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WEB June 1995

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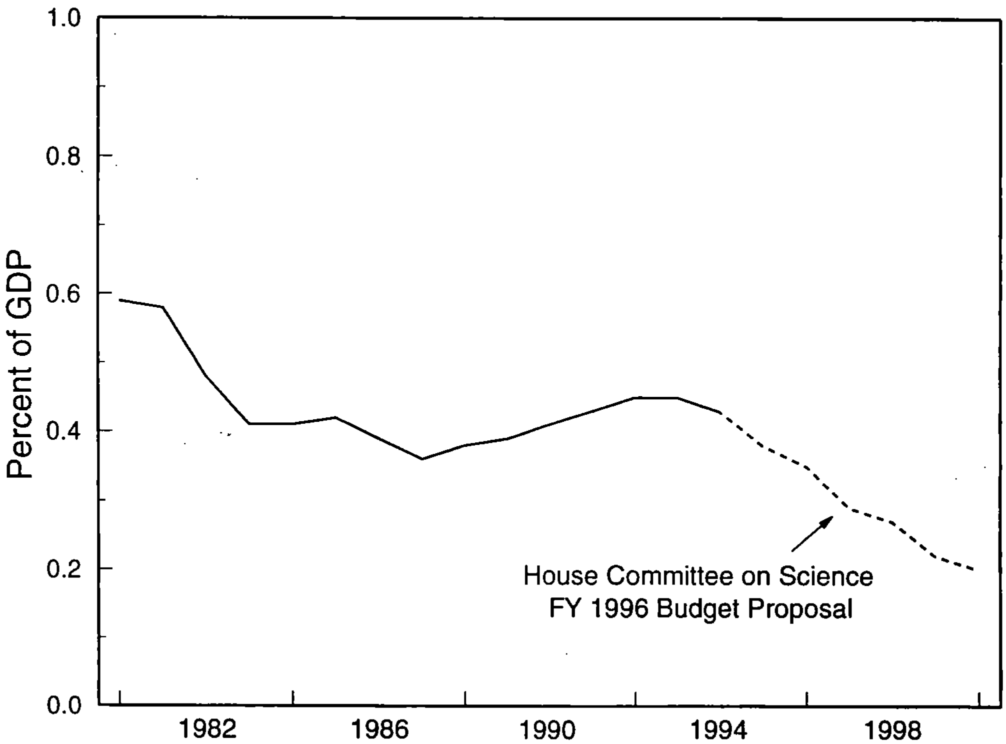
WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

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

June 29, 1995

CHART OF THE WEEK

Federal Spending on Civilian Research



Federal spending on civilian research and development will decline sharply under the Republican budget proposal, falling by more than half as a percent of GDP over the next five years. Cuts of this size would seriously hinder the government's ability to fulfill its role in promoting basic research. The Administration has proposed an increase of 3.2 percent in research funding in its 1996 budget.

And what over 5 years

EYES ONLY

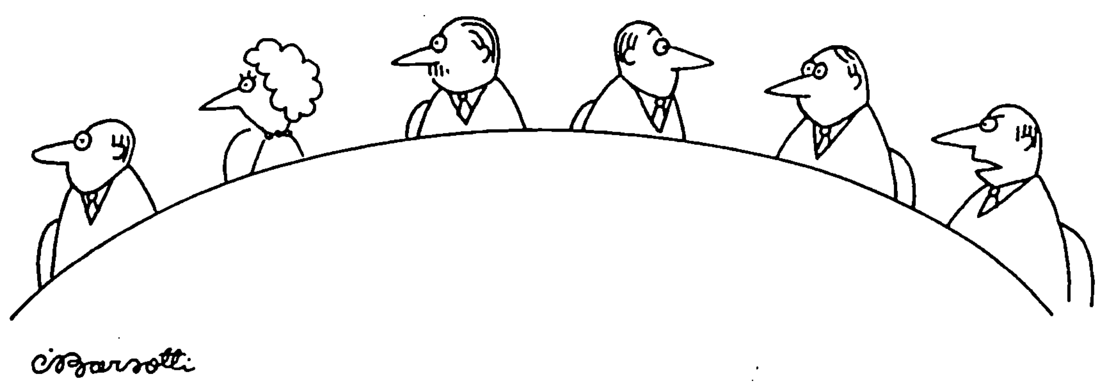
CONTENTS

CURRENT DEVELOPMENT

SPECIAL ANALYSIS

ARTICLE

DEPARTMENTS



"We're looking toward the Pacific Rim, Greenfield. What the hell are you doing?"

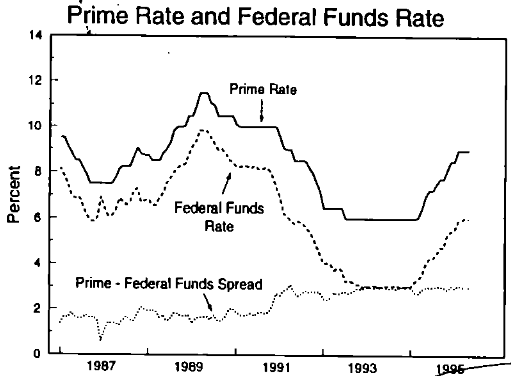
EYES ONLY

CURRENT DEVELOPMENT

Why Hasn't the Prime Rate Declined?

The prime interest rate has remained at 9 percent since February, despite a significant decline in interest rates on Treasury securities, home mortgages, and corporate bonds. Banks for the last several years have been setting the prime rate three percentage points above the Federal funds rate. Because the funds rate has been pegged at 6 percent since February by the Federal Reserve, the prime rate therefore has not fallen.

Prime Rate and Federal Funds Rate



The prime rate has become much less important for business loans, especially for large businesses. Because large businesses can now often borrow elsewhere, banks are increasingly offering these borrowers loans tied to market rates rather than to the prime rate. The share of new prime-based business loans has fallen from 40 percent to 25 percent since the late 1980s. At the same time, consumer, credit-card, and home-equity loans have been more frequently tied to the prime rate. Therefore it is mainly consumers and small businesses that borrow at rates linked to prime.

When loans are tied to the prime rate, borrowers typically pay the prime rate plus a margin. During the past few months the margin has fallen, lowering slightly the average interest rate on new prime-based business loans. But since margins on outstanding loans already are fixed, a significant decline in borrowing costs will come only if there is a drop in the prime rate.

EYES ONLY

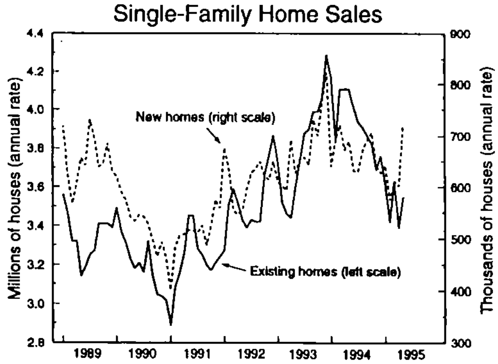
CURRENT DEVELOPMENT

Home Sales Rise, Unemployment Claims Fall

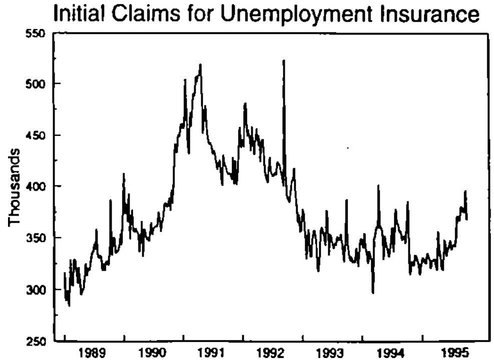
Home sales rose sharply in May after falling in April. When combined with the news that initial claims for unemployment insurance decreased by 7 percent last week, these announcements have been interpreted by financial markets as a sign of renewed strength in the economy. Long-term interest rates rose following the announcements, a development that many analysts suggest reduces the likelihood that the Fed will lower interest rates next week.

Analysis. Home sales and unemployment claims are highly volatile (see charts). It is, therefore, a mistake to place too much emphasis on any one month's figures. A sustained rise in home sales will be needed before we can conclude that the housing market is strengthening, especially in light of the weakness in housing starts. Similarly, weekly unemployment claims have not always been a reliable indicator of overall job loss. The employment report for May, to be released July 7, will provide a clearer picture of how the labor market is faring. Despite these cautions, it is welcome to get some upbeat data after a string of negative reports.

Single-Family Home Sales



Initial Claims for Unemployment Insurance



EYES ONLY

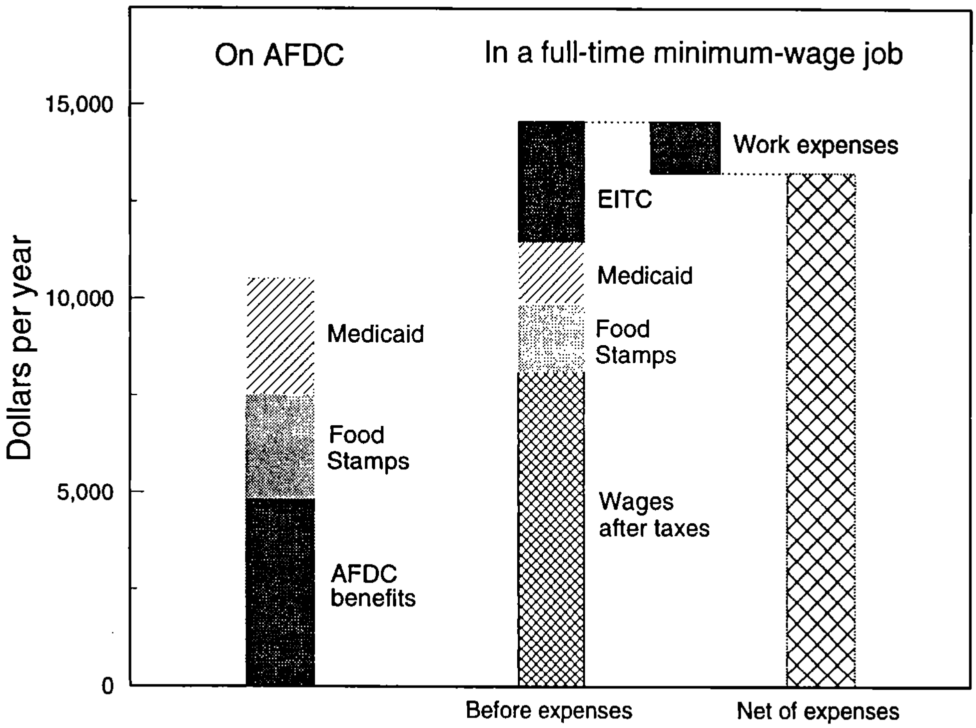
SPECIAL ANALYSIS

Moving from Welfare to Work: Why Bother?

The average welfare recipient gains little financially from going to work. High implicit rates of "taxation"—most importantly due to the loss of welfare benefits—mean that out of each dollar earned, the typical welfare recipient's overall income will rise only about thirty cents.

The Government Giveth, the Government Taketh Away. For example, a non-working mother with two children who receives AFDC in Pennsylvania (a state with AFDC benefit levels at about the national median) receives $4,836 from AFDC. With the cash value of her Food Stamps and Medicaid coverage added in, her total annual income rises to $10,537 (see chart).

Income on Welfare versus at Work



If she takes a full-time job at the minimum wage, her earnings after payroll taxes come to $8,141, or nearly 70 percent more than she received from AFDC alone. The Earned Income Tax Credit (or EITC, which is calculated here at the fully phased-in 1996 levels) adds another $3,094. But because she is now gainfully employed, her Food Stamp and Medicaid benefits drop by over 40 percent, while she loses entirely her eligibility for AFDC. As a result, her total net income as a working woman is $14,577—barely $4000 more than she would get by not working.

In effect, the phase-out of benefits adds up to a "tax" on wages of 58 percent—more onerous than the marginal rates faced by the highest-income earners. With the higher costs of transportation and child care for the working mother taken into account, her remaining income is even lower: $13,247, meaning that the working mother faces an effective "tax rate" of 72 percent. In terms of the amount it adds to her consumption, this is equivalent to working for an after-tax wage of $1.30 an hour. In this example, without the EITC the effective "tax rate" would be just over 100 percent.

Analysis. More than half of all welfare recipients would face an effective tax rate of between 50 and 90 percent, were they to take full-time jobs at the minimum wage. These high effective tax rates not only discourage welfare recipients from taking jobs, but also encourage them not to report their income when they do work.

What can government do to improve these incentives?

• Coordinate and extend the phase-out of benefits. AFDC, Food Stamps, Medicaid, and housing subsidies all phase out with income at varying rates and over varying income ranges, with each program using a different measure of income. Although these phase-out provisions may seem individually sensible, together they often add up to prohibitive effective tax rates. Better coordination of benefit phase-out could reduce these disincentives.

Nevertheless, coordination alone cannot resolve a fundamental trade-off: If government wishes to provide adequate benefits to the lowest-income recipients at limited budgetary cost, phase-out is necessarily rapid. To put it another way, improving work incentives generally requires either spending more or reducing benefit levels for those on welfare.

• Impose work requirements for welfare recipients. One way around the phase-out problem is to require AFDC recipients to work after a certain time period, as the Administration supports. Combined with improved job training and a higher minimum wage, this approach could improve work incentives sharply.

EYES ONLY

ARTICLE

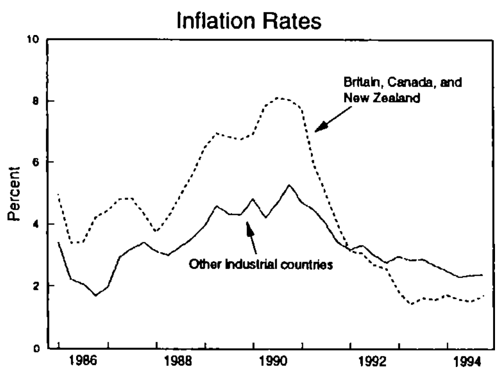
Should the Fed Focus Only on Inflation?

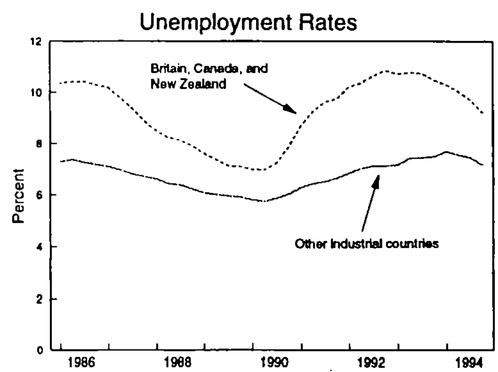
The Fed's mandate for monetary policy is to achieve maximum growth and employment while maintaining stable prices. Some Republican members of Congress reportedly are considering legislation mandating that the Fed focus exclusively on keeping inflation low.

Why target inflation? Proponents argue that workers and their employers, provided with a clear, public, and believable commitment to low inflation, will not need to worry about rising inflation. Because wage and price increases will be adjusted accordingly, it is argued, the authorities will not need to raise interest rates and generate higher unemployment in order to reduce inflation.

Have inflation targets been tried? Since the early 1990s, Canada, New Zealand, and the United Kingdom have adopted price stability as their goal for monetary policy and translated this into explicit inflation targets. The British authorities, for example, have declared a target range of 1 to 4 percent for annual inflation, as well as a longer-term commitment of bringing inflation down to 2-1/2 percent or less by mid-1997. Australia, Finland, Spain, and Sweden are or soon will begin targeting inflation. Although changing the Fed's mandate would not necessarily require that explicit inflation targets be adopted, the experiences of Canada, New Zealand, and the United Kingdom may shed some light on whether an exclusive focus on inflation yields the benefits claimed by its proponents.

Have inflation targets worked? Annual inflation averaged more than 6 percent in Canada and the United Kingdom and almost 12 percent in New Zealand during the 1980s. Since 1990, inflation has fallen more rapidly in these countries than in other industrial countries (see left chart). But lower inflation has come at the cost of higher unemployment (see right chart).





EYES ONLY

Have the targets themselves made it less costly to reduce inflation? Thus far it seems the answer is no. The greater reduction in inflation achieved in Britain, Canada, and New Zealand has coincided with a correspondingly greater rise in unemployment.

Britain, Canada, and New Zealand are now well into economic recoveries and inflationary pressures have begun to emerge, especially in Britain and New Zealand. If monetary policy is tightened to restrain these pressures and unemployment rises further, the authorities' commitment to their inflation targets will be tested. Although surveys indicate that inflation expectations have fallen markedly, it is not yet clear whether the commitment to inflation targets is fully credible. Only in Canada do surveys show that average forecasts of future inflation lie within the government's target range.

Conclusion. In general, reducing inflation requires a rise in unemployment. So far there is no clear evidence that inflation targets have reduced this cost. Even if it ultimately turns out that inflation targets do reduce this cost, they would restrict the ability of central banks to lower interest rates if a recession arises unexpectedly. And with fiscal policy constrained by high deficits, the authorities would find both hands tied behind their backs in a recession. NB

EYES ONLY

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

Charging the 'Net. Visa and MasterCard announced this week that they would join forces to support technical specifications securing financial transactions made over the Internet. The new, public-domain standards are due to be published in September, and the two companies expect consumers will begin purchasing in earnest over the Internet early next year. Development of secure systems for transferring data is critical to the transformation of the Internet into an effective online marketplace. A recent survey found that fully 80% of Internet users would make online purchases if a major credit-card company were involved. Visa and MasterCard have a combined transaction volume of more than a trillion dollars and over 670 million cards issued, so the agreement should head off incompatibilities in the way online financial transactions are handled. This will save both consumers and merchants the trouble of understanding and learning to use multiple payment systems. All in all, it looks like a 'Net gain.

Chrysler Bets on Japanese Market. Chrysler announced early this week that it will pay $100 million to acquire a controlling interest in its jointly owned Japanese distribution company. Chrysler also said it intends to invest additional funds soon in regional sales offices and in adding to its existing technical and service abilities in Japan. Chrysler projects sales of 20,000 vehicles in Japan this year. The company hopes that its plan to acquire additional retail dealers will push total yearly Japanese sales to 100,000 vehicles by the end of the decade. Toward this end, Chrysler recently announced plans to spend $180 million developing right-hand drive versions of the Jeep Grand Cherokee Sport Utility, the Chrysler Neon subcompact, and a new minivan. The first two models will hit the Japanese market next year, while the minivan is expected in early 1997.

CEA Axed by House Appropriations Committee. The Council of Economic Advisers has been targeted for elimination by the House Appropriations Committee as part of their effort to cut government spending. The government would save only $3.4 million with the elimination of CEA, a fraction of the Administration's projected FY96 deficit of $196.7 billion so small that it can be expressed only in scientific notation: 1.73×10^{-5}.

EYES ONLY

RELEASES THIS WEEK

Gross Domestic Product

****Embargoed until 8:30 a.m., Friday, June 30, 1995****

According to final estimates, real gross domestic product grew at an annual rate of 2.7 percent in the first quarter.

Consumer Confidence

Consumer confidence, as measured by the Conference Board, fell 9.2 index points in June, to 92.8 (1985=100).

