	2.1 (Aug)
Japan	1.1 (Q2)	4.9 (Jul)	-0.1 (Jul)
France	2.1 (Q2)	11.3 (Jun)	0.3 (Jun)
Germany	0.6 (Q2)	7.1 (Jul)[2/]	0.6 (Jul)
Italy	0.8 (Q2)	12.1 (Apr)	1.7 (Aug)
United Kingdom	1.4 (Q2)	6.1 (May)	1.1 (Aug)

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 former West Germany. Using OECD standardized unemployment data, the unemployment rate for unified Germany for July was 9.1 percent.

EYES ONLY

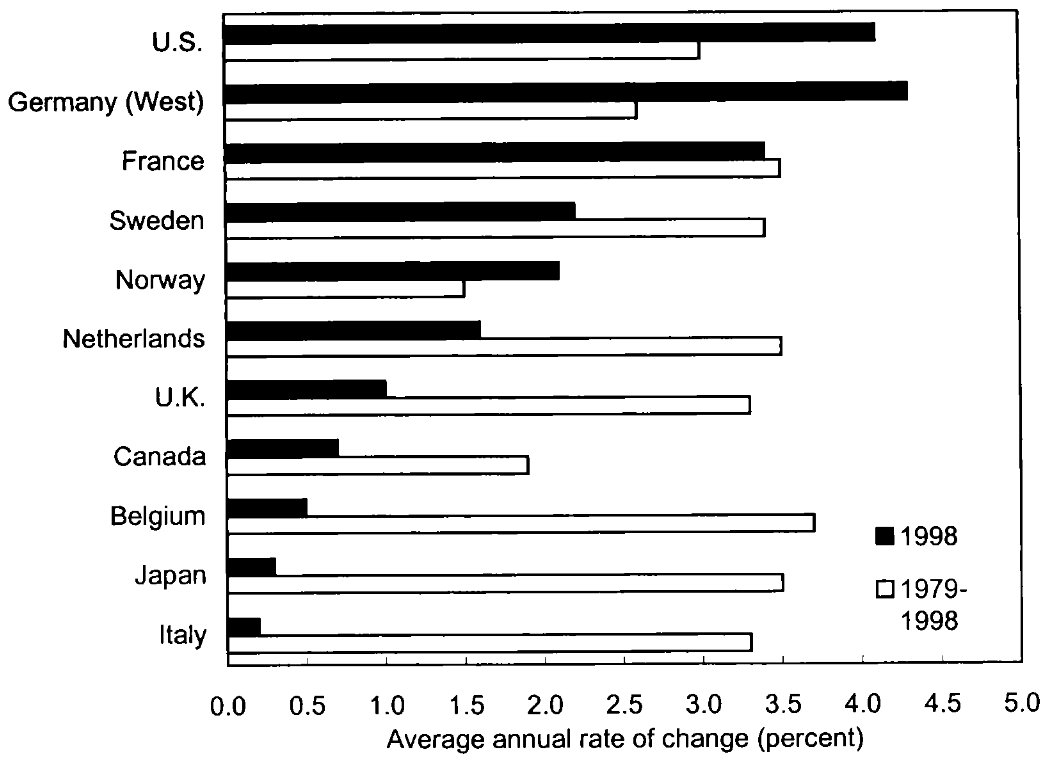
WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

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

September 17, 1999

CHART OF THE WEEK

Manufacturing Productivity Growth in Selected Countries



The latest international comparisons of manufacturing productivity from the Bureau of Labor Statistics show that labor productivity in U.S. manufacturing increased 4.1 percent in 1998, second only to Germany's 4.3 percent. The United States and Germany (together with Norway) were also the only countries to achieve faster growth in 1998 than their long-term trend growth rate. (The U.S. output series used for international comparisons is different from the one used in the standard quarterly series on productivity and costs.)

EYES ONLY

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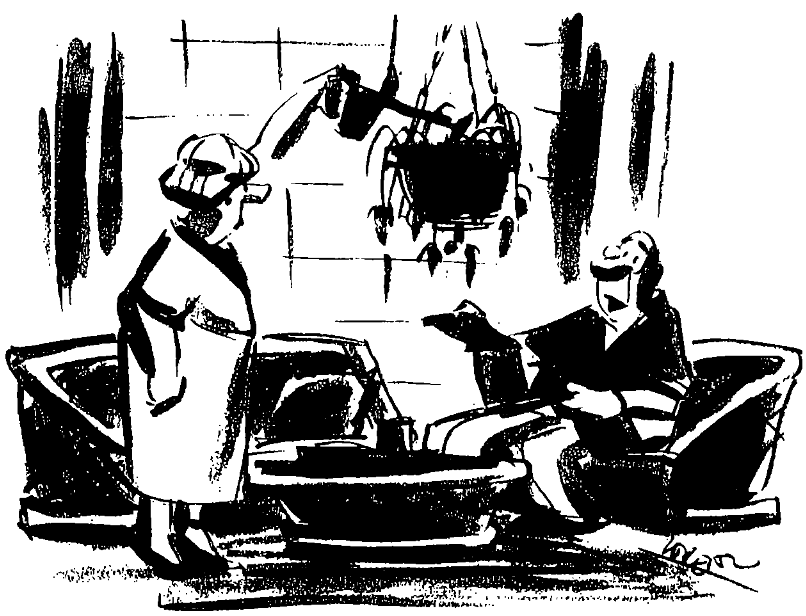


"Is this the year, Pumpkin? Goodbye, love boat, hello, elder hostel?"

EYES ONLY

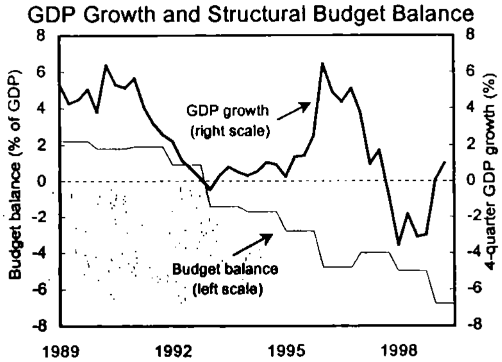
CURRENT DEVELOPMENT

Has Japan Turned the Corner?