MAJOR RELEASES NEXT WEEK

Personal Income (Monday)
Leading Indicators (Thursday)
Employment (Friday)

EYES ONLY

U.S. ECONOMIC STATISTICS

	1970–1993	1994	1994:3	1994:4	1995:1
Percent growth (annual rate)					
Real GDP	2.5	4.1	4.0	5.1	2.7
GDP deflator	5.5	2.3	1.9	1.3	2.2
Productivity					
Nonfarm business	1.2	1.8	2.7	4.3	2.7
Manufacturing (1978-93)	2.1	4.2	3.4	3.7	3.4
Real compensation per hour	0.6	0.6	–0.8	1.5	1.2
Shares of Real GDP (percent)					
Business fixed investment	11.0	12.6	12.7	13.0	13.6
Residential investment	4.7	4.3	4.3	4.3	4.2
Exports	8.0	12.3	12.4	12.8	**12.9**
Imports	9.2	14.4	14.6	14.8	**15.1**
Shares of Nominal GDP (percent)					
Personal saving	4.9	3.0	3.0	3.4	3.8
Federal surplus	–2.8	–2.4	–2.3	–2.3	–2.2

			March 1995	April 1995	May 1995
Unemployment Rate	6.7*	6.1*	5.5	5.8	5.7

*Figures beginning 1994 are not comparable with earlier data.

	1970–1993	1994	March 1995	April 1995	May 1995
Payroll employment (thousands)					
increase per month			179	–7	–101
increase since Jan. 1993					6717
Inflation (percent per period)					
CPI	5.8	2.7	0.2	0.4	0.3
PPI-Finished goods	5.0	1.7	0.0	0.5	0.0

New or revised data in **boldface**.
GDP data for first quarter **embargoed until 8:30 a.m., Friday, June 30, 1995**.

EYES ONLY

FINANCIAL STATISTICS

	1993	1994	April 1995	May 1995	June 29, 1995
Dow-Jones Industrial Average	3522	3794	4231	4392	4551
Interest Rates					
3-month T-bill	3.00	4.25	5.65	5.67	5.50
10-year T-bond	5.87	7.09	7.06	6.63	6.28
Mortgage rate, 30-year fixed	7.33	8.36	8.32	7.91	7.53
Prime rate	6.00	7.15	9.00	9.00	9.00

INTERNATIONAL STATISTICS

Exchange Rates	**Current level June 29, 1995**	**Percent Change from**	
		Week ago	**Year ago**
Deutschemark-Dollar	1.380	−1.2	−12.9
Yen-Dollar	84.53	−0.0	−14.3
Multilateral (Mar. 1973=100)	81.54	−0.7	−9.0

International Comparisons	**Real GDP growth (last 4 quarters)**	**Unemployment rate**	**CPI inflation (last 12 months)**
United States	4.0 (Q1)	5.7 (May)	3.2 (May)
Canada	4.2 (Q1)	9.4 (Apr)	2.9 (May)
Japan	0.1 (Q1)	3.0 (Mar)	−0.2 (Apr)
France	3.8 (Q1)	12.1 (Mar)	1.6 (May)
Germany	3.3 (Q4)	6.4 (Mar)	2.1 (May)
Italy	2.7 (Q4)	12.2 (Jan)	5.5 (May)
United Kingdom	3.8 (Q1)	8.6 (Apr)	3.4 (May)

U.S. GDP data **embargoed until 8:30 a.m., Friday, June 30, 1995.**

EYES ONLY

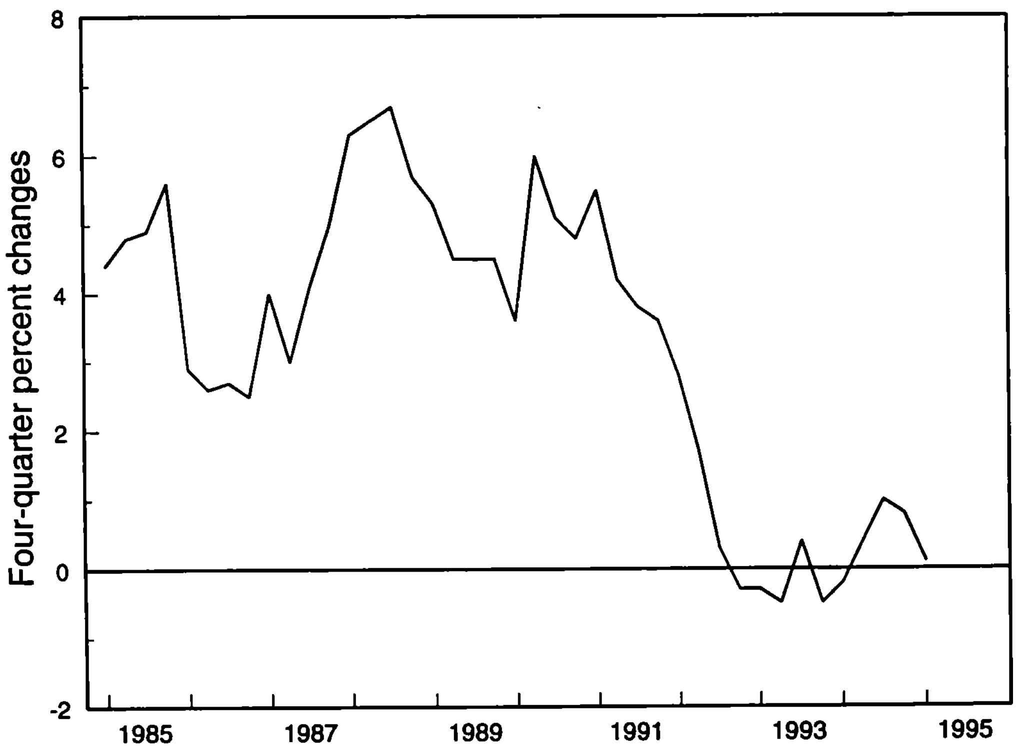
WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

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

June 22, 1995

CHART OF THE WEEK

Real GDP in Japan



From the early 1960s through 1991, GDP growth in Japan averaged more than 6 percent per year. The slowdown in the macroeconomy that began in 1992 is not over yet. Data for the first quarter of this year show only a scant rise in economic activity, and some now expect a contraction in the second quarter. The precarious state of Japan's banking system poses an additional risk to recovery. In a recent speech (discussed in this issue), Chairman Greenspan cited the performance of foreign economies as an important factor bearing on the outlook for the U.S. economy.

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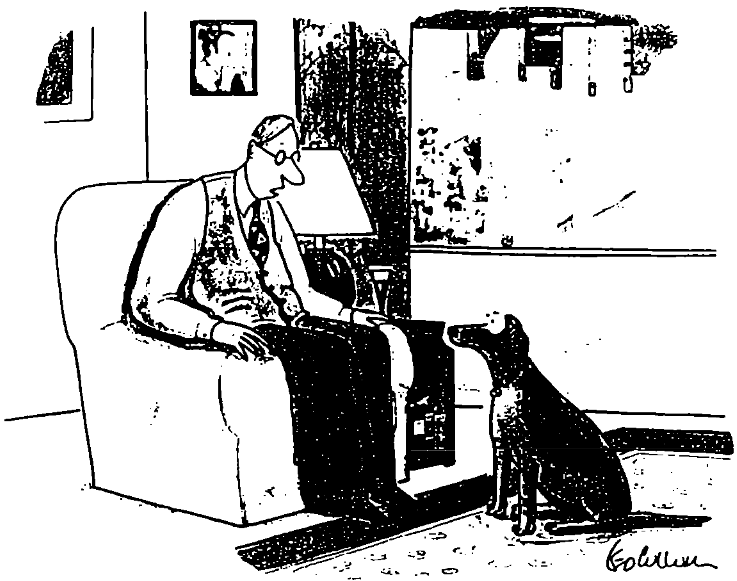
CONTENTS



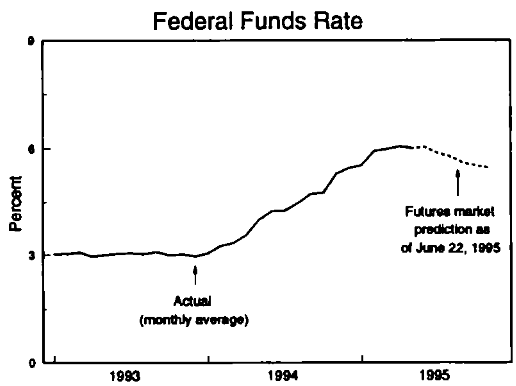
"You've been with us a long time, Winnie, and we're prepared to offer you a generous severance package."

EYES ONLY

CURRENT DEVELOPMENT

What Does Chairman Greenspan Think?

In a speech delivered on June 20, Chairman Greenspan said he sees "some increased risk of a modest near-term recession, but the early onset of this process of moderation [of growth] also indicates markedly reduced prospects for a more severe inventory-induced downturn later."



On balance, financial market participants continue to expect the Federal Reserve to nudge interest rates down in coming months—possibly when the Federal Open Market Committee meets on July 5, but if not then, later in the year. Participants in the futures market for federal funds are betting that the funds rate will be down 50 basis points from its current level by October of this year (see chart).

Analysis. Chairman Greenspan expressed the view that any downturn of the economy, if one were to occur, would likely be mild. He based this view in large part on the relatively small buildup thus far in inventories. For this reason, he believes that a sharp and prolonged drop in production will not be needed to pare inventories to desired levels. The Chairman also emphasized the recent upward surge in stock and bond prices, along with plentiful credit available at banks, as factors favoring continued economic expansion.

EYES ONLY

SPECIAL ANALYSIS

The Analytics of Federal Asset Sales

Under current budget rules, the proceeds from non-routine asset sales are not scorable for PAYGO purposes, but any reduction in net revenue resulting from such sales must be scored. The Administration favors relaxing this rule to allow the proceeds from the sale of an asset to be scored provided "the President and the Congress agree that selling a particular asset is good policy." In their Budget Resolution, Senate Republicans went one step further and simply proposed to score all proceeds.

Analysis. An asset sale makes sense financially from the perspective of the government if the proceeds from the sale exceed the value of all revenues (royalties, user fees, etc.) that would have been collected net of operating costs had the government decided to hold onto the asset. The current prohibition on scoring the proceeds of asset sales prevents lawmakers from using asset sales in an inappropriate fashion to help reduce a budget deficit. Absent the prohibition, lawmakers could sell a long-lived asset of the government, score the receipt from the sale, show only a small offset from the revenue lost during the budget window, and thus use asset sales to mask a chronic operating deficit.

Well-intentioned as they are, however, current scoring rules go too far. Because they recognize only the cost of asset sales (i.e., the lost net revenues) and none of the benefit (i.e., the proceeds generated), they discourage even asset sales that would be in the long-run financial interest of the Federal government.

Major factors bearing on the desirability of asset sales include the following:

- In some cases, <u>the private sector may be able to operate an asset more efficiently</u> than the government can. The private sector may have greater know-how in certain areas, and the profit motive may give it a stronger incentive to achieve maximum efficiency.

- <u>The private sector is free of some constraints</u> that may reduce the value of some assets held by the government. For example, a private rancher may have little trouble charging a fair-market grazing fee, while the government may be prevented from doing so by political considerations.

- On the other hand, <u>the private sector may operate assets in a way that gives short shrift to the general public interest</u>. For example, private developers may insufficiently value the heritage of Civil War battlefields. In principle, such divergences between public and private interests can be addressed through regulation. In some circumstances, however, it may be simpler for the government to operate the asset itself rather than sell it and then regulate the private owner.

EYES ONLY

ARTICLE

Subsidizing Agricultural Exports: A User's Guide

The Federal government spent $1.3 billion in 1994 subsidizing the export of various agricultural commodities. By far the largest part of spending under agricultural export subsidy programs is used to subsidize exports of wheat. This spending is intended to provide support for American farmers and to boost our agricultural exports. But there is considerable reason to believe that the programs fall far short of these objectives. In fact, they appear to do relatively little to boost our exports. Moreover, they probably deliver most of their financial benefits to foreign consumers, not American farmers. Fortunately, a relatively simple mechanism can be implemented to reduce the cost of these programs to the American taxpayer, while simultaneously reducing administrative burden and preserving whatever benefits the subsidies may provide for farmers.

How do the subsidy programs typically work? Under the present system, exporters first negotiate a tentative deal with an overseas customer, specifying both a price and a volume. The exporter then presents this tentative contract to the Department of Agriculture, together with a proposed subsidy rate to be paid to the exporter. The Department of Agriculture reviews bids on a daily basis, and rejects those deemed to specify excessive subsidy rates. Rejected bids may be resubmitted immediately, even with only slight improvements in terms. In principle, commodity traders can use this process to discover the most favorable terms that will be accepted by the Department.

Subsidies provided under these programs are deliberately targeted at a relatively small number of countries. Between 1989 and 1993, more than 60 percent of the subsidies went to just four regions—the former Soviet Union, China, Algeria, and Egypt—and nearly three-fourths of the subsidies went to those regions plus the other countries of the Middle East.

What economic effects do the export subsidy programs really have? Agricultural subsidy programs have become increasingly important in recent years. For example, over the last four years, 60 percent of all U.S. wheat exports have been subsidized under these programs. Nonetheless, many analysts believe that these programs have had relatively little effect on net exports, and have brought relatively little benefit to the American farmer. How can this be?

<u>Little effect on net exports</u>. To a large extent, the export of an extra bushel of wheat from the United States will induce the import of an extra bushel of wheat into the United States. American consumers want to eat their wheat, and if they can't get it from domestic producers, then they'll get it from other countries. Most academic studies conclude that agricultural export subsidies have increased net exports by no more than 10 percent of the total volume subsidized. That is, the real effect of the subsidy programs is much less than

the apparent effect. A concrete example of this "import offset" has occurred in the past several years. Some analysts argue that the sharp increase in wheat imports from Canada after 1991 reflected the higher export subsidies to American wheat exporters that became available in that year.

Little benefit to the American farmer. If the subsidy programs fail to boost net exports materially, then they also fail to increase the income of the American farming community.

Considerable benefit to foreign consumers. The export subsidy programs drive prices in the targeted markets (China, Egypt, etc.) below international levels. In effect, American taxpayers pay the difference between the international price and the price in the favored country. (Prices in these markets may also be below international levels due to subsidies offered by other countries, including the countries of the European Union.)

Competitive advantage to foreign processors. The export subsidy programs allow some overseas processors of raw American foodstuffs to purchase their inputs at a subsidized price, possibly giving them a competitive advantage over American processors. This explains why many American processors do not support the export subsidy programs.

How could the subsidy programs be made more cost-effective? Under the Uruguay Round of the General Agreement on Tariffs and Trade (GATT) ratified last year, annual Federal spending on agricultural export subsidies will have to fall by about one-half by 2001. Even so, these programs as currently designed could cost as much as $5.3 billion over the next six years.

In its 1995 Farm Bill recommendations, the Administration committed to reform these programs to make them more cost-effective, and to reduce their administrative complexity. As one possible mechanism for achieving these objectives, the Administration proposed having the Department of Agriculture award export subsidies through regular auctions rather than through the current clunky bureaucratic mechanism, which is potentially subject to manipulation by commodity traders. Under the auction reform, exporters would compete head-to-head with each other for subsidies; the winners of the auction would be those bidders that offered contracts to sell with the lowest subsidy rates.

An auction-based subsidy program would allow the Department of Agriculture to provide exporters with a large enough subsidy to enable them to compete with exports subsidized by the European Union, as well as to subsidize the maximum volume of exports allowed under the GATT, thus avoiding "unilateral disarmament." But unlike the current system, the proposed auction system would achieve these results at minimum possible taxpayer cost.

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

Image is Everything. Most primary-care physicians seeking the help of a specialist in reading x-rays must employ couriers to transfer hardcopy radiological images. But fiber optic technology now allows such images to be moved electronically, saving valuable time and making top experts more accessible to ordinary patients and their physicians. Starting in February, the Medical Technology Transfer Corp. (MTT) has taken advantage of this technology, allowing patients in its local area of Melbourne, Fla., to be "treated" by UCLA specialists. The introduction of such services raises a number of thorny regulatory issues. Since doctors currently are regulated at the state level, companies like MTT will have to contend with state rules, despite the fact that their services ultimately may facilitate the treatment of patients anywhere in the world. For example, Florida requires that a local doctor examine x-rays before an out-of-state specialist may be consulted. In an online economy, such regulations may serve to protect the profits of local specialists at patients' expense. This tension between existing regulations and technological advance seems sure to broaden as more services like MTT's hit the market.

Still Running Warm in Many Areas. Economic activity remains relatively strong across much of the nation, though there are some signs that it is softening, according to the Federal Reserve's latest survey of business conditions. Despite the slowdown in the auto sector, the Midwest remains the relative economic hotspot. The West coast continues to show signs of revival; real estate and construction lending have been particularly active in California. Labor markets are still tight in many areas of the country, though Philadelphia-area manufacturers report plans to trim payrolls. Notwithstanding such tightness, there still is little evidence of wage pressures. Instead, some employers (e.g. in the St. Louis area) say they have been easing their hiring standards for entry-level positions.

Record-Breaking Merger Creates First Eastern Superregional Bank. In what would be the largest bank merger ever, First Union of Charlotte, N.C., has announced plans to buy First Fidelity of Newark, N.J. The merger would create the nation's sixth-largest bank holding company in terms of assets, and the largest institution in the country in terms of number of branches. In addition, the merged bank will be the first superregional banking company in the East, with branches from eastern Connecticut down through south Florida. Because First Union and First Fidelity have no territorial overlap, the acquiring bank expects no branch closings and few job reductions to result from the merger. Analysts say that the merger's benefits will arise from product synergies, as First Union channels new products and services to First Fidelity's customers. More big deals are likely to follow. Thanks to the interstate banking law advocated by the Administration and passed by Congress last year, remaining Federal barriers to interstate banking through a holding company structure are set to fall on September 30.

EYES ONLY

RELEASES LAST WEEK

Advance Durable Orders

****Embargoed until 8:30 a.m., Friday, June 23, 1995****

Advance estimates show that new orders for durable goods increased 2.5 percent in May, following a decrease of 4.5 percent in April. This is the first monthly increase since January.

Housing Starts

Housing units were started at an annual rate of 1.24 million units in May, a slight decline from the April level of 1.26 million units.

U.S. International Trade in Goods and Services

The goods and services trade deficit was $11.4 billion in April, compared with a deficit of $9.8 billion in March.

MAJOR RELEASES THIS WEEK

Consumer Confidence—Conference Board (Tuesday)
Gross Domestic Product (Friday)

EYES ONLY

U.S. ECONOMIC STATISTICS

	1970–1993	1994	1994:3	1994:4	1995:1
Percent growth (annual rate)					
Real GDP	2.5	4.1	4.0	5.1	2.7
GDP deflator	5.5	2.3	1.9	1.3	2.2
Productivity					
Nonfarm business	1.2	1.8	2.7	4.3	2.7
Manufacturing (1978-93)	**2.1**	4.2	3.4	3.7	3.4
Real compensation per hour	0.6	0.6	–0.8	1.5	1.2
Shares of Real GDP (percent)					
Business fixed investment	11.0	12.6	12.7	13.0	13.6
Residential investment	4.7	4.3	4.3	4.3	4.2
Exports	8.0	12.3	12.4	12.8	12.8
Imports	9.2	14.4	14.6	14.8	15.0
Shares of Nominal GDP (percent)					
Personal saving	4.9	3.0	3.0	3.4	3.8
Federal surplus	–2.8	–2.4	–2.3	–2.3	–2.2

	1970–1993	1994	March 1995	April 1995	May 1995
Unemployment Rate	6.7*	6.1*	5.5	5.8	5.7

*Figures beginning 1994 are not comparable with earlier data.

	1970–1993	1994	March 1995	April 1995	May 1995
Payroll employment (thousands)					
increase per month			179	–7	–101
increase since Jan. 1993					6717
Inflation (percent per period)					
CPI	5.8	2.7	0.2	0.4	0.3
PPI-Finished goods	5.0	1.7	0.0	0.5	0.0

New or revised data in **boldface**.

EYES ONLY

FINANCIAL STATISTICS

	1993	1994	April 1995	May 1995	June 22, 1995
Dow-Jones Industrial Average	3522	3794	4231	4392	4590
Interest Rates					
3-month T-bill	3.00	4.25	5.65	5.67	5.37
10-year T-bond	5.87	7.09	7.06	6.63	6.04
Mortgage rate, 30-year fixed	7.33	8.36	8.32	7.91	7.53
Prime rate	6.00	7.15	9.00	9.00	9.00

INTERNATIONAL STATISTICS

Exchange Rates	**Current level June 22, 1995**	**Percent Change from Week ago**	**Percent Change from Year ago**
Deutschemark-Dollar	1.397	−1.0	−12.9
Yen-Dollar	84.55	−0.2	−16.1
Multilateral (Mar. 1973=100)	82.08	−0.6	−9.3

International Comparisons	**Real GDP growth (last 4 quarters)**	**Unemployment rate**	**CPI inflation (last 12 months)**
United States	4.0 (Q1)	5.7 (May)	3.2 (May)
Canada	4.2 (Q1)	9.4 (Apr)	2.4 (Apr)
Japan	0.1 (Q1)	3.0 (Mar)	−0.4 (Mar)
France	3.8 (Q1)	12.1 (Mar)	1.6 (Apr)
Germany	3.3 (Q4)	6.4 (Mar)	2.2 (Apr)
Italy	2.7 (Q4)	12.2 (Jan)	5.0 (Mar)
United Kingdom	3.7 (Q1)	8.6 (Apr)	3.4 (Apr)

EYES ONLY

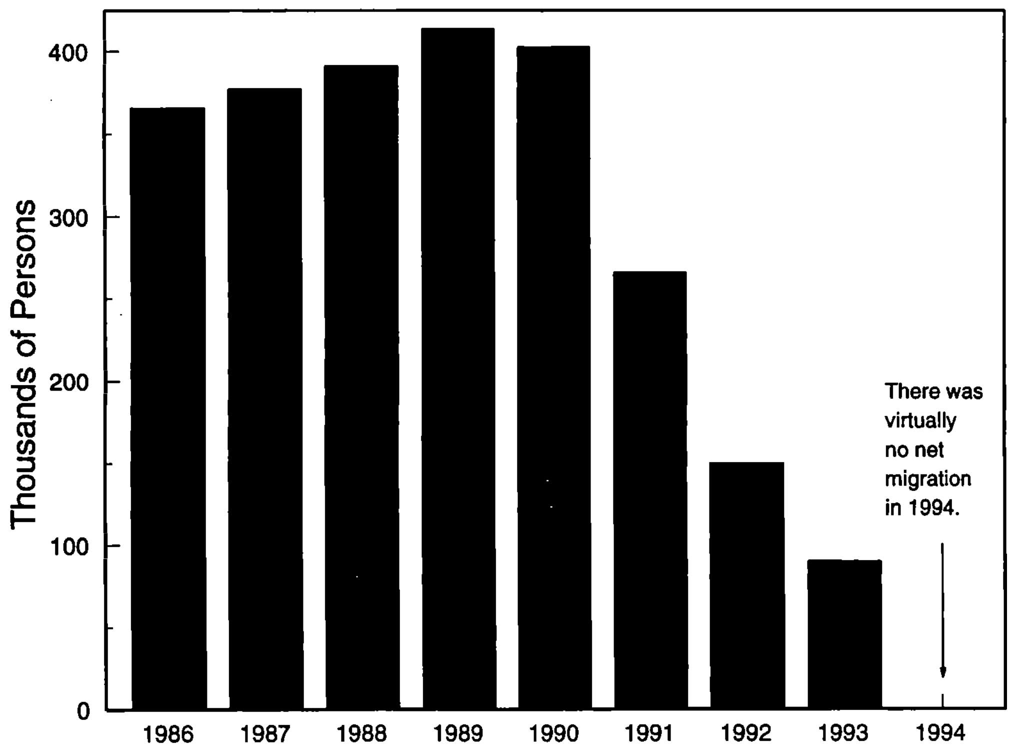
WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

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

June 19, 1995

CHART OF THE WEEK

Net Migration into California



Migration typically plays an important role in helping to return a region's economy to equilibrium following an economic downturn. Eventually, a depressed region's unemployment rate tends to recover to its normal value, but only partly because job growth returns. Net migration into the region tends to slow, as workers move instead to areas where job prospects are more promising. Recent data suggest that this pattern is being repeated in California, where net migration into the state slowed from more than 400,000 in 1989 to essentially nothing in 1994. An item in this issue of the Briefing provides additional information on the economies of the Pacific Rim states.

EYES ONLY

CONTENTS

"My lawyer says I'm not allowed to guess what's wrong with you until after the tests are complete, and even then I'm supposed to cross my fingers."

EYES ONLY

CURRENT DEVELOPMENT

The Tide Rolls Out: States Backtrack on Health Reform

Several states that had pursued comprehensive health care reforms during the last two years are now backtracking. The biggest step backward in state health reform appears to have occurred in the state of Washington. In May, most of the reforms enacted in 1993 were repealed. Although the new law still prohibits denial of coverage for preexisting conditions, it repeals employer and individual mandates, premium caps, and a minimum benefits package. Similar, though less dramatic, setbacks have occurred in Montana, Vermont, and Oregon.

Analysis. What lies behind the turnaround at the state level? Because reform plans were never fully implemented, bad experience with the programs can hardly be the explanation. Hawaii, which is the one state that has had an employer mandate in place for a long time, has not taken any steps backwards.

In large part, the turnaround probably reflects the election of more conservative lawmakers at the state level. In addition, it may reflect the recent deceleration of health benefits costs, which may have served to reduce the sense of urgency felt by state residents about the matter.

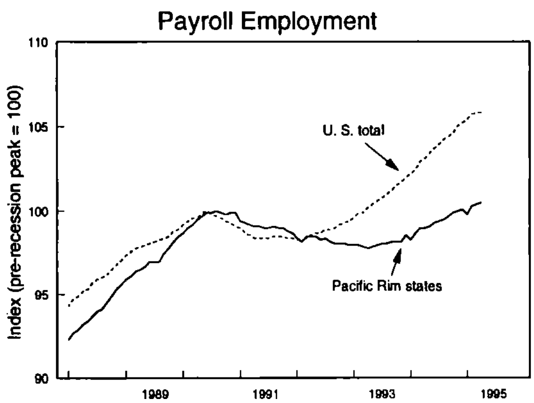
Health care reform may be inherently more difficult to enact and sustain at the state level than it is at the Federal level. Employers can easily and credibly threaten that they will move out of a particular state—or never move in—if it implements reforms that prove expensive to firms.

EYES ONLY

TREND

Weathering the Economic Storms on the Pacific Rim

During the early 1990s, the Pacific Rim region of the United States (defined to include Alaska, Washington, Oregon, California, and Hawaii) suffered a recession that was 60 percent longer and 30 percent deeper than the recession endured by the nation as a whole. Whereas total employment in the nation fell 1.7 percent from peak to trough, in the Pacific Rim states it fell 2.2 percent (see chart). And whereas the turnaround in employment was only 21 months in coming in the rest of the country, on the Rim the turnaround took 33 months to arrive. Since early 1993, employment on the Rim has risen steadily, but there has still been no "rebound" period of rapid job growth. As a result, the Pacific states' employment now exceeds its pre-recession peak by only 0.5 percent; for the nation as a whole, the comparable figure is 5.8 percent.



Not all parts of the region have suffered equally. Job loss and sluggish growth have been most pronounced in southern California and Hawaii. In California, the unemployment rate has stagnated for the past six months at around 7-3/4 percent—2 percentage points above the national average. And Hawaii now has fewer employed workers than it did two years ago. By contrast, job growth in the Pacific Northwest has been strong over the past year.

Key factors shaping the regional economy in the recent past and influencing its prospects include:

- Defense conversion. The cutback in defense spending has cost California hundreds of thousands of jobs in aerospace alone. But according to one recent study, the downsizing of California's aerospace industry is now 80 percent complete. Furthermore, other industries are picking up the slack. In 1994, Hollywood and the recreation industry together created as many California jobs as were lost in aerospace in that year. This year, labor markets should continue to strengthen: In southern California, two to three times as many firms plan to add workers as plan to cut jobs in 1995. Washington state, which has suffered layoffs at Boeing and at the Hanford nuclear plant, has managed to keep employment growing by adding more jobs in other manufacturing industries.

- Natural-resource conversion. Oregon has made great progress in diversifying away from the declining timber industry. Thanks largely to growth in high-technology industries—which now employ more workers than the timber and wood-products industries—Oregon has outpaced the nation in job creation throughout the 1990s. Alaska, however, remains heavily dependent on natural resources; with only about 5 percent of its jobs in manufacturing, Alaska's economy remains vulnerable to booms and busts in the oil industry.

- Natural disasters. After suffering more than its share of natural disasters over the past several years, California may see a silver lining. Only a small fraction of available insurance and relief money has been spent thus far on rebuilding from the Northridge earthquake. According to one recent study, another $10 billion or more will be pumped into southern California's economy before reconstruction is complete. Similarly, this year's heavy rains are not all bad news. Although they did damage fruit and nut crops in flooded areas, they may boost agricultural production elsewhere in the state. With reservoirs filled, farmers will receive their full water allotment for the first time in years.

- Foreign trade and tourism. On net, foreign trade has contributed less than expected to the region's growth in recent months. The devaluation of the peso and the collapse of the Mexican economy have reduced demand for the region's exports to Mexico. The strength of the yen should have increased demand for the region's exports, but any such stimulus has probably been at least partly offset by the fact that the Japanese economy has been so sluggish. Nonetheless, tourist arrivals in Hawaii rose substantially last year, and they should increase further if and when Japan's economy revives.

EYES ONLY

ARTICLE

Designing Environmental Policies for a More Competitive Electricity Industry

Although the electricity industry produces less than 3 percent of the output of the economy, it accounts for more than one-third of both greenhouse gas emissions and nitrogen dioxide emissions (a precursor of ozone smog). It also accounts for three-fourths of the nation's sulfur dioxide emissions (although these emissions will fall sharply in the future due to limits imposed by the Clean Air Act).

Federal and state regulators have responded to this environmental impact by attempting to influence the type of generating capacity that is built, and by promoting energy conservation through a variety of programs collectively known as demand-side management programs. For example, a state regulator may mandate that utilities under its jurisdiction subsidize the purchase of fluorescent light bulbs, or offer rebates on the installation of energy-efficient windows. Demand-side management programs are one way of addressing the problem that many households fail to invest in cost-effective energy-saving technology. Such programs have also probably helped redress the fact that, under the prevailing regulatory regime (which is based on a cost-plus-type approach), utilities have a financial incentive to build too much capacity.

The challenge of industry reorganization. The advent of competition to the electrical utility industry will render many current conservation and clean technology programs impossible to implement. Requirements for the use of certain types of generating technology will become more difficult to enforce as unregulated electricity generators take a larger share of the market, and in any event, these requirements work contrary to the goal of restructuring. Mandates for financing customer conservation and the use of cleaner technologies could be maintained by imposing them on the distribution network, which will in all likelihood remain a regulated monopoly, but this would concentrate costs on a smaller share of the industry. It is an indication of the complexity of these issues that California, which has been a forerunner both in mandating conservation and alternative technologies and in proposing a restructuring of the industry, has not yet developed a clear plan for how environmental issues associated with restructuring should be addressed.

However, in many respects, the demise of current conservation and clean technology programs would represent an opportunity for achieving improved efficiency while protecting the environment. In many cases, these programs are excessively costly, even taking account of the environmental benefits they deliver. For example, many states effectively mandate the purchase of electricity from alternative suppliers at inflated prices even though this is contrary to the intent of the relevant authorizing legislation. There also are debates about the cost-effectiveness of conservation programs under the current regulatory regime.

Critics argue that these programs may be much more costly than is commonly thought. It may also be that the capacity such programs displace is new, clean generating plant rather than older, dirtier plant.

Appropriate pricing is crucial. Fortunately, the environmental goals of Federal and state conservation and technology programs can be achieved in other (often more efficient) ways even as the restructuring of the industry goes forward. Appropriate supply and demand decisions can be encouraged by ensuring that consumers pay prices that reflect the full cost to society of generating electricity, including the cost of environmental damage. One efficient means of achieving full-cost pricing is to create regional emissions trading programs that cover all relevant generation sources (as EPA and the states are attempting to do in a number of locations). Emissions trading programs represent a market-oriented mechanism for rewarding utilities that invest in cleaner technology. These programs can be complemented with information campaigns and state conservation subsidies that are targeted, for example, to lower-income households that are less likely to make energy-efficient purchases. They can also be complemented by continued support for research on renewable energy technologies (a program targeted for severe cuts in the Republican budget proposals).

Policy issues. At the Federal level, the most immediate issue is the fate of the 1978 Public Utilities Regulatory Policies Act (PURPA). The original objectives of this Act were to guarantee more open access to the utility grid system and to promote the development of environmentally friendly alternative energy sources (such as waste heat industrial cogenerators and plants operated with renewable resources like solar energy and municipal waste). The Act attempts to accomplish these objectives by requiring utilities to purchase the electrical output of certain "qualifying facilities" (mainly cogenerators and renewables users) at a certain price known in the trade as "full avoided cost" (roughly speaking, a price that reflects both the capital and operating costs the utility would have to pay in order to produce the electricity itself from a new plant).

Critics of PURPA argue that under the new competitive regime, access will not be a problem, and full-cost pricing and technology R&D represent more cost-effective mechanisms for encouraging the development and adoption of environmentally friendly approaches to electricity generation than does PURPA. However, many supporters of PURPA, while acknowledging problems of implementation that have caused economic distortions, argue that the basic requirements set out by the Act should be retained until restructuring of the industry is more advanced, environmental concerns have been addressed, and support for renewable energy technologies has been assured.

EYES ONLY

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

Orange County Returns to the Well, but Finds It Half-Empty. For the first time since declaring bankruptcy last December, Orange County returned to the bond market. The sale of "recovery bonds" raised $279 million, which will be used to repay the school districts and municipalities that had invested in Orange County's infamous investment pool. The county attempted to reassure investors who were still nervous about its finances by purchasing insurance on all principal and interest payments. With the insurance, the bonds received a AAA rating, leading observers to predict that Orange County would have to pay an interest-rate premium of only about 10 basis points over the yield on comparably rated bonds issued by other counties. But in the event, the market priced the bonds at a premium of 15 to 25 basis points. Even with the higher yield, many large investors refused to bite, and Orange County fell $16 million short of its reported original sales target of $295 million.

Privatization Sputters in Slovakia—or Does It? Slovakia's government has thrown investors for a loop with its eleventh-hour cancellation of a mass privatization plan. Until just recently, Slovakia was scheduled to privatize companies with a combined value of more than $1 billion later this summer through a mass auction. But Prime Minister Meciar cancelled plans to distribute share-purchase coupons to 3.5 million Slovak citizens, raising doubts that the auction will take place at all. Does this change spell trouble for Slovakia's transition to a market economy? Not necessarily. Some observers see these developments in a benign light, and point out that Meciar has previously declared a preference for achieving privatization through sales to small groups of investors (such as a firm's managers or workers) rather than through mass auctions. Moreover, drawing on the experiences of other Central European countries, these analysts argue that direct privatization may result in a more decisive change of ownership and corporate control than mass privatization. But even these optimists await further evidence that the government will follow through with its preferred form of privatization.

The Corporate 109 Line Up to Meet the G-7. In keeping with its commitment to fiscal austerity, Canadian Prime Minister Jean Chretien's government found some creative ways to defray the costs of hosting the Halifax summit. Taking a cue from the Olympics, the government persuaded corporate sponsors to chip in $4 million—or about 20 percent of the total cost of hosting the summit. In return for payments of up to $360,000, sponsors were allowed to display their corporate logos at the summit. Among the 109 firms that took advantage of this opportunity were Air Canada, General Motors of Canada, Moosehead Breweries, and Northern Telecom. One other penny-pinching measure: Rather than buy a new conference table, the government borrowed the table used at last year's Naples summit.

EYES ONLY

RELEASES LAST WEEK

Consumer Price Index

The consumer price index increased 0.3 percent in May. Excluding food and energy, consumer prices rose 0.2 percent.

Retail Sales

Advance estimates show that retail sales rose 0.2 percent in May following a 0.3 percent decrease in April. Excluding sales in the automotive group, retail sales rose 0.1 percent.

Productivity

Nonfarm business productivity increased 2.7 percent at an annual rate in the first quarter. Manufacturing productivity increased 3.4 percent.

Industrial Production and Capacity Utilization

The Federal Reserve's index of industrial production fell 0.2 percent in May. Capacity utilization fell 0.5 percentage point to 83.7 percent.

MAJOR RELEASES THIS WEEK

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

EYES ONLY

U.S. ECONOMIC STATISTICS

	1970–1993	1994	1994:3	1994:4	1995:1
Percent growth (annual rate)					
Real GDP	2.5	4.1	4.0	5.1	2.7
GDP deflator	5.5	2.3	1.9	1.3	2.2
Productivity					
Nonfarm business	1.2	**1.8**	**2.7**	**4.3**	**2.7**
Manufacturing (1978-93)	**2.0**	**4.2**	**3.4**	**3.7**	**3.4**
Real compensation per hour	0.6	**0.6**	**–0.8**	**1.5**	**1.2**
Shares of Real GDP (percent)					
Business fixed investment	11.0	12.6	12.7	13.0	13.6
Residential investment	4.7	4.3	4.3	4.3	4.2
Exports	8.0	12.3	12.4	12.8	12.8
Imports	9.2	14.4	14.6	14.8	15.0
Shares of Nominal GDP (percent)					
Personal saving	4.9	3.0	3.0	3.4	3.8
Federal surplus	–2.8	–2.4	–2.3	–2.3	–2.2

			March 1995	April 1995	May 1995
Unemployment Rate	6.7*	6.1*	5.5	5.8	5.7

*Figures beginning 1994 are not comparable with earlier data.

Payroll employment (thousands)					
increase per month			179	–7	–101
increase since Jan. 1993					6717
Inflation (percent per period)					
CPI	5.8	2.7	0.2	0.4	0.3
PPI-Finished goods	5.0	1.7	0.0	0.5	0.0

New or revised data in **boldface**.