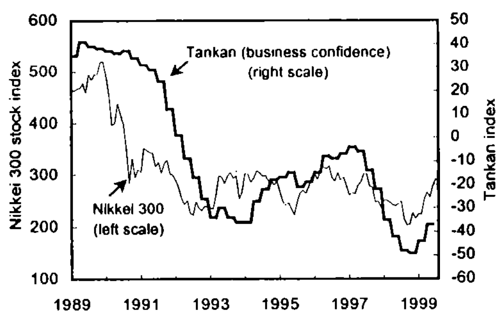
Japanese real GDP growth has recovered strongly in 1999 (see upper chart), following the longest downturn since the war. Despite hopeful signs, however, macroeconomic and structural concerns suggest a need for continued caution.

Slowdown, decline, and rebound. Despite a brief upward blip in 1996, Japan has suffered lackluster economic performance throughout the 1990s. Faced with rising budget deficits, Japan implemented a sharp fiscal consolidation in 1997. But this coincided with the onset of the Asian financial crisis and the collapse of several major financial institutions. The country plunged into recession.

GDP Growth and Structural Budget Balance



Stock Market and Business Confidence Indexes



Despite the large budget deficit, Japan implemented a major fiscal stimulus package in late 1998. Monetary policy became more aggressive in early 1999, as already low short-term interest rates were cut to virtually zero. Structural reforms may also have helped the recovery. For example, Japan has put in place a comprehensive framework to deal with banking weaknesses, and announced a package of tax and regulatory measures to promote corporate restructuring. These steps may have contributed to a recent surge in stock prices and an improvement in (the still low levels of) business confidence in 1999 (see lower chart).

Risks remain. Japan is not necessarily out of the woods. For example, public investment boosted demand in late 1998 and early 1999, but declined in the second quarter and would be a drag on growth if it returns to normal levels as proejcted. Residential investment surged in the second quarter, reflecting tax breaks, but its rapid pace is not sustainable. In addition, non-residential investment remains weak, and yen strength could curtail net exports.

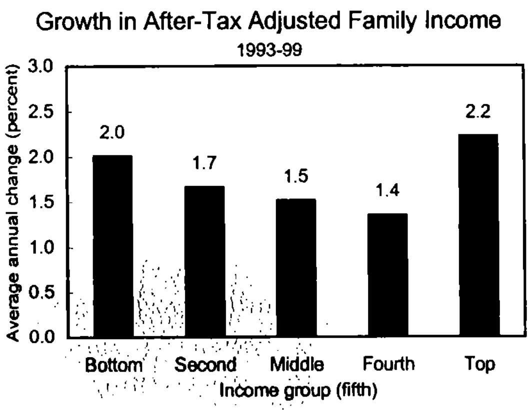
Observers also point to the need to further strengthen the financial system, encourage corporate restructuring, increase labor mobility, and accelerate deregulation. Without continuing structural reforms, combined with appropriate fiscal and monetary policy, Japan runs the risk that rising growth will turn out to be transitory. After all, Japan has already had a previous, sharp recovery of growth—which, unfortunately, ended abruptly with the recession of 1997 and 1998.

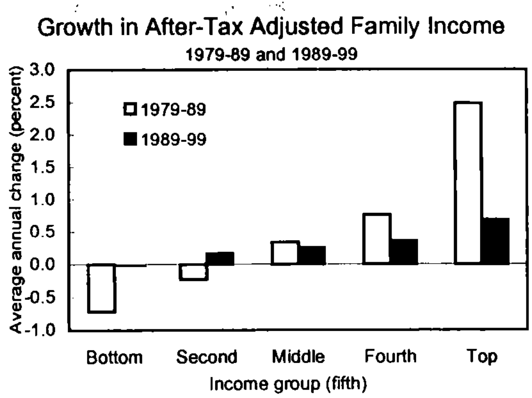
SPECIAL ANALYSIS

The Distribution of Family Income

In the current long economic expansion, labor market outcomes and family incomes have improved for traditionally disadvantaged groups. Income inequality, by contrast, has remained relatively high.

A rising tide... Since the economy began to pick up steam in 1993, growth in after-tax family income (adjusted for family size) has been strongest in the top and bottom fifths of the distribution, but it has also been solid in the middle (see upper chart). The chart is based on Congressional Budget Office calculations in which each family's income is expressed relative to the poverty rate for a family of its size. It includes CBO estimates for 1999.





...but a dragging anchor. While the strong growth in family income at the bottom of the distribution during this expansion is encouraging, overall growth since since 1989 (the last high-employment year in the previous expansion) has been less so. The largest gains in after-tax adjusted family income have come at the top of the distribution, while the income of the bottom fifth of families remained the same (see lower chart).

This pattern is similar to, but not so severe as, the pattern that prevailed in the 1980s. One reason is that changes in Federal taxes in the 1980s aggravated income inequality, while they have ameliorated it in the 1990s. It is also possible that some of the growth in the current expansion represents an improvement in the long-term trend—though we are still far from the 1948-73 trend, when strong productivity and real wage growth contributed to an approximate doubling of average family income and the gains were shared up and down the distribution.

Conclusion. Official Census Bureau statistics on money income and poverty for 1998 are due to be released at the end of this month. While the Census Bureau, unlike the CBO, does not adjust for taxes or family size, its data are likely to reveal the same trends as the CBO estimates: rising incomes in this expansion but not yet to levels substantially above previous peaks at lower income levels. Evidence on whether long-term trends in inequality may have improved is likely to be inconclusive.

EYES ONLY

SPECIAL ANALYSIS

Privatization of Air Traffic Control in Canada

Recently, U.S. fliers have experienced delays attributable to air traffic control, raising questions about whether the delivery of air navigation services could be improved. Canada's experience with a privatized air traffic control system may provide a useful perspective on this issue.

The decision to privatize. In 1996, Canada transferred the authority to run its air traffic control system to a non-profit private company, Nav Canada. One of the important benefits for Canada from privatization was the ability of the new corporation to raise the funds necessary for long-term capital improvements. Another benefit was separating the role of regulating safety from that of operating the air traffic control system. Responsibility for safety regulation remained with the government, eliminating any possible conflicts of interest.