EYES ONLY

FINANCIAL STATISTICS

	1993	1994	April 1995	May 1995	June 15, 1995
Dow-Jones Industrial Average	3522	3794	4231	4392	4496
Interest Rates					
3-month T-bill	3.00	4.25	5.65	5.67	5.48
10-year T-bond	5.87	7.09	7.06	6.63	6.18
Mortgage rate, 30-year fixed	7.33	8.36	8.32	7.91	7.55
Prime rate	6.00	7.15	9.00	9.00	9.00

INTERNATIONAL STATISTICS

Exchange Rates	**Current level June 15, 1995**	**Percent Change from**	
		Week ago	**Year ago**
Deutschemark-Dollar	1.411	0.2	−13.7
Yen-Dollar	84.70	0.1	−17.4
Multilateral (Mar. 1973=100)	82.58	0.3	−10.2

International Comparisons	**Real GDP growth (last 4 quarters)**	**Unemployment rate**	**CPI inflation (last 12 months)**
United States	4.0 (Q1)	5.7 (May)	3.2 (May)
Canada	4.2 (Q1)	9.4 (Apr)	2.4 (Apr)
Japan	0.9 (Q4)	3.0 (Mar)	−0.4 (Mar)
France	3.6 (Q1)	12.1 (Mar)	1.6 (Apr)
Germany	3.3 (Q4)	6.4 (Mar)	2.2 (Apr)
Italy	2.7 (Q4)	12.2 (Jan)	5.0 (Mar)
United Kingdom	3.7 (Q1)	8.6 (Apr)	3.4 (Apr)

EYES ONLY

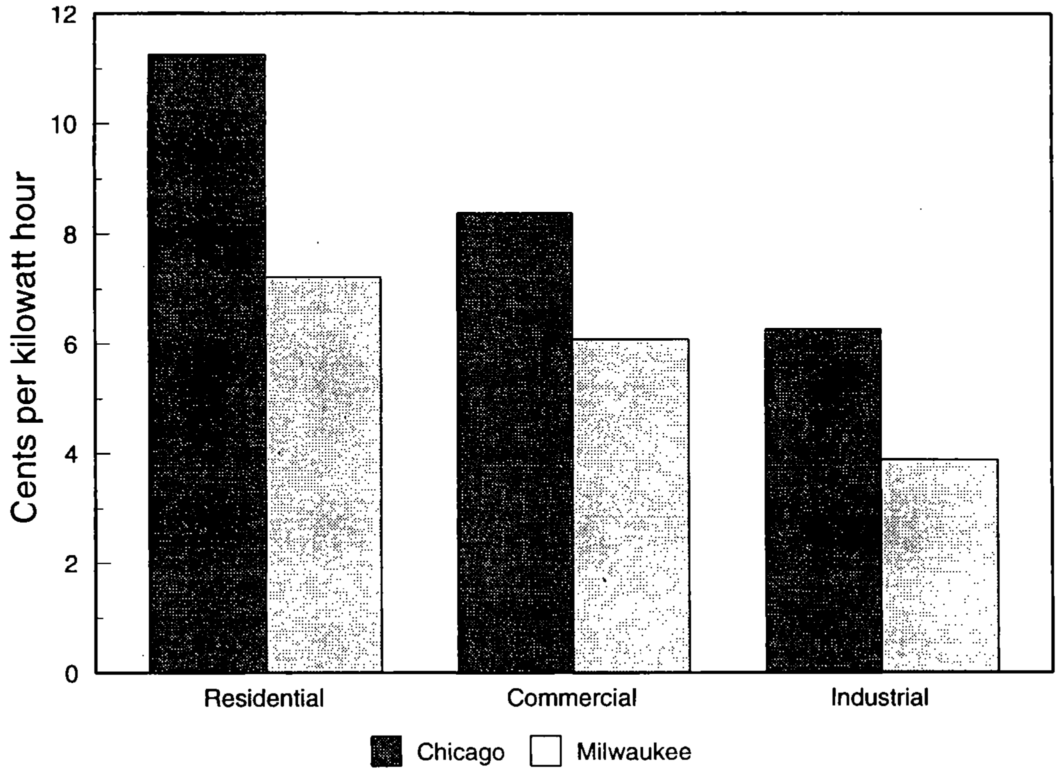
WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

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

June 12, 1995

CHART OF THE WEEK

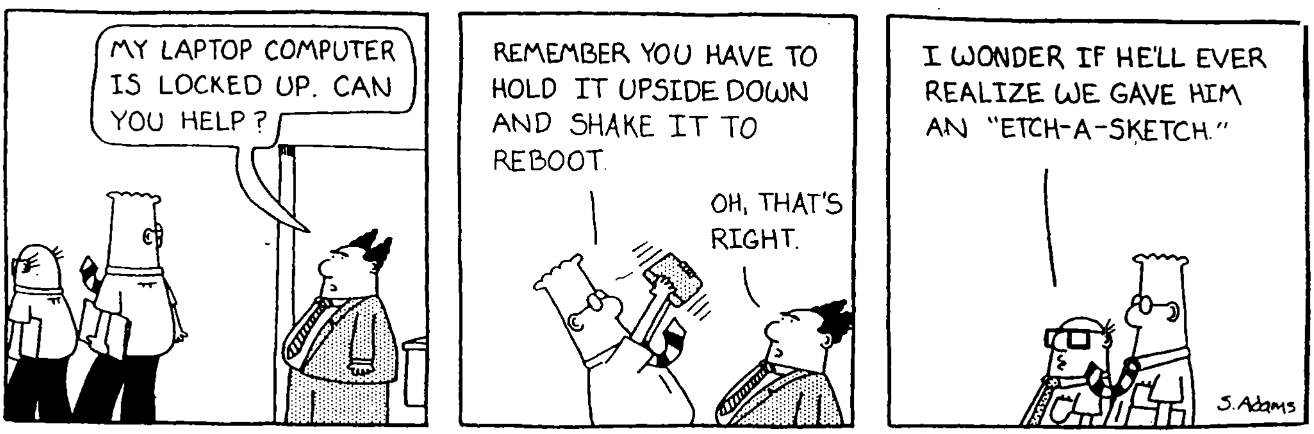
Electricity Rates in the Chicago Area, 1993



Electricity prices differ greatly by location. In Chicago, for example, residential customers paid an average rate of 11.2 cents per kilowatt hour in 1993. In nearby Milwaukee, however, residential customers paid only 7.2 cents per kilowatt hour, or about 35 percent less. Similar differentials prevailed for commercial and industrial customers. Rate differentials such as these are symptomatic of the non-competitive structure of the market for electricity in the United States. The Article in this issue of the Briefing examines issues related to the introduction of competition into that market.

EYES ONLY

CONTENTS



EYES ONLY

CURRENT DEVELOPMENT

The Economic Policies of the New French Government

President Chirac's new government has proposed several policy initiatives intended to alleviate the economic hardship of the working class and the unemployed, including a significant boost in unemployment benefits and a 4 percent increase in the minimum wage.

The incoming government has also reiterated its commitment to reducing the fiscal deficit from 6 percent of GDP in 1994 to the 3 percent necessary for entry into the European economic and monetary union. The government has not yet outlined how its policy initiatives square with deficit reduction, however, and some analysts believe it will be difficult to realize both goals even with the increase in the value-added tax that is rumored to be under consideration.

Analysis. Despite the fact that the proposed increase in the minimum wage is small by American standards, it has attracted considerable attention because the minimum wage in France already is very high—indeed, the highest in any G-7 country. Moreover, French employers face a hefty payroll tax of about 32 percent for workers at the minimum wage. Although employers can shift the burden of payroll taxes onto workers earning more than the minimum wage, they cannot do so for workers at the minimum because they cannot cut the wages of those workers.

Many economists believe that minimum wage laws do not significantly depress employment provided the wage floors are set at moderate levels. However, there is a consensus that France's effective minimum (consisting of the statutory minimum plus applicable payroll taxes) is high enough to have significant adverse effects.

EYES ONLY

SPECIAL ANALYSIS

The Poor Are Different: Their Lives Are Worse

The debate over welfare reform has been clouded by many misleading statements about the living conditions of the poor. For example, Robert Rector of the Heritage Foundation has argued that "the overwhelming majority of persons officially identified as 'poor' are in fact well fed and well housed." He notes that nearly 40 percent of all poor households own their own home, 53 percent have air conditioning, and 91 percent own a color television.

Rector's figures are not very informative for the welfare debate partly because they include elderly poor, who typically are not eligible for many welfare benefits. They also fail to convey the fact that, along a number of important dimensions, the circumstances of the poor are far worse than the circumstances of the non-poor; this is particularly true for those most likely to qualify for welfare (e.g., poor single-parent families). The following table compares the living conditions of poor and non-poor families. It shows that the poor are indisputably worse off in important respects.

Indicators of Living Conditions

	Percent of people in ...		
	non-poor families	poor families	poor, single-parent families
evicted within the past year	0.4	2.1	2.4
living in crowded housing	4.2	19.2	16.7
who had gas or electric service turned off within the past year	1.8	8.5	10.1
without enough food at some point within the past 4 months	1.3	11.0	13.1
without a telephone	2.8	23.3	30.1
not owning their own home	22.4	59.2	75.7
Addenda:			
number of infant deaths per 1,000 live births	8.5	14.3	15.2
percent of infants with low weight at time of birth	5.7	10.4	12.7
number of violent crimes suffered per 1,000 people per year	26.2	53.7	87.5

EYES ONLY

MACROECONOMIC UPDATE

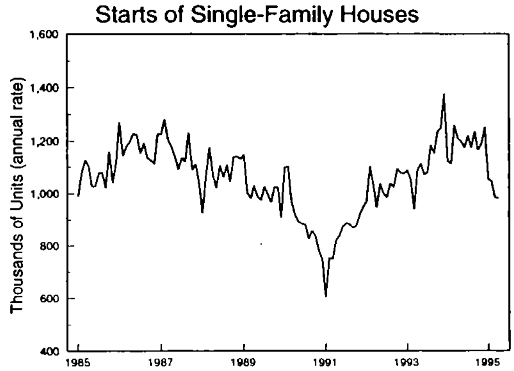
Still Looking Like a Bump in the Road

The employment data for May, as well as other recent indicators, suggest that real GDP growth in the second quarter will be very weak and may well be negative. Among other factors, this lull reflects a slowdown in homebuilding activity and a fairly aggressive move by automakers to clean up excess inventories.

Despite the decidedly weak tenor of recent indicators, the economy still appears to be fundamentally healthy, and free of the types of imbalances that in the past have been harbingers of a recession. Inflation is low, long-term interest rates have declined significantly from their recent peaks, consumer and business confidence is still relatively high despite some slippage in recent months, and the overhang in inventories is not terribly large. As a result, the prospects for a resumption of moderate growth during the second half of this year still appear good.

Sources of the weakness in the second quarter. Demand for new homes has been weak in recent months—surprisingly so, in light of the fact that housing is arguably the most interest-sensitive sector of the economy and mortgage rates have been declining since late last year. In response to this weakening in demand, builders have slowed the pace of housing production considerably (see chart), but not by enough to prevent the stock of unsold new homes from continuing to rise.

Starts of Single-Family Houses



Production in the motor vehicles industry was cut significantly during the second quarter in order to pare inventories. These cutbacks and a modest rebound in sales in May have done part of the job, but there still appears to be no immediate prospect of a rebound in production.

EYES ONLY

ARTICLE

The Advent of Competition to the Market for Electricity

The electrical utility industry is undergoing a fundamental transformation similar in many respects to the changes taking place in the telecommunications industry. The central feature of this transformation will be the introduction of a greater degree of competition. In turn, that competition should result in higher productivity and lower prices. But policy decisions still to be made at the Federal and state levels, and in the courts, will be critical in determining the extent of those benefits, as well as the division of them between various interest groups.

Background. The electrical utility industry generates electricity, transmits it over bulk lines to local utilities, and then distributes it to retail customers. Until fairly recently, most utilities have performed all three functions rather than specializing in any one of them. In broad-brush terms, the industry has been regulated on a "cost-plus" basis. That is, retail rates have been set so as to allow utilities to recover operating costs (e.g., fuel costs and salaries) and earn a "fair" return on their investment in plant and equipment. Analysts lay much of the blame for the industry's perceived inefficiencies at the doorstep of cost-plus-type regulation: Under this approach, any move to cut costs may have little or no effect on profits if the state or local regulator responds by cutting allowable rates.

Pressure for change. Much of the current agitation for change reflects the fact that electricity rates differ dramatically across the country, and often between neighboring utilities as is illustrated in the Chart of the Week. In part, these rate differentials probably reflect the fact that—for whatever reason—some utilities simply run a tighter ship than others: They operate with fewer people, get by with less excess capacity, and operate that capacity with less waste. The rate differentials also reflect that some utilities made better choices than others about what type of generating capacity they would build. In retrospect, for example, nuclear capacity has turned out to be relatively expensive whereas natural gas is cheap at the moment; as a result, utilities that built nuclear plants tend to have relatively high rates. Confronted with these large rate differentials, large industrial and commercial electricity consumers increasingly have demanded the flexibility to purchase their power from the lowest-cost producer in the marketplace, rather than being constrained to pay whatever price is charged by the local monopolist.

Already there is some competition in generation. Congress in 1978 authorized certain independent, non-utility generators (NUGs) to sell power to utilities at essentially unregulated rates. Freed from cost-based regulation, NUGs have strong incentives to cut costs because they are able to keep the difference in the form of higher profits. Until now, NUGs have sold mostly to utilities. California and Rhode Island are considering taking the next step and allowing out-of-area generators (or other utilities) to sell power to customers directly, under new market institutions to be determined.

Implementing more extensive competition will not be easy. Generators will not be able to reach their customers unless they have access to utilities' transmission lines on reasonable terms. The Federal Energy Regulatory Commission (FERC) is developing a proposal that would force utilities to offer access to all suppliers on "comparable terms." But the enforcement of comparable terms will be difficult because utilities will have the incentive to provide preferential access to their own generating capacity. To prevent similar favoritism in long distance service, the Justice Department in 1984 separated AT&T into a long distance company and local-telephone monopolists (the regional Bells) that were barred from providing long distance services. It remains to be seen if equal transmission access can be implemented in electricity without creating unwieldy regulation, or separating generators from transmission companies.

The move to competition could result in cost-shifting. In addition to yielding overall gains, the move to competition might cause some parties to bear costs that otherwise would have been borne by others.

Large versus small customers. Some small buyers in California and elsewhere have been cool to the trend toward a more competitive market. One possible reason for this lack of enthusiasm is that in the current regulated environment large industrial and commercial customers may be subsidizing residential customers. Such cross subsidization will probably be reduced or eliminated in a more competitive environment. Another possible reason may be a fear that large customers will be able to use their size to obtain electricity on preferential terms. There are mechanisms available for addressing this latter concern. For example, one plan currently under consideration in California would cause electricity to be purchased from generators on a competitive basis, and then distributed on a non-discriminatory basis to all customers—industrial, commercial, and residential.

Stranded costs. If unrestricted competition is permitted, market prices in some areas might well not be high enough to provide generators the rate of return they would have been granted by state and local regulatory authorities under the old system. Vulnerable utilities cry foul: Utilities historically have been forced to serve all customers in their areas and, with approval of state regulators, some have made large investments in generating plant to ensure their ability to serve. Utilities argue that their stockholders should not bear the consequences of an unexpected change in the rules of the regulatory game. Stranded costs are estimated at tens of billions of dollars. FERC has recently argued that customers who leave their utility for lower rates outside should pay some of these stranded costs, and has proposed a mechanism for collecting such payments. If states disagree with FERC's approach and try to recover stranded costs by imposing their own charges on distribution lines, a major confrontation is possible between them and FERC over who has legal jurisdiction over the "wires."

Conclusion. Competition is coming to the market for electricity, and the decisions taken by Federal and state regulators will help determine the extent of the gains from that competition, and how those gains are distributed.

EYES ONLY

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

IBM Bids for Lotus, Girds for Microsoft. IBM recently announced a hostile $3.3 billion takeover bid for Lotus Development Corp., the nation's third largest producer of computer software. Industry analysts say that IBM's main target is Lotus' popular Notes networking software, which already has a base of more than 1 million installed customers. IBM apparently hopes that grabbing leadership in the fast-growing "groupware" segment of the industry will allow it to challenge Microsoft, which currently dominates the market for PC software (see Weekly Economic Briefing, April 3, 1995.) IBM's bid of $60 per share topped Lotus's pre-bid price by 85 percent. But investors apparently are betting that the bidding will go even higher: As of the close of the market on June 8, Lotus was trading at $63-1/2 per share.

Sweet Victory for the United Farm Workers. Farm workers at Chateau Ste. Michelle, Washington state's largest winery, made labor history in early June by voting to unionize. The vote marked the first time since the early 1970s that farm workers in Washington had even voted on unionization. Workers at the winery began pushing for the right to unionize in 1987, and organized a boycott of the winery's products when discussions broke down. A breakthrough occurred this spring when both sides agreed to submit the matter to a neutral commission, chaired by former House Speaker Tom Foley, that was charged with setting the ground rules for the election. For the United Farm Workers (UFW), reaching this point was no mean feat: Federal law does not guarantee farm workers the right to organize, and among the states, only California offers full protection. As a result, the UFW has not negotiated a farm-worker contract outside California since 1972. But in Washington, where Chateau Ste. Michelle has committed itself to good-faith negotiations with the union, this record looks set to fall.

Why Do Workers Lose Their Jobs? A recent study published by the Economic Policy Institute took a strikingly simple approach to answering this question: It listened to employers. The study relied on data from the Department of Labor, which regularly surveys employers on the causes of large-scale layoffs (those that idle more than 50 workers). The study found that 35 percent of gross job losses during the 1987-90 period stemmed from temporary causes—most commonly seasonality of the work, but also including plant repairs, model changeovers, and weather disruptions. Another 30 percent of layoffs were due to faltering product demand, while 8 percent occurred after the firm failed or was acquired. By contrast, labor disputes and import competition were cited as responsible for only 3 percent and 2 percent of job losses, respectively. Surprisingly, automation and overseas relocation together accounted for less than 1 percent of layoffs. What about environmental and safety regulation? In the employers' own estimation, regulatory costs were responsible for only 0.1 percent of job loss.

EYES ONLY

RELEASES LAST WEEK

Producer Price Index

The producer price index for all finished goods was unchanged in May. Excluding food and energy, producer prices increased 0.3 percent.

Domestic Auto Sales

Domestic autos were sold at an annual rate of 7.1 million units in May.

MAJOR RELEASES THIS WEEK

Consumer Prices

****Embargoed until 8:30 a.m., Tuesday, June 13, 1995**

The consumer price index increased 0.3 percent in May. Excluding food and energy, consumer prices rose 0.2 percent.

Retail Sales

****Embargoed until 8:30 a.m., Tuesday, June 13, 1995**

Advance estimates show that retail sales rose 0.2 percent in May following a 0.3 percent decrease in April. Excluding sales in the automotive group, retail sales rose 0.1 percent.

Productivity (Wednesday)

Industrial Production and Capacity Utilization (Thursday)

EYES ONLY

U.S. ECONOMIC STATISTICS

	1970–1993	1994	1994:3	1994:4	1995:1
Percent growth (annual rate)					
Real GDP	2.5	4.1	4.0	5.1	2.7
GDP deflator	5.5	2.3	1.9	1.3	2.2
Productivity					
Nonfarm business	1.2	2.0	3.2	4.0	0.7
Manufacturing (1978-93)	2.1	4.7	3.5	3.4	3.6
Real compensation per hour	0.6	0.7	–0.4	1.2	1.0
Shares of Real GDP (percent)					
Business fixed investment	11.0	12.6	12.7	13.0	13.6
Residential investment	4.7	4.3	4.3	4.3	4.2
Exports	8.0	12.3	12.4	12.8	12.8
Imports	9.2	14.4	14.6	14.8	15.0
Shares of Nominal GDP (percent)					
Personal saving	4.9	3.0	3.0	3.4	3.8
Federal surplus	–2.8	–2.4	–2.3	–2.3	–2.2
			March 1995	**April 1995**	**May 1995**
Unemployment Rate	6.7*	6.1*	5.5	5.8	5.7

*Figures beginning 1994 are not comparable with earlier data.