Getting started. Nav Canada raised more than $2 billion (Canadian) in debt-based financing to fund its start-up and paid the government $1.5 billion for existing assets and operating rights. Nav Canada covers its costs by charging user fees to airlines and other major users of its services. Any excess funds remaining after covering its costs are returned to the users in the form of lower fees. When the user fee system was implemented, the Canadian government eliminated the Air Transport Tax that had been charged to individual consumers.

Building a better air traffic control system. After beginning operations as a private company, Nav Canada made a series of changes designed to improve customer service. It began by setting aside $600 million to fund capital improvements. In addition, the company has tried to improve safety by hiring and training more controllers to overcome chronic shortages inherited from the government-run system. Nav Canada has also implemented a number of cost-control measures, including streamlining its management structure. Because of lower costs, traffic growth, and a broader base of paying customers, Nav Canada has been able to set its fees below the levels originally anticipated, with the result that customers paid approximately 27 percent less than they would have under the Air Transport Tax.

A user-based governance structure. Although Nav Canada is a privatized monopoly, Canada does not impose direct government regulation of its fee level. Instead, responsibility for setting fees is entrusted to Nav Canada's board of directors, which is composed of representatives drawn from the community that uses its services. Five of the 15 board members are drawn from the commercial and general aviation community, with the remainder being representatives of the government, the unions, and the general public. This board composition allows the users most directly affected by the fees to have a say in both the fees charged and in the programs Nav Canada chooses to undertake to improve customer service.

EYES ONLY

ARTICLE

Asset Transfers and Medicaid Receipt

About 35 percent of 65 year-olds will use a nursing home at some point during the remainder of their lifetimes, according to one estimate. Medicaid is the main source of government support for such care. However, it is a needs-based program and is unavailable to individuals who have not first exhausted their own resources.

Policymakers have been concerned individuals have an incentive to transfer their assets to other family members in order to qualify for support. Past research had found little evidence of such asset shifting, but a recent study, using improved data, finds that those who believe they are more likely to enter nursing homes do indeed transfer assets with greater frequency and in larger amounts than others.

The high cost of care. An average nursing home stay now costs more than $40,000 per year, and many people mistakenly believe that Medicare will cover the costs of their long-term care. In fact, however, nearly 50 percent of the costs of long-term care are paid out-of-pocket by nursing home patients and their families, and most of the remaining costs are borne by *Medicaid*. Because costs are so high, spend-down (the process by which individuals first exhaust their own assets before qualifying for Medicaid) typically occurs very rapidly. Using a sample of Massachusetts residents over age 66, one study estimated that 63 percent of those living alone would become Medicaid-eligible within 13 weeks after entering a nursing home.

Evidence of asset transfers. Previous efforts to examine the extent to which people transfer assets to others as a means of qualifying for Medicaid used data on individuals who were already in nursing homes or were very likely to enter them, and hence whose transfer behavior might already have occurred. (Current rules prohibit the transfer of assets within 3 years of entering a nursing home, the so-called "look back" period.) The new study makes use of a nationally representative survey of individuals above age 70 that contains, among other key information, individuals' assessments of the likelihood that they will enter a nursing home within 5 years and the amount of money already transferred to others. It finds that a household with average net worth and a self-assessed 60 percent probability of entering a nursing home within 5 years will make transfers that are 21 percent higher than a household with average net worth and the average self-assessed probability of entering a nursing home (19 percent). In addition, among those who made transfers of more than $1,000 the average amount transferred was over $6,000.

Costs to Medicaid. The recent research suggests that the cost savings to the Medicaid program could be larger than previously thought. It is estimated that close to 12 million households might transfer assets for the purpose of qualifying for Medicaid. If everyone transferred assets at the same rate as the study population, these 12 million households would make $3.5 billion in transfers, representing 15 percent of Federal Medicaid spending on nursing homes in 1993. Of course, not all of these transfers represent a loss to the Medicaid system since some of the individuals who transfer money to qualify for Medicaid do not actually need nursing home care, and the study suggests that the actual loss to the Medicaid system from these transfers is likely to be less than half of this amount.

Implications. Although the new evidence suggests that asset transfers are large enough to raise Medicaid costs, efforts to control costs by tightening rules regarding transfer behavior have been unpopular. Alternative approaches might examine ways to control rising long-term care costs, increase the availability of long-term care insurance, and create positive incentives for individuals who can afford it to share responsibility for payment.

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

Long-Term Temps Are a Rare Breed. Although popular perceptions may be otherwise, employment in the temporary help services industry is relatively small (about 1 to 2 percent of the labor force). Moreover, only a small fraction of temps represent long-term jobholders, according to a recent analysis of Bureau of Labor Statistics data by a private foundation. In fact, 54 percent of all temps leave their jobs within 6 months. And while 38 percent of new temps cite inability to find a permanent job as their reason for temping, this percentage drops to below 6 percent for those with more than 48 months of tenure. Those with longer tenure are also considerably more likely to prefer their current arrangement. This study emphasizes the positive side of temporary work for some, while previous analyses in the *Weekly Economic Briefing* (November 14, 1997 and September 11, 1998) have also recognized that lower wages and changeable work settings may create problems for other temporary workers.

How Do Layoffs Affect Stock Prices? Layoffs may be getting more attention in the press than they used to, but a recent study finds that the total number of layoff announcements follows the business cycle quite closely. What has changed, according to the study, is the stock market's reaction to layoff announcements: on average, a layoff announcement is more likely to be associated with a rise in the price of the company's stock than it used to be. One possible explanation for this change is that reductions in force designed to improve efficiency are becoming more common relative to those designed to deal with reductions in demand for the company's product. The study found that layoffs associated with reorganization have, in fact, increased dramatically and that the fraction associated with plant closings has declined. It also found that layoffs due to plant closings received a negative stock market reaction while those due to reorganization were generally positively received. However, the authors were more confident in documenting that stock market reactions to layoffs have become less negative over time than they were in attributing this change to any particular cause.

Attending Elite Colleges May Have Little Payoff—Except for Minorities. A new study finds that attending a more selective (higher average SAT score) college does not appear to boost future earnings, contrary to previous findings. The study uses 1995 earnings data for about 14,000 students who entered college in 1976. Because factors affecting college admission may also affect future earnings, the study groups together students who were accepted and rejected from a similar set of schools, and then compares, within groups, the outcomes of those who chose to attend a more selective college with those who chose a less selective one. Post-college earnings were found to be similar for those who attended elite colleges and those who could have, but did not—except for students from more disadvantaged backgrounds, whose earnings were raised by attending a more selective college. An implication of the study is that efforts to attract qualified students from more disadvantaged family backgrounds to elite colleges could improve matching of these students' abilities to their future jobs, without adversely affecting that matching for others, on average.

EYES ONLY

INTERNATIONAL ROUNDUP

Asian Recovery Exceeds Forecasts. After strong first-quarter regional growth of 4.8 percent (relative to year earlier levels), reinforced by continued strong growth in the second quarter, the Asian Development Bank raised its forecasts for most countries in the 14 "Developing Asia" economies. The faster-than-expected recovery in 1999, from 1 percent growth in the last quarter of 1998, has been fueled by domestic demand stimulated by expansionary policies and increased global demand for semi-conductors and electronic products. The implementation of corporate and financial sector reforms has helped raise industrial production and exports in most of the crisis-affected economies and, in many cases, reverse capital outflows. However, the recovery has not been evenly spread, with South Korea, Taiwan, Singapore, the Philippines, and Thailand leading the way, while Hong Kong, Malaysia, and Indonesia are lagging behind. Despite an overall positive forecast, the Asian Development Bank notes several factors that could moderate the effectiveness of the reforms in the region, including debt and structural problems of Korean Chaebols, the slow pace of bank restructuring and consolidation, and the problems associated with China's banking and state-owned enterprise sectors.

Israel Moves Toward ILO Core Labor Standards. Although Israel has made progress in ratifying International Labor Organization core labor standards, progress still needs to be made in order to protect some groups of workers from abuses, according to a WTO-commissioned report by the International Confederation of Free Trade Unions (ICFTU). The report found that, while most Israeli workers are able to exercise their basic trade union rights, the government has at times forced striking workers to return to work in arbitrarily defined "essential" public services. The report also found that significant discrimination against women and Israeli Arabs remains despite legislative improvements in recent years, due in part to lack of resources for enforcement. Also, while child labor is a relatively minor phenomenon, it is reported to be a problem for some groups of the population. The ICFTU recommends that Israel amend its law on the definition of "essential" public services, remove the penalty of forced labor for those engaging in an illegal strike, extend full freedom of association and collective bargaining rights to all workers including those from the West Bank and Gaza, and provide adequate resources for implementing its laws regarding discrimination against women and Israeli Arabs.

UK sees record lows in unemployment, inflation. Unemployment as measured in the United Kingdom fell by 22,300 in August to a 19-year low of 4.2 percent of the workforce. (The unemployment rate approximating U.S. concepts is nearly 2 percentage points higher.) The number of people employed in the UK rose to a record high in the May-July period, increasing by almost 300,000 from the same period last year. Average earnings also increased in July by 4.6 percent, up from 4.4 percent in June. At the same time, inflation fell to its lowest level since the mid-1960s, standing at just over 1 percent.

EYES ONLY

RELEASES THIS WEEK

Housing Starts

****Embargoed until 8:30 a.m., Friday, September 17, 1999****

Housing starts were about unchanged in August at 1.676 million units at an annual rate. For the first 8 months of 1999, housing starts are 5 percent above the same period a year ago.

Industrial Production and Capacity Utilization

The Federal Reserve's index of industrial production rose 0.3 percent in August following an increase of 0.7 percent in July. Capacity utilization rose 0.1 percentage point to 80.8 percent.

Consumer Price Index

The consumer price index increased 0.3 percent in August. Excluding food and energy, consumer prices rose 0.1 percent.

Retail Sales

Advance estimates show that retail sales rose 1.2 percent in August following an increase of 1.0 percent in July. Excluding sales in the automotive group, retail sales rose 0.7 percent following an increase of 0.4 percent.

MAJOR RELEASES NEXT WEEK

U.S. International Trade in Goods and Services (Tuesday)

EYES ONLY

U.S. ECONOMIC STATISTICS

	1970-1993	1998	1998:4	1999:1	1999:2
Percent growth (annual rate)					
Real GDP (chain-type)	2.7	4.3	6.0	4.3	1.8
GDP chain-type price index	5.4	0.9	0.8	1.6	1.5
Nonfarm business (NFB) sector:					
Productivity (chain-type)	1.5	2.6	4.1	3.6	0.6
Real compensation per hour:					
Using CPI	0.6	2.5	2.0	2.9	1.5
Using NFB deflator	1.3	3.7	3.4	3.0	3.7
Shares of Nominal GDP (percent)					
Business fixed investment	10.9	11.0	11.0	11.0	11.2
Residential investment	4.5	4.3	4.5	4.6	4.7
Exports	8.2	11.3	11.3	10.9	11.0
Imports	9.2	13.0	13.1	13.2	13.7
Personal saving	5.2	0.3	-0.0	-0.5	-0.9
Federal surplus	-2.7	0.9	0.8	1.4	1.6

	1970-1993	1998	June 1999	July 1999	August 1999
Unemployment Rate (percent)	6.7**	4.5**	4.3	4.3	4.2
Payroll employment (thousands)					
increase per month			281	338	124
increase since Jan. 1993					19403
Inflation (percent per period)					
CPI	5.8	1.6	0.0	0.3	**0.3**
PPI-Finished goods	5.0	0.0	-0.1	0.2	0.5

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

New or revised data in **boldface**.

EYES ONLY

FINANCIAL STATISTICS

	1997	1998	July 1999	August 1999	Sept. 16, 1999
Dow-Jones Industrial Average	7441	8626	11052	10935	10737
Interest Rates (percent per annum)					
3-month T-bill	5.06	4.78	4.55	4.72	4.57
10-year T-bond	6.35	5.26	5.79	5.94	5.90
Mortgage rate, 30-year fixed	7.60	6.94	7.63	7.94	7.82
Prime rate	8.44	8.35	8.00	8.06	8.25

INTERNATIONAL STATISTICS

Exchange Rates	**Current level September 16, 1999**	**Percent Change from Week ago**	**Year ago**
Euro (in U.S. dollars)	1.042	-1.2	N.A.
Yen (per U.S. dollar)	105.1	-2.7	-22.1
Major currencies index (Mar. 1973=100) (trade-weighted value of the U.S. $)	93.11	-0.3	-3.6

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	3.9 (Q2)	4.2 (Aug)	2.3 (Aug)
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France	2.1 (Q2)	11.3 (Jun)	0.3 (Jun)
Germany	0.6 (Q2)	7.1 (Jul) 2/	0.6 (Jul)
Italy	0.9 (Q1)	12.1 (Apr)	1.7 (Jul)
United Kingdom	1.2 (Q2)	6.1 (May)	1.3 (Jul)

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 former West Germany. Using OECD standardized unemployment data, the unemployment rate for unified Germany for July was 9.1 percent.