Payroll employment (thousands)					
increase per month			179	–7	–101
increase since Jan. 1993					6717
Inflation (percent per period)					
CPI	5.8	2.7	0.2	0.4	**0.3**
PPI-Finished goods	5.0	1.7	0.0	0.5	**0.0**

New or revised data in **boldface**.
CPI data **embargoed until 8:30 a.m., Tuesday, June 13, 1995.**

EYES ONLY

FINANCIAL STATISTICS

	1993	1994	April 1995	May 1995	June 8, 1995
Dow-Jones Industrial Average	3522	3794	4231	4392	4459
Interest Rates					
3-month T-bill	3.00	4.25	5.65	5.67	5.59
10-year T-bond	5.87	7.09	7.06	6.63	6.22
Mortgage rate, 30-year fixed	7.33	8.36	8.32	7.91	7.51
Prime rate	6.00	7.15	9.00	9.00	9.00

INTERNATIONAL STATISTICS

Exchange Rates	**Current level June 8, 1995**	**Percent Change from**	
		Week ago	**Year ago**
Deutschemark-Dollar	1.407	–0.5	–15.9
Yen-Dollar	84.64	–0.2	–18.7
Multilateral (Mar. 1973=100)	82.33	–0.4	–11.8

International Comparisons	**Real GDP growth (last 4 quarters)**	**Unemployment rate**	**CPI inflation (last 12 months)**
United States	4.0 (Q1)	5.7 (May)	**3.2** (May)
Canada	5.6 (Q4)	9.4 (Apr)	2.4 (Apr)
Japan	0.9 (Q4)	3.0 (Mar)	–0.4 (Mar)
France	3.7 (Q4)	12.1 (Mar)	1.6 (Apr)
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Italy	2.7 (Q4)	12.2 (Jan)	5.0 (Mar)
United Kingdom	3.7 (Q1)	8.6 (Apr)	3.4 (Apr)

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EYES ONLY

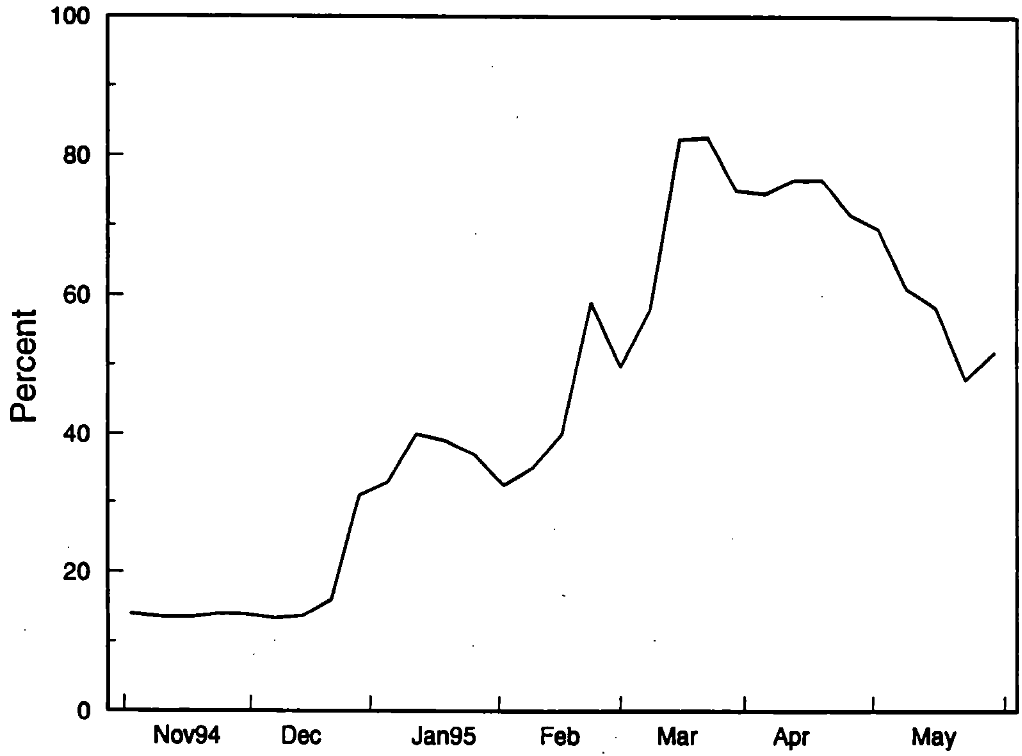
WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

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

June 5, 1995

CHART OF THE WEEK

Interest Rates on 28-Day Mexican Government Securities



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EYES ONLY

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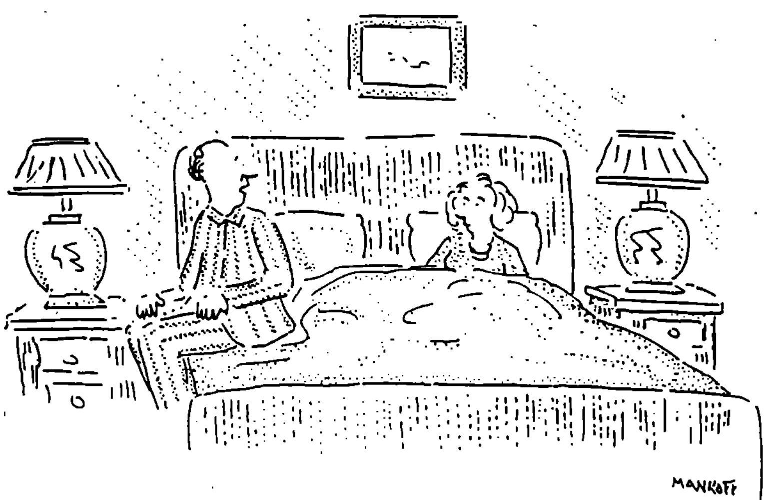


"I can't sleep. I just got this incredible craving for capital."

EYES ONLY

CURRENT DEVELOPMENT

Some Pain, Some Gain

The Mexican people are paying a price for the financial crisis that erupted late last year. More than 500,000 people have lost their jobs, and the urban unemployment rate by February had already increased from 3.2 percent to 5.3 percent. Nonetheless, there are some encouraging signs that the adjustment program is taking effect:

- The peso has stabilized at around 6 pesos per dollar, up from a low of about 7-1/2 pesos per dollar in early March.
- Inflation may have peaked. After rising more than 5 percent in the first half of April, consumer prices rose "only" slightly more than 2 percent during the second half (still more than 60 percent at an annual rate).
- Domestic interest rates have fallen from more than 80 percent in March to about 50 percent today (see Chart of the Week).
- More than half of the troublesome dollar-linked short-term government debt due this year has been retired with the help of the financing package from the IMF and the United States. And there appear to be ample resources for dealing with the remaining 40 percent of this debt.
- The fiscal situation has improved dramatically. Excluding interest expense, the federal budget was in surplus to the tune of 7 percent of GDP in the first quarter of this year, up from 3-1/2 percent one year earlier.
- The trade balance has turned around rapidly (see Chart of the Week, Weekly Economic Briefing, May 1, 1995).

Analysis. At this point, the stabilization plan appears to be on track but there remain some risks. In particular, the plan has been tough on the Mexican people, and it remains to be seen whether the program will continue to command their support.

EYES ONLY

SPECIAL ANALYSIS

Be Prepared

At the summit you will be attending in Halifax later this month, the G-7 countries will agree on recommendations aimed at improving the ability of the International Monetary Fund (IMF) to deal with financial crises of the type that Mexico suffered late last year:

- Enhanced reporting and surveillance. The G-7 will recommend that all IMF members be required to report certain key economic indicators on a more timely basis. The G-7 will also urge the IMF to sharpen its policy advice, especially to countries that appear to be avoiding necessary policy actions. Some observers have speculated that more timely reporting of data might have led to earlier detection of the crisis in Mexico, and provided the basis for stronger warnings from the IMF to Mexico at an earlier stage.
- Beefed-up crisis procedures. The G-7 will recommend that the IMF establish a procedure for providing emergency financing in crisis situations. This procedure could be activated more quickly than existing IMF arrangements, and would be linked to monies to be provided by the G-7 and other countries.

The G-7 may also recommend the study of a more controversial proposal: institutional arrangements permitting a country to suspend payment to creditors temporarily until it can get its fiscal house in order.

Analysis. Some analysts have argued that advance preparations for financial crises may be counter-productive: By reducing the pain associated with financial crises, such actions may also reduce the incentives for countries to avoid those crises. The opposing view—shared by the United States—is that crisis preparation should have little if any adverse impact on incentives because the IMF will have authority not only to disburse aid but also to impose economic reform programs.

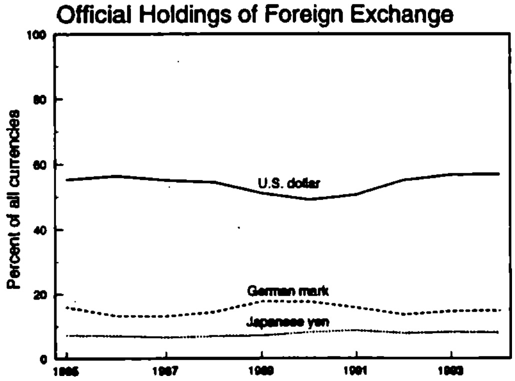
EYES ONLY

TREND

The Role of the Dollar in the International Economy

In the wake of the dollar's recent slide against the Japanese yen and the German mark, some observers have speculated that the U.S. dollar might be in jeopardy of losing its role as the world's principal reserve currency. But the dollar has endured much greater reductions in its value in the past, and yet retained its central role in the international financial system:

Official Holdings of Foreign Exchange



Central banks around the world hold the bulk of their foreign-currency reserves in dollar-denominated assets (e.g., U.S. Treasury securities). At the end of 1994, 57 percent (or about $585 billion) of these holdings were in dollar-denominated assets, compared with only 15 percent for German marks and 8 percent for Japanese yen (see chart). Since at least the mid-1980s, the dollar's share in central bank portfolios has been broadly stable, despite enormous changes in the exchange value of the dollar.

Many international transactions, both trade-related and purely financial, are executed in terms of dollars. For example, U.S. trade is almost always invoiced in terms of dollars. Worldwide, a good guess is that about half of all international trade in goods and services is invoiced in dollar terms. Furthermore, about 40 percent of the nearly $1 trillion in foreign exchange transactions conducted daily involve dollars on either the buying or selling side.

Many residents of foreign countries hold dollars as legal tender. Dollars are often used instead of the local currency in high-inflation countries such as Russia. Dollars are also often used to finance illicit activity such as trade in illegal drugs. All holdings of dollars (whether abroad or at home) in effect amount to an interest-free form of financing for the U.S. government. (Both Treasury bonds and dollar bills represent liabilities of the Federal government. But the holder of a Treasury bond receives interest whereas the holder of a dollar bill does not.) This source of financing may be saving the government as much as $15 billion in debt-servicing charges per year.

Summary. In many respects, the dollar plays a central role in the international economy. History suggests that it will continue to play that role despite the recent decline in the foreign exchange value of the dollar.

EYES ONLY

ARTICLE

Death and Taxes

If enacted, the tax bill passed by the House earlier this year would ease the terms of the Federal gift and estate tax. Specifically, the bill would increase the lifetime amount of gifts and bequests exempt from tax from $600,000 to $750,000 by 1998, and would index it thereafter. Treasury estimates that this change would cut the number of taxable estates by nearly one-half, at a revenue cost of between $1 billion and $2 billion per year.

Structure of the tax. The Federal tax code treats gifts and estates on a unified basis (i.e., added together and taxed as a single amount). During an individual's lifetime, he or she may give up to $10,000 per recipient per year with no tax consequences (married couples are allowed $20,000). Any excess over $10,000 per recipient per year is added to a running total, as is any bequest. Taxes must be paid only after the running total exceeds the lifetime exemption amount, currently $600,000. An important exception is that married individuals are allowed to transfer an unlimited amount to their surviving spouses without incurring any tax. Statutory marginal tax rates for transfers exceeding the lifetime exemption amount vary from 37 percent to 55 percent (applicable to gift-plus-bequest totals of more than $3 million.)

Who pays the tax? Only 1 percent of adult deaths result in estates subject to taxation. Thus, only the very wealthiest Americans stand to benefit from any relaxation of the estate tax.

How much revenue does the tax raise? Ostensibly, the gift and estate tax raised $15.2 billion in 1994, about 1 percent of total Federal revenues. However, some analysts believe that this figure overstates the net revenue-producing power of the gift and estate tax, because strategic estate planning has the side-effect of reducing income tax revenues. For example, taxpayers may give assets during their lifetimes to persons in lower tax brackets, or to tax-exempt charities. A cut in estate tax rates might reduce the effort expended in tax avoidance, and so might actually result in an increase in income tax revenues.

Oddly enough, the Federal gift and estate tax provides a substantial amount of revenue to state governments. Currently, the Federal estate tax allows a credit to be taken for estate taxes paid to State governments up to a limit. At this time, all States have enacted estate taxes substantial enough to at least cover or "pick up" the amount of Federal credit. This provision, a form of revenue-sharing between the Federal government and the states, yields the states more than $3 billion per year.

The "lock-in" effect in the income tax. One provision of the income tax law has profound implications for estate planning. This provision is called the "step-up" in basis on assets transferred at death; it grants heirs a cost basis on bequeathed assets equal to the fair market value of those assets at time of the donor's death. Effectively, this provision permits any accumulated capital gain on the bequeathed assets to escape income taxation.

The step-up provision will often create a strong incentive for individuals to hold onto their assets until they die. Some analysts believe that this "lock-in" effect distorts economic decisions. For the Federal government, a more pressing concern with the step-up loophole is that it costs the Treasury a great deal of income tax revenue. The Congressional Budget Office estimates that elimination of the step-up in basis might yield as much as $10 billion per year. As a practical matter, any reform of the step-up in basis would probably have to make some special provisions for small businesses and farms along the lines of those currently contained within the estate tax.

Possible reforms. In the past, piecemeal reform of the step-up in basis has run into Congressional opposition. In principle, it should be possible to craft a tax reform *package* that would close an income tax loophole, modify or eliminate the state tax credit, substantially reduce the number of people subject to the gift and estate tax, reduce marginal rates under the gift and estate tax (thereby reducing the incentive to engage in socially wasteful strategic tax planning), and raise revenue. Alternative approaches to designing such a package are under study within the Administration.

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

Electric Car Technology Surges Ahead. A four-passenger electric car recently set a new world distance record by going 238 miles in mixed city-highway driving without a recharge. Built by Solectria, a Massachusetts-based company, the Ford Taurus-sized Sunrise is powered by nickel-metal hydride batteries. Although nickel-based auto batteries are not yet in commercial production, a joint venture between the Ovonic Battery Corp. and General Motors plans to begin production soon. In attracting consumers, range matters: Many observers feel that electric vehicles will need to offer a consistent range of 100-200 miles, under more punishing conditions than the Sunrise encountered. Cost will also be a factor, of course. Solectria estimates that if battery prices fall as the firm expects and if it can log 20,000 orders per year, it will be able to market the Sunrise at about $20,000.

... and So Does Boeing. Even before making its first commercial flight, Boeing's new twin-engine 777 scored a significant victory. The Federal Aviation Administration (FAA) ruled in late May that the plane can immediately begin flying routes that take it up to 3 hours away from the nearest landing strip. In practice, this means that the 777 is cleared right off the bat to fly all major transoceanic routes. In the past, the FAA has required twin-engine jets to stay close to airports during their first 2 years of commercial flights, while they accumulate safety records under actual flying conditions. But Boeing put its new jet through an extensive pre-launch testing program aimed at winning early approval from the FAA. Wall Street reacted well to news of Boeing's success. The firm's stock rose $1.75 per share, to $58.25, after the announcement.

Poverty's Toll. In its first annual World Health Report, the World Health Organization identifies "extreme poverty" as the world's most ruthless killer. After adjusting for age and sex, the Report found that an inhabitant of the developing world is nearly twice as likely as his/her developed-world counterpart to die in any given year. (In large part, the difference is due to communicable diseases, which cause half of Third World deaths but are generally prevented or treated in wealthier countries.) Children disproportionately bear the health consequences of poverty. For young children in the developing world, the mortality rate from all causes is 10 times the developed-world rate. Each year, 3 million young children in the Third World die of diarrhoeal diseases, 4 million die for lack of inexpensive antibiotics, and more than 2 million because they have not been immunized against measles, tetanus, and other diseases. In most of these cases, the child's life could have been saved with only a small expenditure on drugs or treatments. And history supports the view that efforts in this area can make a difference. The Report estimates that between 1985 and 1993, the number of children dying from vaccine-preventable deaths fell by 1.3 million (more than one-third).

EYES ONLY

RELEASES LAST WEEK

Employment and Unemployment
****Embargoed until 8:30 a.m., Friday, June 2, 1995****

In May, the unemployment rate declined to 5.7 percent from 5.8 percent in April. Nonfarm payroll employment decreased by 101,000, to 116.2 million.

Leading Indicators
****Embargoed until 8:30 a.m., Friday, June 2, 1995****

The index of leading economic indicators fell 0.6 percent in April, following decreases of 0.5 percent in March and 0.3 percent in February.

Personal Income and Expenditures

Personal income increased 0.3 percent in April (monthly rate). Disposable personal income decreased 0.7 percent. Personal consumption expenditures increased 0.3 percent.

Gross Domestic Product

According to revised estimates for the first quarter, real gross domestic product grew at an annual rate of 2.7 percent.

Consumer Confidence

Consumer confidence, as measured by the Conference Board, decreased 3.0 index points in May, to 101.6 (1985=100).

MAJOR RELEASES THIS WEEK

Producer Prices (Friday)

EYES ONLY

U.S. ECONOMIC STATISTICS

	1970–1993	1994	1994:3	1994:4	1995:1
Percent growth (annual rate)					
Real GDP	2.5	4.1	4.0	5.1	**2.7**
GDP deflator	5.5	2.3	1.9	1.3	2.2
Productivity					
Nonfarm business	1.2	2.0	3.2	4.0	0.7
Manufacturing (1978-93)	2.1	4.7	3.5	3.4	3.6
Real compensation per hour	0.6	0.7	–0.4	1.2	1.0
Shares of Real GDP (percent)					
Business fixed investment	11.0	12.6	12.7	13.0	**13.6**
Residential investment	4.7	4.3	4.3	4.3	4.2
Exports	8.0	12.3	12.4	12.8	**12.8**
Imports	9.2	14.4	14.6	14.8	**15.0**
Shares of Nominal GDP (percent)					
Personal saving	4.9	3.0	3.0	3.4	**3.8**
Federal surplus	–2.8	–2.4	–2.3	–2.3	**–2.2**

			March 1995	April 1995	May 1995
Unemployment Rate	6.7*	6.1*	5.5	5.8	**5.7**

*Figures beginning 1994 are not comparable with earlier data.

			March 1995	April 1995	May 1995
Payroll employment (thousands)					
increase per month			**179**	**–7**	**–101**
increase since Jan. 1993					**6717**
Inflation (percent per period)					
CPI	5.8	2.7	0.2	0.4	N.A.
PPI-Finished goods	5.0	1.7	0.0	0.5	N.A.

New or revised data in **boldface.**
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Dow-Jones Industrial Average	3522	3794	4231	4392	4473
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Mortgage rate, 30-year fixed	7.33	8.36	8.32	7.91	7.71
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INTERNATIONAL STATISTICS

Exchange Rates	**Current level June 1, 1995**	**Percent Change from Week ago**	**Percent Change from Year ago**
Deutschemark-Dollar	1.414	0.7	−14.0
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Canada	5.6 (Q4)	9.7 (Mar)	2.4 (Apr)
Japan	0.9 (Q4)	3.0 (Feb)	−0.4 (Mar)
France	3.7 (Q4)	12.1 (Feb)	1.6 (Apr)
Germany	3.3 (Q4)	6.4 (Mar)	2.2 (Apr)
Italy	2.7 (Q4)	12.2 (Jan)	5.0 (Mar)
United Kingdom	3.7 (Q1)	8.6 (Mar)	3.4 (Apr)

Dena
Please file with WEBs.
Laura

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

June 5, 1995

CHART OF THE WEEK

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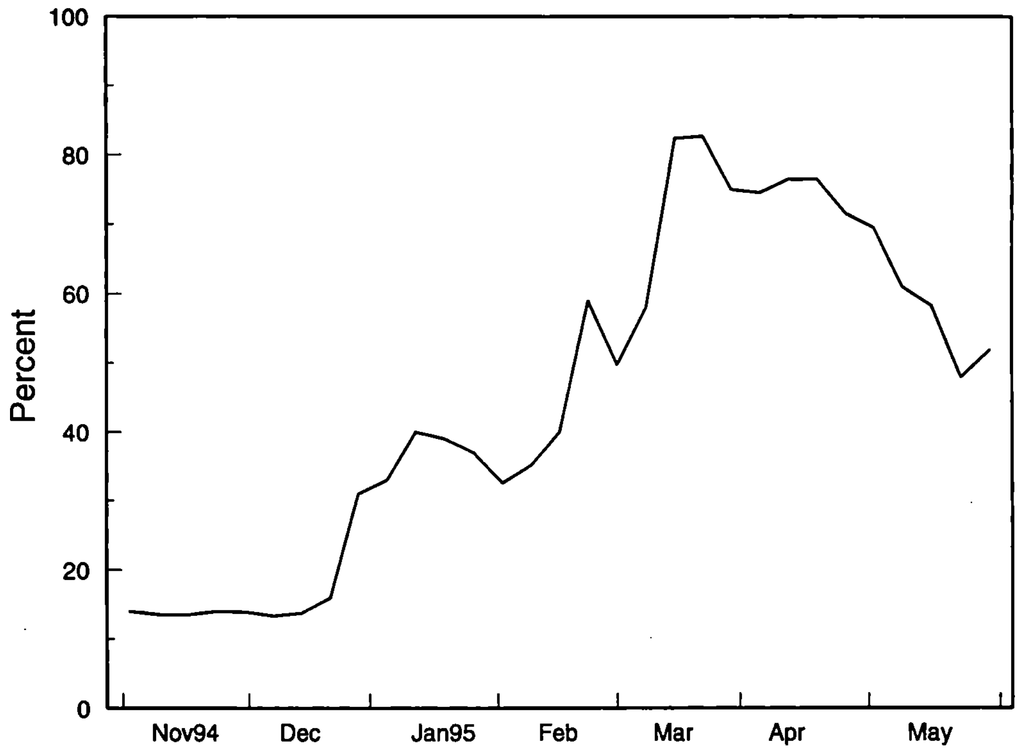

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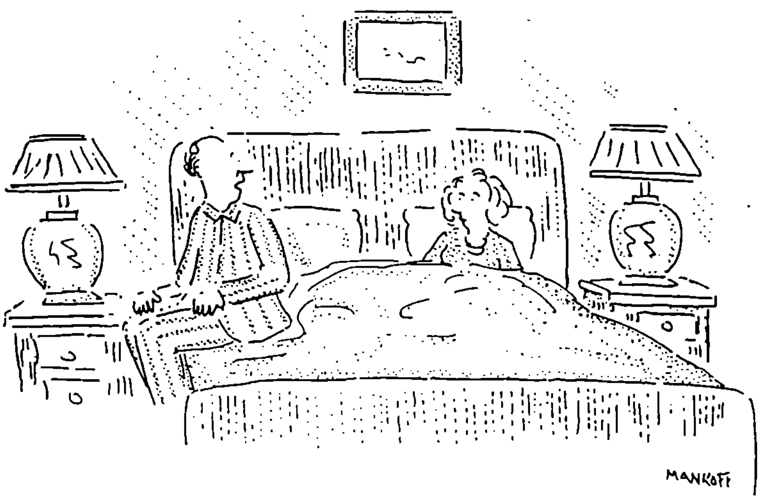

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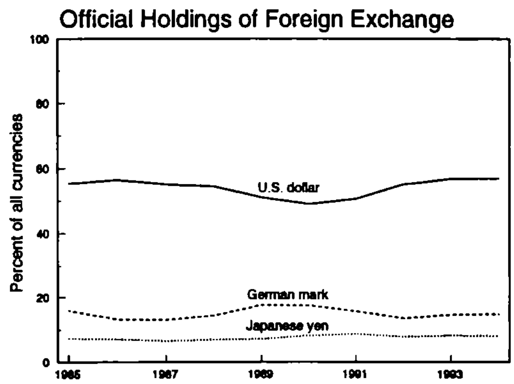
EYES ONLY

<u>TREND</u>

The Role of the Dollar in the International Economy

In the wake of the dollar's recent slide against the Japanese yen and the German mark, some observers have speculated that the U.S. dollar might be in jeopardy of losing its role as the world's principal reserve currency. But the dollar has endured much greater reductions in its value in the past, and yet retained its central role in the international financial system:



Central banks around the world hold the bulk of their foreign-currency reserves in dollar-denominated assets (e.g., U.S. Treasury securities). At the end of 1994, 57 percent (or about $585 billion) of these holdings were in dollar-denominated assets, compared with only 15 percent for German marks and 8 percent for Japanese yen (see chart). Since at least the mid-1980s, the dollar's share in central bank portfolios has been broadly stable, despite enormous changes in the exchange value of the dollar.

Many international transactions, both trade-related and purely financial, are executed in terms of dollars. For example, U.S. trade is almost always invoiced in terms of dollars. Worldwide, a good guess is that about half of all international trade in goods and services is invoiced in dollar terms. Furthermore, about 40 percent of the nearly $1 trillion in foreign exchange transactions conducted daily involve dollars on either the buying or selling side.

Many residents of foreign countries hold dollars as legal tender. Dollars are often used instead of the local currency in high-inflation countries such as Russia. Dollars are also often used to finance illicit activity such as trade in illegal drugs. <u>All</u> holdings of dollars (whether abroad or at home) in effect amount to an interest-free form of financing for the U.S. government. (Both Treasury bonds and dollar bills represent liabilities of the Federal government. But the holder of a Treasury bond receives interest whereas the holder of a dollar bill does not.) This source of financing may be saving the government as much as $15 billion in debt-servicing charges per year.

Summary. In many respects, the dollar plays a central role in the international economy. History suggests that it will continue to play that role despite the recent decline in the foreign exchange value of the dollar.

EYES ONLY

ARTICLE

Death and Taxes

If enacted, the tax bill passed by the House earlier this year would ease the terms of the Federal gift and estate tax. Specifically, the bill would increase the lifetime amount of gifts and bequests exempt from tax from $600,000 to $750,000 by 1998, and would index it thereafter. Treasury estimates that this change would cut the number of taxable estates by nearly one-half, at a revenue cost of between $1 billion and $2 billion per year.

Structure of the tax. The Federal tax code treats gifts and estates on a unified basis (i.e., added together and taxed as a single amount). During an individual's lifetime, he or she may give up to $10,000 per recipient per year with no tax consequences (married couples are allowed $20,000). Any excess over $10,000 per recipient per year is added to a running total, as is any bequest. Taxes must be paid only after the running total exceeds the lifetime exemption amount, currently $600,000. An important exception is that married individuals are allowed to transfer an unlimited amount to their surviving spouses without incurring any tax. Statutory marginal tax rates for transfers exceeding the lifetime exemption amount vary from 37 percent to 55 percent (applicable to gift-plus-bequest totals of more than $3 million.)

Who pays the tax? Only 1 percent of adult deaths result in estates subject to taxation. Thus, only the very wealthiest Americans stand to benefit from any relaxation of the estate tax.

How much revenue does the tax raise? Ostensibly, the gift and estate tax raised $15.2 billion in 1994, about 1 percent of total Federal revenues. However, some analysts believe that this figure overstates the net revenue-producing power of the gift and estate tax, because strategic estate planning has the side-effect of reducing income tax revenues. For example, taxpayers may give assets during their lifetimes to persons in lower tax brackets, or to tax-exempt charities. A cut in estate tax rates might reduce the effort expended in tax avoidance, and so might actually result in an increase in income tax revenues.

Oddly enough, the Federal gift and estate tax provides a substantial amount of revenue to state governments. Currently, the Federal estate tax allows a credit to be taken for estate taxes paid to State governments up to a limit. At this time, all States have enacted estate taxes substantial enough to at least cover or "pick up" the amount of Federal credit. This provision, a form of revenue-sharing between the Federal government and the states, yields the states more than $3 billion per year.

The "lock-in" effect in the income tax. One provision of the income tax law has profound implications for estate planning. This provision is called the "step-up" in basis on assets transferred at death; it grants heirs a cost basis on bequeathed assets equal to the fair market value of those assets at time of the donor's death. Effectively, this provision permits any accumulated capital gain on the bequeathed assets to escape income taxation.

The step-up provision will often create a strong incentive for individuals to hold onto their assets until they die. Some analysts believe that this "lock-in" effect distorts economic decisions. For the Federal government, a more pressing concern with the step-up loophole is that it costs the Treasury a great deal of income tax revenue. The Congressional Budget Office estimates that elimination of the step-up in basis might yield as much as $10 billion per year. As a practical matter, any reform of the step-up in basis would probably have to make some special provisions for small businesses and farms along the lines of those currently contained within the estate tax.

Possible reforms. In the past, piecemeal reform of the step-up in basis has run into Congressional opposition. In principle, it should be possible to craft a tax reform *package* that would close an income tax loophole, modify or eliminate the state tax credit, substantially reduce the number of people subject to the gift and estate tax, reduce marginal rates under the gift and estate tax (thereby reducing the incentive to engage in socially wasteful strategic tax planning), and raise revenue. Alternative approaches to designing such a package are under study within the Administration.

EYES ONLY

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

Electric Car Technology Surges Ahead. A four-passenger electric car recently set a new world distance record by going 238 miles in mixed city-highway driving without a recharge. Built by Solectria, a Massachusetts-based company, the Ford Taurus-sized Sunrise is powered by nickel-metal hydride batteries. Although nickel-based auto batteries are not yet in commercial production, a joint venture between the Ovonic Battery Corp. and General Motors plans to begin production soon. In attracting consumers, range matters: Many observers feel that electric vehicles will need to offer a consistent range of 100-200 miles, under more punishing conditions than the Sunrise encountered. Cost will also be a factor, of course. Solectria estimates that if battery prices fall as the firm expects and if it can log 20,000 orders per year, it will be able to market the Sunrise at about $20,000.

... and So Does Boeing. Even before making its first commercial flight, Boeing's new twin-engine 777 scored a significant victory. The Federal Aviation Administration (FAA) ruled in late May that the plane can immediately begin flying routes that take it up to 3 hours away from the nearest landing strip. In practice, this means that the 777 is cleared right off the bat to fly all major transoceanic routes. In the past, the FAA has required twin-engine jets to stay close to airports during their first 2 years of commercial flights, while they accumulate safety records under actual flying conditions. But Boeing put its new jet through an extensive pre-launch testing program aimed at winning early approval from the FAA. Wall Street reacted well to news of Boeing's success. The firm's stock rose $1.75 per share, to $58.25, after the announcement.

Poverty's Toll. In its first annual World Health Report, the World Health Organization identifies "extreme poverty" as the world's most ruthless killer. After adjusting for age and sex, the Report found that an inhabitant of the developing world is nearly twice as likely as his/her developed-world counterpart to die in any given year. (In large part, the difference is due to communicable diseases, which cause half of Third World deaths but are generally prevented or treated in wealthier countries.) Children disproportionately bear the health consequences of poverty. For young children in the developing world, the mortality rate from all causes is 10 times the developed-world rate. Each year, 3 million young children in the Third World die of diarrhoeal diseases, 4 million die for lack of inexpensive antibiotics, and more than 2 million because they have not been immunized against measles, tetanus, and other diseases. In most of these cases, the child's life could have been saved with only a small expenditure on drugs or treatments. And history supports the view that efforts in this area can make a difference. The Report estimates that between 1985 and 1993, the number of children dying from vaccine-preventable deaths fell by 1.3 million (more than one-third).

EYES ONLY

RELEASES LAST WEEK

Employment and Unemployment
****Embargoed until 8:30 a.m., Friday, June 2, 1995****

In May, the unemployment rate declined to 5.7 percent from 5.8 percent in April. Nonfarm payroll employment decreased by 101,000, to 116.2 million.

Leading Indicators
****Embargoed until 8:30 a.m., Friday, June 2, 1995****

The index of leading economic indicators fell 0.6 percent in April, following decreases of 0.5 percent in March and 0.3 percent in February.

Personal Income and Expenditures

Personal income increased 0.3 percent in April (monthly rate). Disposable personal income decreased 0.7 percent. Personal consumption expenditures increased 0.3 percent.

Gross Domestic Product

According to revised estimates for the first quarter, real gross domestic product grew at an annual rate of 2.7 percent.

Consumer Confidence

Consumer confidence, as measured by the Conference Board, decreased 3.0 index points in May, to 101.6 (1985=100).

MAJOR RELEASES THIS WEEK

Producer Prices (Friday)

EYES ONLY

U.S. ECONOMIC STATISTICS

	1970–1993	1994	1994:3	1994:4	1995:1
Percent growth (annual rate)					
Real GDP	2.5	4.1	4.0	5.1	**2.7**
GDP deflator	5.5	2.3	1.9	1.3	2.2
Productivity					
Nonfarm business	1.2	2.0	3.2	4.0	0.7
Manufacturing (1978-93)	2.1	4.7	3.5	3.4	3.6
Real compensation per hour	0.6	0.7	–0.4	1.2	1.0
Shares of Real GDP (percent)					
Business fixed investment	11.0	12.6	12.7	13.0	**13.6**
Residential investment	4.7	4.3	4.3	4.3	4.2
Exports	8.0	12.3	12.4	12.8	**12.8**
Imports	9.2	14.4	14.6	14.8	**15.0**
Shares of Nominal GDP (percent)					
Personal saving	4.9	3.0	3.0	3.4	**3.8**
Federal surplus	–2.8	–2.4	–2.3	–2.3	**–2.2**
			March 1995	**April 1995**	**May 1995**
Unemployment Rate	6.7*	6.1*	5.5	5.8	**5.7**

*Figures beginning 1994 are not comparable with earlier data.

	1970–1993	1994	March 1995	April 1995	May 1995
Payroll employment (thousands)					
increase per month			**179**	**–7**	**–101**
increase since Jan. 1993					**6717**
Inflation (percent per period)					
CPI	5.8	2.7	0.2	0.4	N.A.
PPI-Finished goods	5.0	1.7	0.0	0.5	N.A.

New or revised data in **boldface**.
Employment and unemployment data **embargoed until 8:30 a.m., Friday, June 2, 1995.**

EYES ONLY

FINANCIAL STATISTICS

	1993	1994	April 1995	May 1995	June 1, 1995
Dow-Jones Industrial Average	3522	3794	4231	4392	4473
Interest Rates					
3-month T-bill	3.00	4.25	5.65	5.67	5.50
10-year T-bond	5.87	7.09	7.06	6.63	6.20
Mortgage rate, 30-year fixed	7.33	8.36	8.32	7.91	7.71
Prime rate	6.00	7.15	9.00	9.00	9.00

INTERNATIONAL STATISTICS

Exchange Rates	**Current level June 1, 1995**	**Percent Change from Week ago**	**Percent Change from Year ago**
Deutschemark-Dollar	1.414	0.7	–14.0
Yen-Dollar	84.80	–0.2	–18.9
Multilateral (Mar. 1973=100)	82.65	0.1	–10.6

International Comparisons	**Real GDP growth (last 4 quarters)**	**Unemployment rate**	**CPI inflation (last 12 months)**
United States	4.0 (Q1)	5.7 (May)	3.1 (Apr)
Canada	5.6 (Q4)	9.7 (Mar)	2.4 (Apr)
Japan	0.9 (Q4)	3.0 (Feb)	–0.4 (Mar)
France	3.7 (Q4)	12.1 (Feb)	1.6 (Apr)
Germany	3.3 (Q4)	6.4 (Mar)	2.2 (Apr)
Italy	2.7 (Q4)	12.2 (Jan)	5.0 (Mar)
United Kingdom	3.7 (Q1)	8.6 (Mar)	3.4 (Apr)

WEB May 1995

EYES ONLY

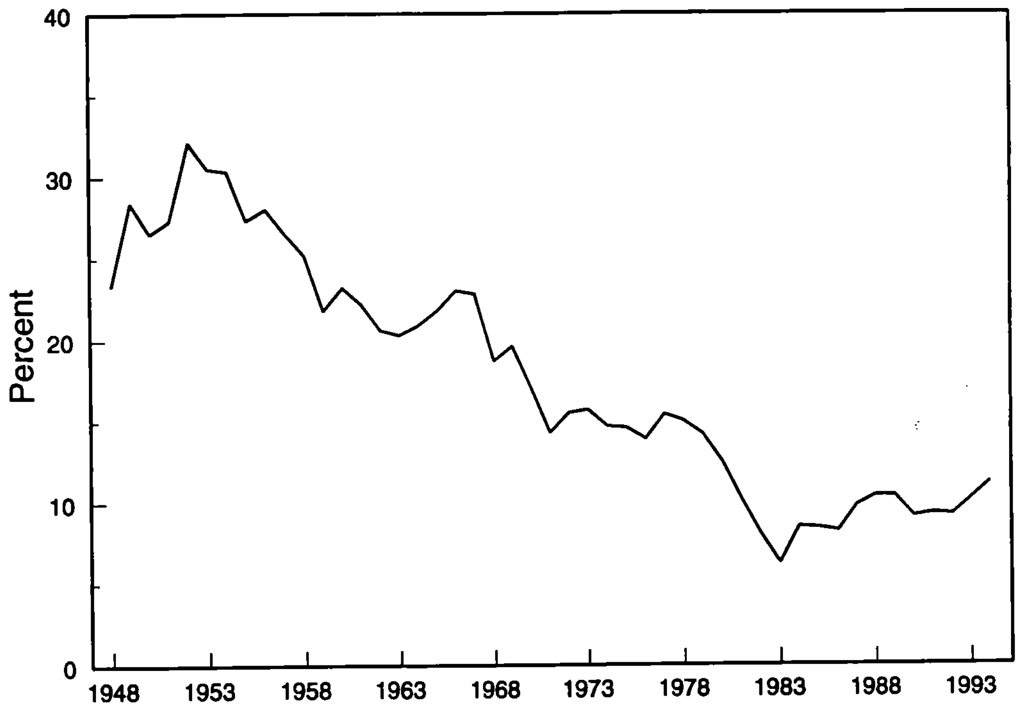
WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

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

May 30, 1995

CHART OF THE WEEK

The Share of Corporate Income Tax Revenues
in Total Gross Federal Revenues



Early in the postwar period, corporate income taxes accounted for about 30 percent of total Federal revenues. By the mid-1980s, this share had dropped below 10 percent. Since then, it has edged back up, and reached 11 percent in FY1994. Ultimately, the corporate income tax is borne by some combination of customers, workers, and shareholders—not by firms. As a result, the distributional implications of these trends are very difficult to determine.

EYES ONLY

CONTENTS

Quote of the Week

"How will next year be?" "Oh, about average. Worse than this year, but better than the year after next."