EYES ONLY

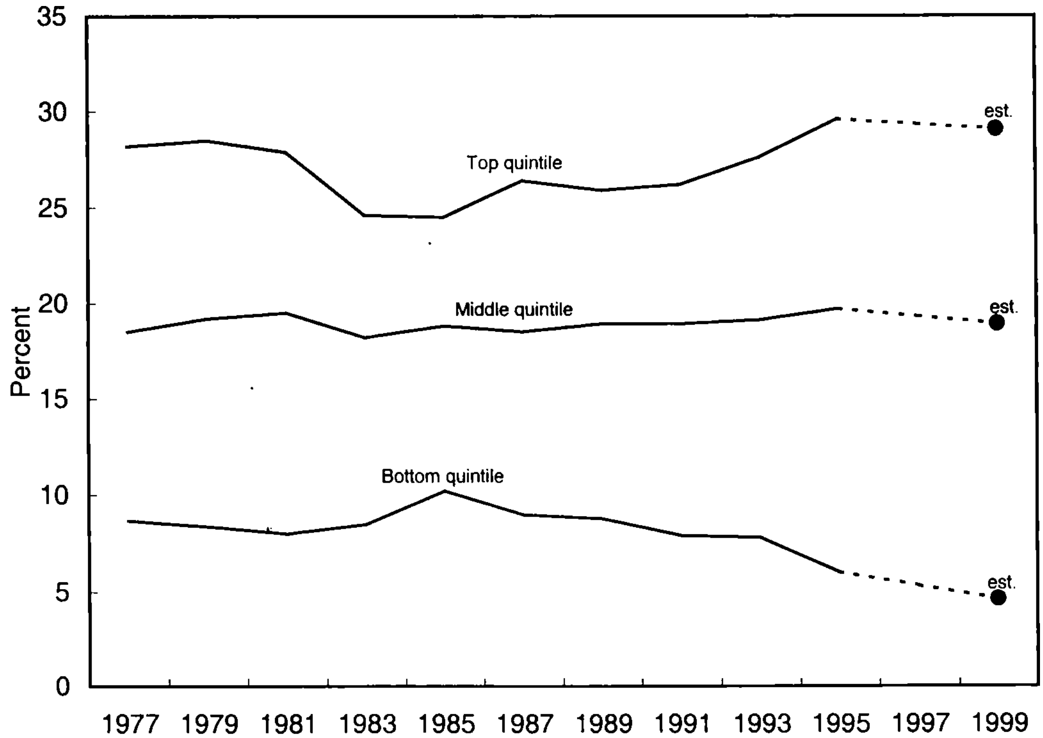
WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

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

September 10, 1999

CHART OF THE WEEK

Average Effective Federal Tax Rates



The Congressional Budget Office has just released estimates of average effective Federal tax rates for 1999. Federal taxes as a share of family income for the bottom fifth of families are the lowest they have been since 1977.

EYES ONLY

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CURRENT DEVELOPMENT

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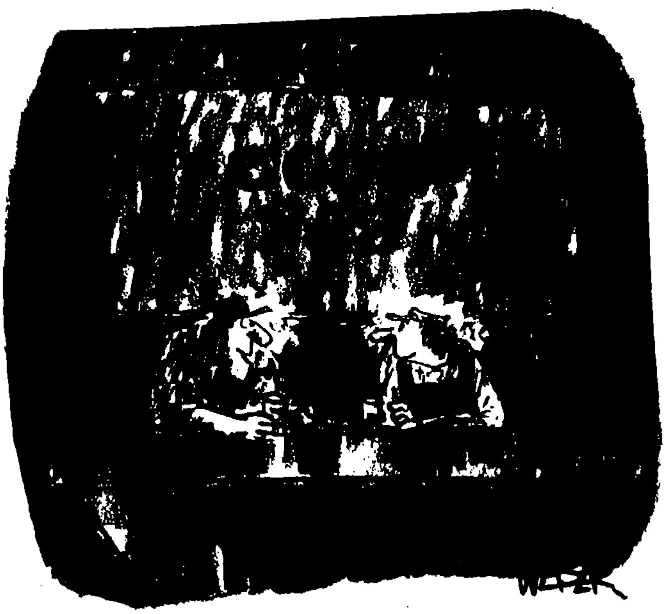
ARTICLE

DEPARTMENTS



"See, Jimmy? If they give a big tax cut to the wealthy, those guys'll feel good and have us come fix their roof and stuff."

EYES ONLY

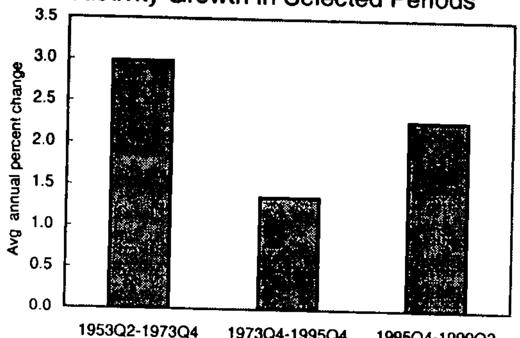
CURRENT DEVELOPMENT

The Role of Computers in Productivity Growth

Productivity growth in the computer and semiconductor industries contributes directly to aggregate productivity growth and, according to one estimate, has been the dominant source of the recent productivity spurt in the U.S. economy. Productivity growth in the manufacture of computers and semiconductors reflects the ability to produce faster processors, greater memory capacity, and larger disk drives without proportional increases in costs. But business investment in computers also adds to the quantity and quality of the capital stock, boosting productivity growth throughout the private sector. In the past, this latter effect on productivity growth was relatively small, but has recently increased.