Popular Hungarian joke

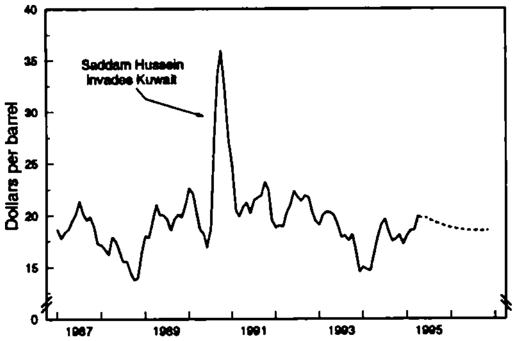
EYES ONLY

CURRENT DEVELOPMENT

Oils Well That Ends Well

Since the end of last year, the price of oil has increased about $2.50 per barrel. The current price of $20 per barrel is near the middle of the range that has prevailed since the end of the Gulf War (see solid line in chart).

Domestic Crude Oil Prices



Note: Dashed line indicates futures prices.

Analysis. The recent uptick in oil prices reflects several developments. At home, the demand for gasoline has been unexpectedly strong. Overseas, a strike by oil workers in Brazil and heightened tensions between the United States and both Iran and Iraq have raised concerns about supply in the near term.

Over the longer term, a number of factors will influence the oil market:

- Driven by domestic economic considerations, several OPEC members appear intent on keeping their production (and hence their revenues) high.
- If Iraq is allowed to resume exporting oil, it could possibly augment world oil supply (currently about 70 million barrels per day) by as much as 4 percent.
- Recent technological breakthroughs in deepwater production in the Gulf of Mexico have increased that area's production potential.
- World economic activity will be the key determinant of demand. At present, economic growth in the industrialized countries is moderate, but East Asia is expanding rapidly.

Many analysts look to the futures market as the best available forecast summarizing all these factors. According to the futures market, the price of oil will drift somewhat lower over the next year or so (see dotted line in chart).

EYES ONLY

CURRENT DEVELOPMENT

Health Care Update: Employer Coalitions Go National

More than 100 health maintenance organizations (HMOs) are bidding this week for the chance to offer health care to 240,000 employees of 10 large companies around the nation (as well as their 360,000 dependents). The 10 employers have banded together in an effort to increase their bargaining power in dealing with HMOs. For each of 27 areas, the coalition plans to select between two and four health plans to offer to employees.

Until recently, health-care purchasing coalitions existed only at the regional level. But Merrill Lynch and American Express formed an alliance for nationwide bargaining in 1993, and eight other firms—including Sears Roebuck, Marriott, and IBM—have since joined the two leaders. Together, the ten companies account for about $1 billion in health-care purchases per year.

Analysis. The emergence of employer coalitions has probably helped intensify the competition among HMOs, lowering health-care expenses for many employers (see Weekly Economic Briefing, February 21, 1995).

Many analysts believe that HMO profit margins remain healthy despite this increase in competition, suggesting that HMOs are succeeding in holding down their own costs. They might be achieving this cost containment by reducing the quality of the medical care they provide. But anecdotal evidence suggests that two other trends have helped. First, HMOs appear to have achieved genuine improvements in efficiency, making them able to provide the same care at lower cost. Second, HMOs appear to be squeezing their suppliers, including doctors, hospitals, and vendors of medical equipment.

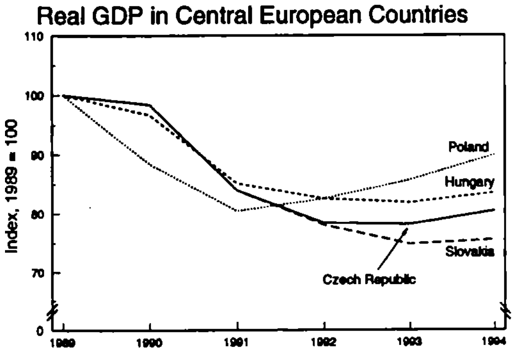
EYES ONLY

SPECIAL ANALYSIS

Why Hasn't Hungary Done Better?

Prime Minister Horn, who will visit Washington in early June, leads a country that is still struggling to achieve sustained growth for the first time since embarking on its transition to a market economy. Many analysts predicted that Hungary would navigate the transition more smoothly: It had a long history of experimentation with market mechanisms, a solid record of exporting to the West, and it had been much more successful in garnering foreign investment than either Poland or the Czech Republic. But Hungary was not spared the recessions experienced in other Central European countries; recovery has been slow to arrive (see chart) and remains fragile. It appears that much of the responsibility for this shortfall relative to expectations rests on Hungarian policy:

Real GDP in Central European Countries



Note: Observations for 1994 are estimates.
Data for Czech Republic and Slovakia are consolidated before 1992.

Fiscal imbalance. Hungary's fiscal situation is the primary obstacle to sustained growth. The budget deficit currently is running at 7 percent of GDP, owing largely to an extensive social welfare system which delivers payments amounting to 29 percent of GDP. Payroll tax rates, at 60 percent, may be the highest in the world. In its March budget, the government finally began to shift toward a needs-based transfer system, announcing cuts in universal family and maternity allowances. But plans to raise retirement ages (currently 55 for women, 60 for men) have repeatedly been postponed, even though the pension system has only three contributors for every two beneficiaries.

Slow privatization. Hungary chose to privatize its state-owned enterprises through individual sales rather than mass distribution of shares (as was done in the Czech Republic and Russia). For the many firms that were sold, the Hungarian strategy produced real owners with money at risk—in most cases owners who were willing to invest further in rehabilitating their firms. But privatization became entangled in Hungarian politics, and in the desire to maintain partial state ownership in "strategic" industries. As a result, large firms remain in state hands as perennial lossmakers, monopolizing credit and limiting growth.

Conclusion. Hungary's experience illustrates that the success of major reform and transformation programs often turns on whether the budget can be brought under control. And it indicates the difficulties inherent in policies that cannot be implemented swiftly while popular support is still strong and special-interest opposition has not yet coalesced.

EYES ONLY

ARTICLE

The AMT Made Easy

As part of their Contract With America, House Republicans have proposed to phase out the corporate alternative minimum tax (AMT). (Complete repeal would be effective beginning in 2001.) The current AMT was created as an attempt to address the fact that, under the regular corporate income tax, it is possible for corporations to earn high profits and yet owe no tax. Many businesses claim the AMT reduces the incentive to invest in plant and equipment (by limiting the value of depreciation allowances) and therefore stunts economic growth. This article focuses exclusively on the corporate AMT, but similar issues arise with the AMT applicable to individual taxpayers.

Why all the fuss? Only about 30,000 firms per year pay the AMT, out of more than 2 million corporations filing tax returns. Moreover, in 1992 (the most recent data available), net AMT receipts accounted for only about $2.6 billion in revenues, less than 3 percent of all corporate income tax payments. But the corporate AMT disproportionately affects larger firms, and large firms have loud voices.

Structure of the AMT. The AMT imposes a lower marginal rate (20 percent rather than the regular corporate income tax rate, whose maximum is 35 percent) against a broader tax base (a more comprehensive measure of income). The broader tax base is computed by adding back into regular taxable income the value of some tax preferences, such as a portion of the immediately deducted exploration and development costs incurred in mining and oil and gas production, and a portion of the depreciation deductions claimed on investment in plant and equipment. Firms compute their liability under both the regular tax and the AMT, and pay the larger amount. In the great majority of cases, AMT payments merely amount to pre-payments of regular income tax liability, because AMT payments above current regular tax liability can be taken as credits against future regular tax liability.

AMT payers tend to be capital-intensive and are heavily represented in mining, manufacturing, and transportation. While most firms pay under the AMT only occasionally—if ever—some firms pay under the AMT year after year.

(A separate environmental tax also uses the AMT tax base, but with a $2 million exemption and a rate of 0.12 percent. This tax raises more than $600 million that goes to Superfund. Firms are subject to this tax regardless of whether they pay the regular income tax or the corporate AMT.)

Arguments against repealing the AMT.

The AMT raises revenue. Treasury estimates that the proposed repeal of the AMT (both corporate repeal and individual reductions) would cost about $19 billion over 5 years and more than $35 billion over 10 years.

The AMT increases the perceived fairness of the tax system. Repeal would result in many large and apparently profitable firms (probably including many household names from the Fortune 500) paying no corporate income tax in some years. This perceived tax avoidance could affect the voluntary compliance of Americans with the rest of the income tax system. The true impact of repeal on fairness is harder to judge.

Arguments for repealing the AMT.

The AMT blunts the effects of tax incentives. The corporate AMT generally does reduce the impact of subsidies provided through the tax code—precisely because the intent of the AMT is to limit the use of tax preferences. Under the AMT, firms making especially heavy use of tax subsidies are compelled to return part of the value of those subsidies to the Treasury.

The AMT increases the cost of capital to firms. Claims that the AMT substantially raises the cost of capital for most firms are exaggerated. For the few firms that are chronically on the AMT, the smaller value of depreciation allowances under the AMT leads to a greater after-tax cost of investment.

The AMT boosts compliance costs. This claim unquestionably is true: operating two tax systems in parallel leads to higher administrative costs.

Summary. Several considerations argue in favor of repealing the AMT: It limits the effectiveness of various investment incentives provided in the tax code; it increases taxpayer compliance burden; and, for some firms, it raises the cost of capital. However, a large segment of the American people might be outraged if they heard that large and highly profitable corporations were paying no income tax in some years (as was the case in the early and mid-1980s). Most Americans probably do not understand that the AMT only shifts the timing of tax payments to the Treasury, and want to see profitable corporations paying income tax every year.

Repeal of the AMT is not the only possible solution to the problems cited above. It may well be that a better solution would involve imposing a lower rate of tax on a base with fewer preferences. In essence, this would involve repealing the regular corporate income tax in favor of the AMT.

EYES ONLY

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

Strike at Bridgestone Rolls to a Halt. The United Rubber Workers (URW) unconditionally ended their strike at Bridgestone/Firestone on May 22. After 4,000 workers in five locations walked out last July, negotiations soon stalled. Bridgestone/Firestone balked at the traditional "pattern bargaining" that would have required it to adopt the same agreement that the URW had negotiated with Goodyear Tire; the union, for its part, refused to accept the benefit reductions and new round-the-clock work schedule sought by the company. The firm eventually hired 2,300 permanent replacement workers. As the strike wore on, the workers' resolve eroded: One of the five locals ended its strike in January, and a second followed suit in early May. Where does this leave the striking workers? Unemployed, in many cases. Although by law Bridgestone/Firestone must offer any new positions to the former strikers first, there may be few jobs available. The tiremaker reemployed only 60 of the 700 who crossed picket lines earlier this month, and says that it is already operating "near capacity." For those leaving the picket lines this week, prospects of reemployment look even dimmer.

Korean Conglomerate Crosses a New Frontier—Just 30 Miles from Seoul. The South Korean government recently approved the country's first industrial joint venture with North Korea since the division of the Korean peninsula fifty years ago. One of South Korea's largest conglomerates, Daewoo Group, won approval to set up a clothing factory in the port of Nampo, near Pyongyang. The government also approved an application by the trading company Kohap to explore joint-venture opportunities with the North. Even taken together, the two projects will involve little capital—only about $11 million, according to current plans. But the North Koreans are well aware of the symbolic importance of the move. They've named Daewoo's Northern joint venture partner "Samchonri," or "Three Thousand *Li*;" using the traditional Korean system of measurement, 3,000 *li* is the length of the (undivided) Korean peninsula.

Seizing Cancer by the Horns. A Massachusetts bioengineering firm has enlisted goats in the fight against cancer. Genzyme Transgenics Corp. announced recently that it had genetically engineered goats in a way that causes them to secrete "monoclonal antibodies" in their milk. These antibodies, which attach themselves to cancer cells, are a crucial ingredient in a Bristol-Myers Squibb drug currently undergoing clinical tests as a breast-cancer treatment. Goat-based production may prove far less costly than conventional "cell culture" techniques, in which the antibodies are extracted from cells grown in vats. In fact, Genzyme Transgenics claims that ten genetically engineered goats will be able to replace "a large state-of-the-art manufacturing plant," at a fraction of the cost of conventional techniques. Bristol seems convinced: The pharmaceutical giant has agreed to pay Genzyme up to $2.7 million to produce more of the goats.

EYES ONLY

RELEASES LAST WEEK

Advance Durable Orders

Advance estimates show that new orders for durable goods decreased 4.0 percent in April, the third consecutive monthly decline. For the first four months of 1995, new orders for durable goods are 10.0 percent above the same period a year ago.

MAJOR RELEASES THIS WEEK

Consumer Confidence

****Embargoed until 10:00 a.m., Tuesday, May 30, 1995****

Consumer confidence, as measured by the Conference Board, decreased 3.0 index points in May, to 101.6 (1985=100).

Gross Domestic Product (Wednesday)
Personal Income (Thursday)
Employment (Friday)
Leading Indicators (Friday)

EYES ONLY

U.S. ECONOMIC STATISTICS

	1970–1993	1994	1994:3	1994:4	1995:1
Percent growth (annual rate)					
Real GDP	2.5	4.1	4.0	5.1	2.8
GDP deflator	5.5	2.3	1.9	1.3	2.2
Productivity					
Nonfarm business	1.2	2.0	3.2	4.0	0.7
Manufacturing (1978-93)	2.1	4.7	3.5	3.4	3.6
Real compensation per hour	0.6	0.7	–0.4	1.2	1.0
Shares of Real GDP (percent)					
Business fixed investment	11.0	12.6	12.7	13.0	13.5
Residential investment	4.7	4.3	4.3	4.3	4.2
Exports	8.0	12.3	12.4	12.8	12.7
Imports	9.2	14.4	14.6	14.8	14.9
Shares of Nominal GDP (percent)					
Personal saving	4.9	3.0	3.0	3.4	3.9
Federal surplus	–2.8	–2.4	–2.3	–2.3	N.A.

			Feb. 1995	Mar. 1995	Apr. 1995
Unemployment Rate	6.7*	6.1*	5.4	5.5	5.8

*Figures beginning 1994 are not comparable with earlier data.

			Feb. 1995	Mar. 1995	Apr. 1995
Payroll employment (thousands)					
increase per month			355	177	–9
increase since Jan. 1993					6315
Inflation (percent per period)					
CPI	5.8	2.7	0.3	0.2	0.4
PPI-Finished goods	5.0	1.7	0.3	0.0	0.5

EYES ONLY

FINANCIAL STATISTICS

	1993	1994	March 1995	April 1995	May 25, 1995
Dow-Jones Industrial Average	3522	3794	4063	4231	4412
Interest Rates					
3-month T-bill	3.00	4.25	5.73	5.65	5.66
10-year T-bond	5.87	7.09	7.20	7.06	6.39
Mortgage rate, 30-year fixed	7.33	8.36	8.45	8.32	7.85
Prime rate	6.00	7.15	9.00	9.00	9.00

INTERNATIONAL STATISTICS

Exchange Rates	**Current level May 25, 1995**	**Percent Change from Week ago**	**Percent Change from Year ago**
Deutschemark-Dollar	1.404	−2.2	−14.7
Yen-Dollar	84.98	−1.7	−18.7
Multilateral (Mar. 1973=100)	82.55	−1.6	−10.8

International Comparisons	**Real GDP growth (last 4 quarters)**	**Unemployment rate**	**CPI inflation (last 12 months)**
United States	4.0 (Q1)	5.8 (Apr)	3.1 (Apr)
Canada	5.6 (Q4)	9.7 (Mar)	2.2 (Mar)
Japan	0.9 (Q4)	3.0 (Feb)	0.2 (Feb)
France	3.7 (Q4)	12.1 (Feb)	1.9 (Mar)
Germany	3.3 (Q4)	6.4 (Mar)	2.3 (Mar)
Italy	2.7 (Q4)	12.2 (Jan)	5.0 (Mar)
United Kingdom	3.9 (Q1)	8.6 (Mar)	3.5 (Mar)

EYES ONLY

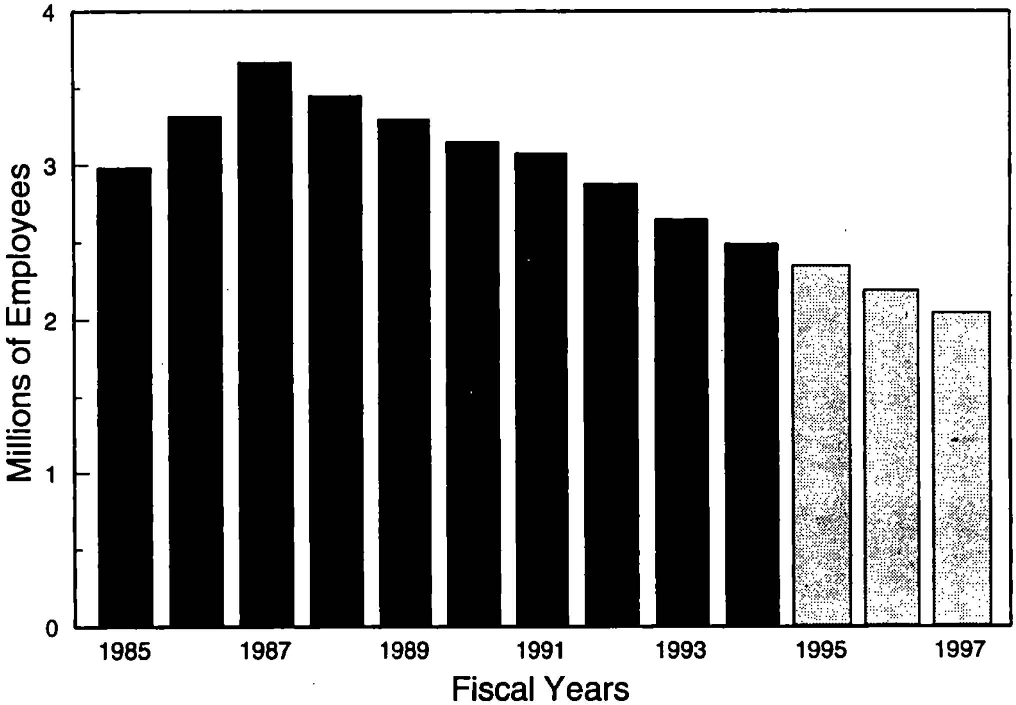
WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

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

May 22, 1995

CHART OF THE WEEK

Employment in Defense Industries



Note: Observations for 1995-97 are projections.

Since 1987, employment in defense-dependent industries has declined 1.3 million. Employment in these same industries is projected to drop another 1/4 million by the end of fiscal year 1997. One of the Special Analyses in this issue of the Weekly Economic Briefing presents results from a study that tracked the experiences of workers laid off several years ago by a large defense contractor.

CONTENTS

SPECIAL ANALYSES

ARTICLE

DEPARTMENTS

"...and over all those years, I always found time to stop and pick the flowers."

EYES ONLY

SPECIAL ANALYSIS

The Social Safety Net Serves a Broad Swath of America

Roughly one in ten Americans is living in poverty today. But a much larger share will likely spend some time in poverty during the next decade:

- One-third of all Americans spent at least one year living in poverty between 1979 and 1991.
- Even of those employed full-time at the beginning of one recent study, 16 percent fell into poverty sometime during the next 32 months.

Jolting events, such as family dissolution or a national recession, are particularly likely to cause working-class families to fall into the safety net:

- The poverty rate for women and children one year after a divorce is twice as high as it was for those same women and children before the divorce. Nearly half of all AFDC spells begin as a result of divorce or separation.
- During the most recent recession, nearly a third of Food Stamp recipients previously had earned at least $7 per hour.

Once their incomes are stabilized by the safety net, relatively few recipients remain on the rolls permanently:

- Of those who enter AFDC, 70 percent leave within 2 years; nearly 90 percent, within 5 years. But the recidivism rate is high: about 70 percent of these women return to welfare within the next 5 years, often due to lack of skills or child care.