The importance of computers in aggregate productivity growth. Productivity in the non-farm private business sector grew at a 2.3 percent annual rate over the last 3½ years (see chart). Adjusting for the typical cyclical pattern of productivity, overall "trend" productivity growth is estimated to be about 2.0 percent per year over this period. This marks a 0.6 percentage point pickup in trend productivity growth over the 1.4 percent annual rate estimated for the previous 22 years.

Productivity Growth in Selected Periods



Note: Data are on a consistently-measured basis for nonfarm private business

So far, the pickup in productivity has been mostly limited to the computer industry, which has seen a 40 percent annual growth rate in productivity since the end of 1995—double the rate recorded over the previous two decades. After accounting for cyclical factors and changes in measurement, trend productivity in the private business sector excluding computers shows very little acceleration. Although computers and semiconductors make up only about 5 percent of private output, the awesome acceleration in productivity growth in these industries more than makes up for their relatively small size. This localization of the productivity boom contrasts sharply with the experience of the productivity slowdown of the 1970s, when trend productivity slowed across most sectors of the economy.

The outlook for productivity growth. The outlook for productivity growth depends on the computer and semiconductor industries' ability to continue their recent pace of innovation and improvements in manufacturing efficiency, together with the effects from the use of growing stocks of computers throughout the economy. It is hard to predict whether the unprecedented pace of productivity growth in the computer and semiconductor industries observed over the last few years can be sustained. On the more positive side, the estimated contribution to productivity growth from the use of computers has increased relative to the previous 25 years and will remain at a high level for the near future. During the 1970-95 period, when the share of computers in the capital stock was very small, the contribution to the annual rate of productivity growth from the use of computers is estimated to have been only about 0.2 percentage points. But, the contribution has been growing and is estimated to have been about 0.4 percentage points per year over the last 3½ years, with the largest effects occurring this year.

SPECIAL ANALYSIS

Benefits for China of Greenhouse Gas Emissions Trading

A recent analysis by the Council of Economic Advisers finds that an international greenhouse gas emissions market would offer substantial economic opportunities for China. By adopting an emissions growth target under the Kyoto Protocol and participating in emissions trading, China could attract significant amounts of capital and technology to reduce its greenhouse gas emissions. By reducing its emissions, China would gain from selling unused emissions allowances to developed countries.

Creating a greenhouse gas market. The Kyoto Protocol calls for the design of an international trading system that will facilitate the transfer of capital and technology to the countries where emissions can be abated at least cost. A country that can abate greenhouse gas emissions at lower cost than others has the opportunity to attract investment for climate-friendly technology. By reducing its emissions, a country can then sell emissions allowances to countries with higher abatement costs. Ideally, an international greenhouse gas emissions market would be similar to the sulfur dioxide trading program in the U.S., which allows trading of permits to emit sulfur dioxide among electric utilities. In the U.S., power plants that can reduce emissions cheaply sell permits to plants for which emissions reduction is more expensive, resulting in estimated cost-savings of 25 to 43 percent. The principle of gains from trade in emissions allowances is basically the same as it is for trade in goods and services.

In order to engage in trading, the Kyoto Protocol requires a country to have a greenhouse gas emissions target. It is broadly recognized that any such targets must be made compatible with a country's legitimate development needs. One way to do so would be for a developing country to set its target above current emissions levels, but below what emissions are forecast to be without additional abatement policies during the Protocol's first commitment period (2008 to 2012). Such an "emissions growth target" could provide for continued economic development, but with a lower emissions growth rate. To mitigate the risk that a target could end up being too stringent (or too lax), a target could be indexed to a country's economic performance between now and the 2008-2012 commitment period.

Economic gains for China. While China is making impressive strides towards lowering its greenhouse gas emissions intensity (emissions per unit of output), a variety of economic analyses and modeling efforts indicate that there are still many low-cost emissions abatement opportunities in China. Some analyses suggest that China has lower abatement costs than virtually any other country in the world. These international economic models can simulate an international emissions market by assessing the projected marginal cost of abating carbon dioxide emissions across countries and then estimating the extent of buying and selling until no further economic gains can be achieved through additional trades – i.e., they find the market clearing price for an emissions allowance.

Results from six international economic models indicate that by taking on an emissions target and actively participating in international emissions trading, China would find it economic to reduce emissions 14 to 24 percent below projected 2010 emissions levels and would be able to sell emissions allowances worth from $4 billion to over $14 billion annually.

Environmental gains for China. Efforts to abate carbon dioxide emissions will likely result in significant reductions in emissions of local air pollutants, such as sulfur dioxide and particulate matter, since both kinds of emissions are by-products of fossil fuel combustion. Local air pollution levels are a significant threat both to China's economy and to its citizens. Current pollution levels increase mortality rates, the incidence of chronic illness, and the number of hospital and emergency room visits. China's position as a low-cost producer in a global greenhouse gas emissions market offers a promising avenue for attracting investment in the energy and industrial technologies necessary to significantly address the high levels of local air pollution.

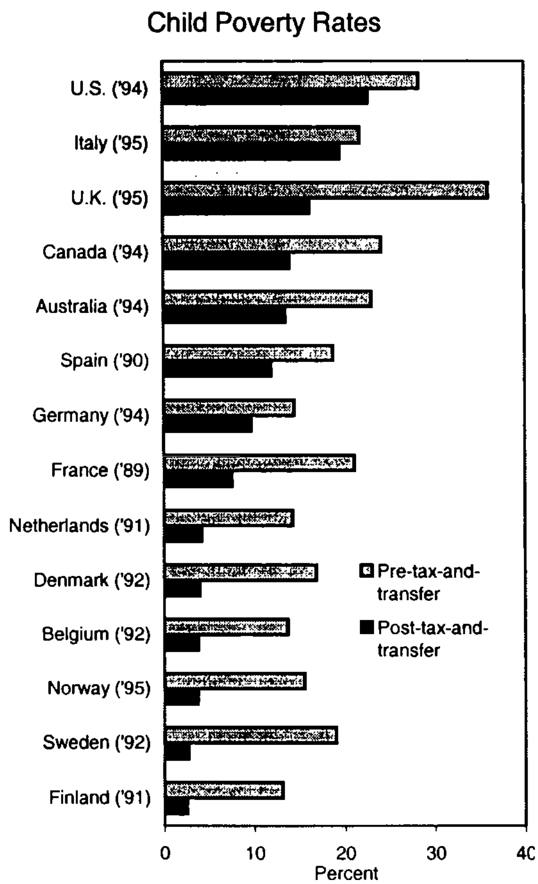
EYES ONLY

ARTICLE

Child Poverty Across Industrialized Nations

Although the official U.S. child poverty rate declined from 22.7 percent in 1993 to 19.9 percent in 1997, child poverty remains more prevalent in the United States than in many other industrialized countries. A major reason is that government support for low income families is typically more generous in these other countries. However, there is a tradeoff. More generous policies may be associated with adverse labor market effects such as higher unemployment and less job creation.

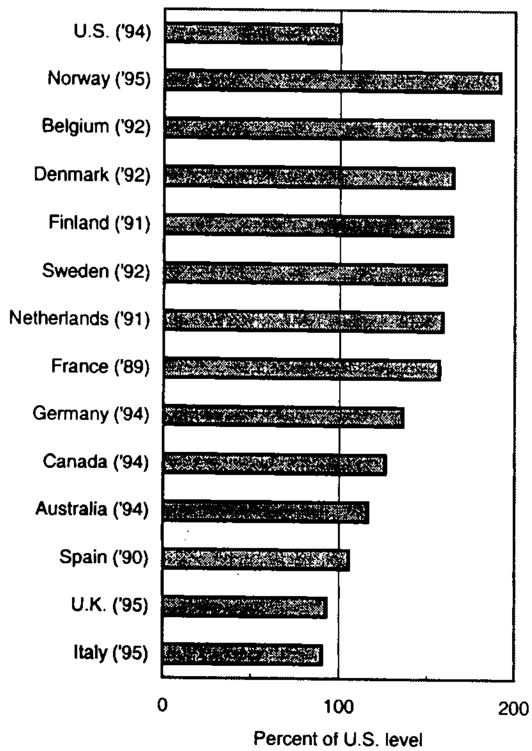
Child poverty comparisons, relatively speaking. No official international standard exists for measuring poverty, but a common approach in making cross-country comparisons is to use a relative income measure. For example, a forthcoming study examines pre- and post-tax-and-transfer child poverty rates for a number of countries using a poverty threshold based on 50-percent-of-median household income (see chart). This threshold is similar to the official European Commission poverty definition of 50 percent of average household disposable income, but the use of medians rather than averages makes the statistics less sensitive to extremely large or small incomes.



Unlike the money income concept used in the official U.S. poverty measure, the income measure used in the study reflects taxes and tax credits (including the EITC) and near-cash transfers (such as food stamps). Like the official U.S. measure, it excludes non-cash transfers such as public housing and publicly-provided health care. The estimated U.S. pre-tax-and-transfer child poverty rate is higher than that of most of the other countries, and it is reduced only modestly through taxes and transfers. In fact, the U.S. post-tax-and-transfer poverty rate is the highest among the countries shown.

Comparing absolute living standards. One reason for the relatively high U.S. child poverty rate is that half of U.S. median income is a high absolute threshold in comparison to other countries. Other countries would have higher child poverty rates based on the U.S. absolute threshold. A consistent measure based on the same absolute threshold does not exist. But, one available measure suggests that many poor children in the United States have limited resources relative to poor children in other countries. In particular, the chart shows that the dollar value of the household income available to the U.S. child at the 10th percentile of the U.S. income distribution is less than that of children at the 10th percentile of many other countries' distributions. Canada's level, for example, is roughly 26 percent higher than ours.

Household Income of Poor Children



Note: The chart shows the level of income at the 10th percentile of the country's distribution of children's household income as a percent of the level of income at the 10th percentile of the U.S. distribution.

Accounting for the differences. Demographic differences explain part of the story. For example, the high proportion of poor single mothers certainly raises the U.S. child poverty rate. But research has suggested that differences in demographics only partially explain the differences in child poverty rates across nations. Instead, the most important factors appear to be differences in taxes and the level of government assistance to low-income families. The United States, for example, provides less cash assistance to low-income families than most industrialized nations. Many European countries pay high levels of unemployment assistance for more than a year after people leave a job, no matter how short their period of employment. Others provide "family allowances"—special cash transfers to families with children.

Conclusion. Child poverty rates vary dramatically across nations, from less than 3 percent to more than 20 percent (using the relative measure). Differences in public policies account for a significant portion of this range. These policies, of course, come with tradeoffs: many European nations have high unemployment rates *and* low child poverty rates, due in part to their extensive system of income transfer programs. The situation in the United States is the reverse. Some poverty experts have criticized both models as being either "too expensive" (in Europe) or "too cheap" (in the U.S).

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

NAFTA Spurs Agricultural Trade with Canada and Mexico. As NAFTA enters its 6th year, the importance of the agreement for U.S. agriculture is more apparent than ever, according to a new report issued by the U.S. Department of Agriculture. While U.S. agricultural exports to non-NAFTA countries rose only 2.6 percent per year from 1994 to 1998, exports to Canada and Mexico rose 8.1 percent annually over the same period. Both U.S. exporters and importers are placing a greater emphasis on the North American market. In 1990, Canada and Mexico purchased 17 percent of U.S. agricultural exports and supplied 25 percent of imports; by 1998, the share of exports had risen to 25 percent and that of imports to 34 percent. The report argues that U.S. beef and pork trade has benefited greatly from NAFTA, with beef exports to Canada estimated to be twice as high as they would have been without the trade agreement. It finds that NAFTA has also facilitated the flow of U.S. and Canadian foreign direct investment in the processed food industry in North America, leading to the dissemination of new technology and efficiency gains for producers, as well as lower food costs and greater choices for consumers.

Minorities Are Less Likely to Have Health Insurance. American minorities are less likely than whites to have health insurance, according to a report from the Commonwealth Fund. The report finds that among Americans aged 18 to 64, 14 percent of whites were uninsured in 1995 compared with 24 percent of blacks and 38 percent of Hispanics. Minorities are also less likely to be covered through work (69 percent of white workers have employer-sponsored coverage compared with 52 percent of black workers and 44 percent of Hispanic workers). Differences in socioeconomic status and type of jobs held may partially explain this discrepancy. For example, workers earning less than $10 per hour are less likely to be insured, and adults who work in large firms, are employed full-time, hold manufacturing or public administration jobs, or are trade union members are more likely to be covered through work. However, even within these categories, minorities are less likely to have employer-based insurance. The study finds that, after controlling for workforce and sociodemographic characteristics, blacks and Hispanics are 21 percent less likely than whites to have coverage through their employers. One possible barrier to minority health insurance mentioned in the report is the out-of-pocket cost associated with obtaining employer-sponsored coverage.

INTERNATIONAL ROUNDUP

Malaysia Eases Investment Controls. The Malaysian government allowed capital controls instituted last September to expire. The government originally imposed these controls to insulate the Malaysian economy from the risks and vulnerabilities of global financial markets. Prior to September 1, 1999, foreign investors could only repatriate their investments by paying a tax of up to 30% of the principal. This tax was lifted on September 1, so that portfolio funds that have been in Malaysia for a year or more are now eligible for repatriation without any levy.

China Set to Impose Savings Tax. China's economic growth rate has declined steadily since 1992 and moderate price deflation has set in over the last two years. Based on a recent article in the Beijing Daily News (China's official English language newspaper), the Chinese government has proposed to impose a 20 percent flat tax on interest earned on bank savings accounts in hopes of stimulating consumption. This follows a recent amendment to the Personal Income Tax Law, allowing taxation of interest from savings accounts. National saving was estimated to be more than 40 percent of GDP in 1997. Anecdotal evidence suggests that the saving rate may have risen recently, in part reflecting uncertainty associated with economic reforms and rising unemployment. Even if the tax fails to boost consumption, it should help improve the weak fiscal condition of the government, which limits its ability to finance expenditures. According to the Chinese Minister of Finance, this new tax revenue will be used to increase payments to laid-off workers from state-owned enterprises, raise the minimum income of urban residents, and increase pensions.

IMF Warns of Risks in Capital Markets. Despite recent favorable developments in the world economy such as strong U.S. growth and Asian recovery, conditions in global financial markets remain fragile, cautions the IMF in its annual report, *International Capital Markets.* The IMF report listed the possibility of a large correction in the U.S. equity market or a sudden weakening of the dollar as particular risks to the developed economies. Risks to emerging markets include a reduced investor base, the level and structure of external financing, and the possibility of a slowdown in capital inflows that could be brought about by inflationary pressures and resultant tight monetary policies in mature markets. The report draws attention to the public policy issues posed by excessive off-balance sheet leverage in modern finance, the impact of highly-leveraged institutions (HLIs) on small and medium-sized financial markets, and the emerging market responses to severe external pressure. In the IMF's view, policies should aim to enhance market discipline, improve disclosure of off-balance sheet risk, provide for more rigorous creditor and counterparty assessments of exposures, and strengthen private risk management and control systems. The report also suggests that closer monitoring of global liquidity conditions could help alert officials to the buildup of excessive leverage and other imbalances.

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RELEASES THIS WEEK

Producer Price Index

****Embargoed until 8:30 a.m., Friday, September 10, 1999****

The producer price index for finished goods rose 0.5 percent in August. Excluding food and energy, producer prices fell 0.1 percent.

MAJOR RELEASES NEXT WEEK

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

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U.S. ECONOMIC STATISTICS

	1970-1993	1998	1998:4	1999:1	1999:2
Percent growth (annual rate)					
Real GDP (chain-type)	2.7	4.3	6.0	4.3	1.8
GDP chain-type price index	5.4	0.9	0.8	1.6	1.5
Nonfarm business (NFB) sector:					
Productivity (chain-type)	1.5	2.6	4.1	3.6	0.6
Real compensation per hour:					
Using CPI	0.6	2.5	2.0	2.9	1.5
Using NFB deflator	1.3	3.7	3.4	3.0	3.7
Shares of Nominal GDP (percent)					
Business fixed investment	10.9	11.0	11.0	11.0	11.2
Residential investment	4.5	4.3	4.5	4.6	4.7
Exports	8.2	11.3	11.3	10.9	11.0
Imports	9.2	13.0	13.1	13.2	13.7
Personal saving	5.2	0.3	-0.0	-0.5	-0.9
Federal surplus	-2.7	0.9	0.8	1.4	1.6

	1970-1993	1998	June 1999	July 1999	August 1999
Unemployment Rate (percent)	6.7**	4.5**	4.3	4.3	4.2
Payroll employment (thousands)					
increase per month			281	338	124
increase since Jan. 1993					19403
Inflation (percent per period)					
CPI	5.8	1.6	0.0	0.3	N.A.
PPI-Finished goods	5.0	0.0	-0.1	0.2	**0.5**

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

New or revised data in **boldface**.
PPI data **embargoed until 8:30 a.m., Friday, September 10, 1999.**

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FINANCIAL STATISTICS

	1997	1998	July 1999	August 1999	Sept. 9, 1999
Dow-Jones Industrial Average	7441	8626	11052	10935	11079
Interest Rates (percent per annum)					
3-month T-bill	5.06	4.78	4.55	4.72	4.68
10-year T-bond	6.35	5.26	5.79	5.94	5.97
Mortgage rate, 30-year fixed	7.60	6.94	7.63	7.94	7.88
Prime rate	8.44	8.35	8.00	8.06	8.25

INTERNATIONAL STATISTICS

Exchange Rates	**Current level**	**Percent Change from**	
	September 9, 1999	**Week ago**	**Year ago**
Euro (in U.S. dollars)	1.054	-1.4	N.A.
Yen (per U.S. dollar)	108.0	-1.1	-20.9
Major currencies index (Mar. 1973=100) (trade-weighted value of the U.S. $)	93.36	-0.3	-4.6

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	3.9 (Q2)	4.2 (Aug)	2.1 (Jul)
Canada	3.7 (Q2)	7.7 (Jul)	1.8 (Jul)
Japan	1.1 (Q2)	4.9 (Jul)	-0.1 (Jul)
France	2.1 (Q2)	11.3 (Jun)	0.3 (Jun)
Germany	0.6 (Q2)	7.1 (Jul) 2/	0.6 (Jul)
Italy	0.9 (Q1)	12.1 (Apr)	1.7 (Jul)
United Kingdom	1.2 (Q2)	6.1 (May)	1.3 (Jul)

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 former West Germany. Using OECD standardized unemployment data, the unemployment rate for unified Germany for July was 9.1 percent.

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