The Earned Income Tax Credit will strengthen the safety net by providing "earnings insurance" for many middle-class Americans:

- One study estimates that at its fully phased-in 1996 level, EITC would have benefitted about 40 percent of prime-age adults with one or more children in at least one year during the 1980s.
- The average credit would have come to a substantial $1,700 (in today's dollars).

EYES ONLY

SPECIAL ANALYSIS

A Tale of One City: Tracking the Workers Who Lost Their Jobs With McDonnell Douglas in St. Louis

The robust recovery since 1993 has offset the loss of hundreds of thousands of defense-related jobs in many regions of the country (the major exception being Southern California). In some cases, defense contractors themselves have created the opportunities for reemployment by shifting into civilian activities or selling overseas. In many other cases, workers are finding new jobs outside the defense industry.

The adjustment has been painful for many workers. The St. Louis County Economic Council tracked the experiences of 1,200 workers who were laid off by McDonnell Douglas in late 1990 and early 1991; the Council conducted surveys in 1992 and 1994. The Council found that a resurgence of auto manufacturing activity in the St. Louis area, plus expansions by small businesses and health-care employers, have combined to ease the adjustment of many of these workers. But this robust growth has not reached all of the displaced workers.

- By the fall of 1994, about 450 of those tracked in the 1992 survey could no longer be reached by phone; many had apparently left the area in search of work or moved in with relatives. Of the 694 remaining in the region, nearly two-thirds had found full-time work.
    - Two-thirds of the workers who were employed full-time at the time of both the 1992 and 1994 surveys held jobs outside the defense sector; only 18 percent were employed in new jobs in the defense sector, while the remaining 16 percent had moved back and forth between the defense and commercial sectors.
    - More than 65 percent of these workers had landed jobs at the same or higher pay. However, workers aged 46-62 were much more likely to suffer a decline in salary than their younger counterparts. Roughly half of these older workers took an annual cut of at least $10,000 on salaries that typically ranged from $20,000 to $40,000 per year.
    - Nearly half of those who were working at full-time jobs in the region by 1994 had held at least one other full-time job since being laid off in 1990-91, and 14 percent had occupied at least two such stopgap positions before they moved to continuing or new career positions.

- Fourteen percent of the laid-off workers who stayed in the region retired. Of these workers, half said their decision was influenced "a great deal" by how difficult they thought it would be to find another satisfactory job.

- The remaining 20 percent of laid-off workers were working only part-time or were still completely unemployed in 1994.

Looking both far and near. Thirty-eight percent of the 694 workers who stayed in the region reported looking for employment outside the region after they were laid off. Nearly a quarter of the jobs that were eventually landed among this group were located outside the St. Louis metropolitan area, though still within the borders of Missouri or Illinois. Sixteen percent of the laid-off workers were back at McDonnell at the time of the 1994 survey.

Making ends meet (or not). Seventeen percent of the 470 respondents with spouses reported that their spouses had increased their number of hours worked after the lay off; 12 percent indicated that at least one non-spousal member of the household had either started working or increased hours worked since the respondent was laid off. Fully half of all workers in the study reported having to cut back "a great deal" or "quite a bit" for basic items such as food and clothing.

Analysis. The difficult experiences of many of the former McDonnell Douglas employees between 1990 and 1994 undoubtedly owed to the 1990-91 recession. The labor market is sufficiently fluid that when the economy is strong, most workers can land a satisfactory job. But for a minority of workers, particularly those over 45 or so, a layoff can have long-lasting effects. Like Pittsburgh steelworkers, Detroit autoworkers and Houston oilworkers before them, defense workers in St. Louis are bearing the brunt of a rapid decline in a regionally concentrated industry, and the heaviest burden is falling on middle-aged and older workers. Over time, a growing civilian economy provides new and often better job opportunities for a majority of those laid off, though many workers may have to leave the region to take advantage of them; in the meantime, unemployment insurance, food stamps, and retraining and relocation services have helped ease the pain of the regional adjustment.

EYES ONLY

ARTICLE

Do Workers Get Their Money's Worth From Social Security?

Many Americans think of Social Security essentially as a government-run retirement saving program: They believe that they are simply getting back (in the form of benefits) what they contributed (in the form of taxes). This view is grossly inaccurate.

Take, for example, the case of George and Martha. They were married in 1951 at the age of 21, began full-time work that year, and have been employed ever since. By now, the Social Security system has received 44 years' worth of contributions from George and Martha and from their employers. Although the system only began to pay retirement benefits to George and Martha this year when they turned 65, it has already paid benefits to some of their contemporaries who decided to retire before age 65. In addition, it has paid benefits to surviving children of deceased contemporaries.

Now suppose that George has earned average wages throughout his career and that Martha has earned low wages. The lifetime contributions paid by George and Martha and couples like them (as well as their employers) have averaged an estimated $148,000 per couple (in 1993 dollars, and including interest). In contrast, the expected lifetime benefits paid to them by the system will average $226,600 per couple (also in 1993 dollars). Therefore, the Social Security system will transfer $78,600 on average to these couples, or 3.8 percent of their lifetime earnings.

More generally, the distributional impact of the Social Security system can be summarized as follows:

- **To date, Social Security has been a "good deal" financially for the vast majority of participants.** The system has subsidized married couples regardless of earnings level and birth year. It has also subsidized almost all never-married women and men (the exception being the cohort of never-married high-wage men who have turned 65 within the last five years or so).

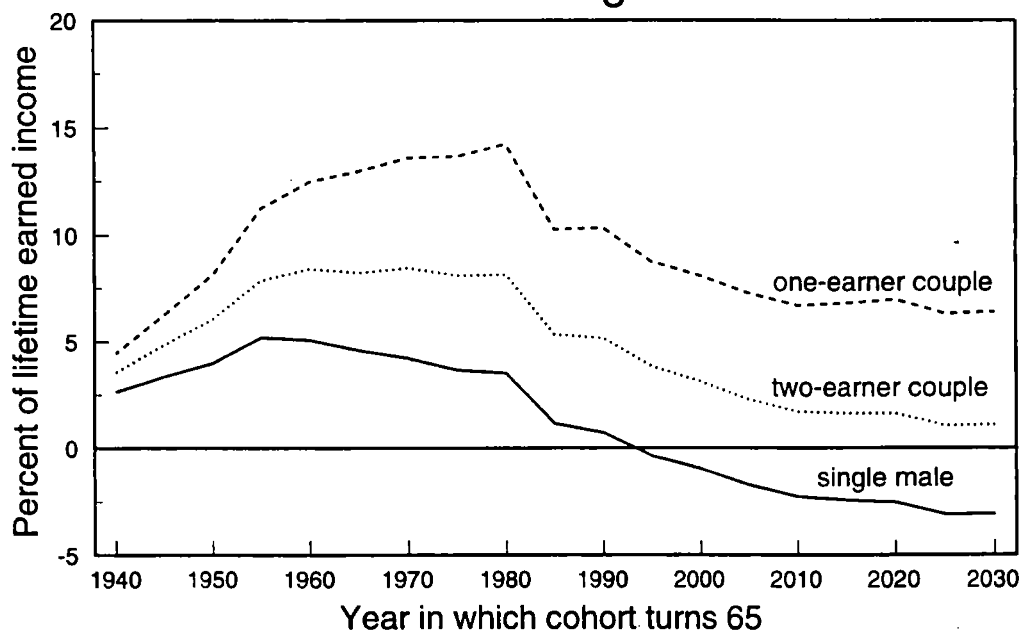
- **The Social Security system will become less generous under current law.** For both couples and singles, subsidies as a percent of lifetime earnings will decline markedly between now and 2010. After 2010, subsidy rates are projected to stabilize for most low-wage and average-wage households, but will continue falling for high-wage households.

- **The system will continue to treat couples—especially one-earner couples—more favorably than it treats never-married singles.** The monthly benefits of one-earner couples are 50 percent greater than the benefits of never-married singles with identical wage histories, because spouses in the one-earner families receive a benefit equal to half of the workers' benefits. In addition, one-earner couples reap value from survivor benefits, whereas singles do not. Two-earner couples also benefit from the spousal and survivor benefit provision (though to a lesser extent because many spouses earn enough to receive higher benefits in their own right).

- **Even though subsidy rates have been highest for low-wage households, subsidy amounts have often been greatest for high-wage households.** For example, low-wage one-earner couples turning 65 in 1980 received a subsidy equal to an astounding 21.2 percent of their lifetime earnings. High-wage one-earner couples of the same age received a subsidy of "only" 11.3 percent. Nonetheless, the system transferred a larger number of dollars to the high-wage couple ($192,000) than to the low-wage couple ($106,000). Under current law, the difference in absolute amounts of transfers will reverse itself over the next few decades.

The chart at the bottom of this page displays subsidy rates for never-married males, one-earner couples, and two-earner couples—all with average wage profiles—turning 65 between 1940 and 2030.

Net Subsidies from Old Age and Survivors Insurance Program



EYES ONLY

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

New Bonds Spread the Pain (and Gain) of Insuring Property. Property insurers live in fear of the Big One—whether that means a magnitude-8 earthquake that strikes Los Angeles or a huge hurricane that sweeps through downtown Miami. One recent financial innovation that may help insurers to spread the risk of natural disasters is the "act of God bond." These bonds offer high returns to their owners if all goes well in the world, but could require them to forfeit part of their principal in the event of a major disaster, or "act of God." Likely customers for these bonds: large institutional investors that can hold a range of such securities and thereby diversify their risk. To date only one insurer and one reinsurer have issued act of God bonds, but several leading Wall Street firms and banks are reportedly preparing to market the new securities. This development follows a trend toward "securitization"—or bundling and reselling to a broader market—of other types of assets such as mortgage loans.

In Fishing, a Shift from Hunting and Gathering to Farming. The global fish catch on the high seas has fallen since 1989, a result of overfishing by the world's fleets. Moreover, fish stocks will need time to replenish themselves, and no increase in the catch is likely over the next decade or two. But a new World Bank study holds out hope for the world's consumers. The study notes a huge growth in the output of fish farms. These sources, which produced just 12 percent of the world's food fish in 1984, accounted for a 22 percent share by 1993. The World Bank concludes that with minimal government investment in research, fish farms could meet up to 40 percent of world demand by 2010, even as fish consumption continues to grow.

A Strategic Move to Corporate Suicide. The Dow Corning Corporation this week filed for Chapter 11 bankruptcy. Once the nation's largest manufacturer of silicone-gel breast implants, Dow Corning had pledged the lion's share—about $2 billion—of a $4.25 billion settlement fund established by implant makers to cover liability claims. But although hundreds of thousands of implant recipients were party to the settlement, at least 7,000 women opted out and launched their own lawsuits. With the bankruptcy filing, Dow Corning can now channel both types of claims through a single mass resolution process funded by a trust; the bankruptcy court judge will likely decide the size of the trust fund. Because claimants will not be allowed to opt out of this resolution, Chapter 11 reorganization will reduce Dow Corning's legal fees and its uncertainty about future breast-implant liability costs. Nevertheless, Chapter 11 probably won't save the investments of Dow Corning's two owners: Dow Chemical this week wrote off its 50 percent stake in Dow Corning, taking a charge of $370 million to do so, and Corning Inc. is considering a similar move. Dow Chemical's stock rose slightly after the move, suggesting that markets had already written off the investment anyway.

EYES ONLY

RELEASES LAST WEEK

Housing Starts

Housing starts in April were about unchanged from March at 1.24 million units at a seasonally adjusted annual rate. For the first four months of 1995, compared with the same period a year ago, starts were down 11 percent.

Industrial Production and Capacity Utilization

The Federal Reserve's index of industrial production decreased 0.4 percent in April following a decrease of 0.3 percent in March. Capacity utilization fell 0.6 percentage point to 84.1 percent.

U.S. International Trade in Goods and Services

The goods and services trade deficit was $9.1 billion in March; it was $9.2 billion in February.

MAJOR RELEASES THIS WEEK

Advance Durable Orders (Wednesday)

EYES ONLY

U.S. ECONOMIC STATISTICS

	1970–1993	1994	1994:3	1994:4	1995:1
Percent growth (annual rate)					
Real GDP	2.5	4.1	4.0	5.1	2.8
GDP deflator	5.5	2.3	1.9	1.3	2.2
Productivity					
Nonfarm business	1.2	2.0	3.2	4.0	0.7
Manufacturing (1978-93)	2.1	4.7	3.5	3.4	3.6
Real compensation per hour	0.6	0.7	–0.4	1.2	1.0
Shares of Real GDP (percent)					
Business fixed investment	11.0	12.6	12.7	13.0	13.5
Residential investment	4.7	4.3	4.3	4.3	4.2
Exports	8.0	12.3	12.4	12.8	12.7
Imports	9.2	14.4	14.6	14.8	14.9
Shares of Nominal GDP (percent)					
Personal saving	4.9	3.0	3.0	3.4	3.9
Federal surplus	–2.8	–2.4	–2.3	–2.3	N.A.

	1970–1993	1994	Feb. 1995	Mar. 1995	Apr. 1995
Unemployment Rate	6.7*	6.1*	5.4	5.5	5.8

*Figures beginning 1994 are not comparable with earlier data.

	1970–1993	1994	Feb. 1995	Mar. 1995	Apr. 1995
Payroll employment (thousands)					
increase per month			355	177	–9
increase since Jan. 1993					6315
Inflation (percent per period)					
CPI	5.8	2.7	0.3	0.2	0.4
PPI-Finished goods	5.0	1.7	0.3	0.0	0.5

EYES ONLY

FINANCIAL STATISTICS

	1993	1994	March 1995	April 1995	May 18, 1995
Dow-Jones Industrial Average	3522	3794	4063	4231	4341
Interest Rates					
3-month T-bill	3.00	4.25	5.73	5.65	5.69
10-year T-bond	5.87	7.09	7.20	7.06	6.61
Mortgage rate, 30-year fixed	7.33	8.36	8.45	8.32	7.83
Prime rate	6.00	7.15	9.00	9.00	9.00

INTERNATIONAL STATISTICS

Exchange Rates	**Current level May 18, 1995**	**Percent Change from Week ago**	**Percent Change from Year ago**
Deutschemark-Dollar	1.436	0.2	−13.3
Yen-Dollar	86.45	0.7	−16.4
Multilateral (Mar. 1973=100)	83.87	0.3	−9.4

International Comparisons	**Real GDP growth (last 4 quarters)**	**Unemployment rate**	**CPI inflation (last 12 months)**
United States	4.0 (Q1)	5.8 (Apr)	3.1 (Apr)
Canada	5.6 (Q4)	9.7 (Mar)	2.2 (Mar)
Japan	0.9 (Q4)	3.0 (Feb)	0.2 (Feb)
France	3.7 (Q4)	12.1 (Feb)	1.9 (Mar)
Germany	3.3 (Q4)	6.4 (Mar)	2.3 (Mar)
Italy	2.7 (Q4)	12.2 (Jan)	5.0 (Mar)
United Kingdom	3.9 (Q1)	8.6 (Mar)	3.5 (Mar)

EYES ONLY

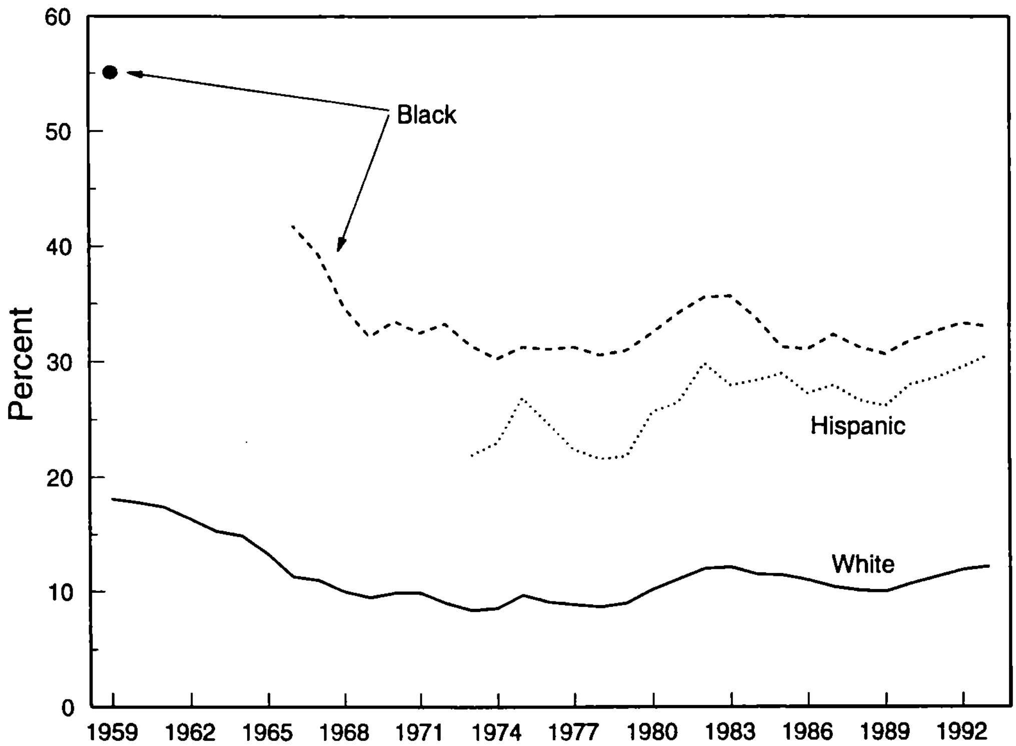
WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

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

May 15, 1995

CHART OF THE WEEK

Poverty Rates By Race



During the 1960s, the poverty rate declined dramatically for both blacks and whites. (Data for Hispanics during the 1960s are not available.) Since the early 1970s, however, the poverty rate has either remained about unchanged (for blacks), edged up slightly (for whites) or increased substantially (for Hispanics). In 1993, the rates for blacks and Hispanics were more than twice the rate for whites. The Article in this issue of the Weekly Economic Briefing examines issues related to the measurement of poverty, and analyzes the key recommendations of a major recent report.

EYES ONLY

CONTENTS

"Congressman, our people would look upon it favorably if you were to oppose any additional sin taxes."

EYES ONLY

SPECIAL ANALYSIS

Nunn-Domenici: "Inside the Beltway" Tax Reform

Senators Nunn and Domenici have proposed transforming the current individual and corporate income taxes into a type of consumption tax levied at both the personal and business levels.

- The goal: The proposal aims to promote saving and investment while continuing to raise about the same amount of aggregate revenue and maintaining the current distribution of the tax burden across broad income classes.
- The assessment: The proposed tax system might not stimulate much additional saving and investment. Moreover, the new system would be even more complicated than the current one, and many taxpayers inevitably would be made worse off by the new system (even though its designers are attempting to maintain the current distribution of tax burdens).

Structure of the plan. The tax liability of individuals would be based on the amount of income they consume. "Consumed income" would be defined to include not only many of the items that are familiar from the current system (e.g., wages, salaries, interest, dividends, alimony received, a portion of social security benefits, and pension benefits), but also the value of employer-provided benefits such as health insurance. An unlimited deduction would be allowed for net additions to savings. Deductions would also be available for mortgage interest, alimony and child support paid, charitable contributions, and post-secondary tuition expenses (up to $2,000 per person per year). In addition, a family allowance and personal exemptions provide taxpayers with an amount of tax-free consumption. However, current-law deductions for state and local taxes, medical expenses, and certain other items would be eliminated.

Consumed income would be taxed at graduated rates ranging in 1996 from 19 percent to 40 percent. For a family of four that consumed all its wage earnings and had no deductions other than the family allowance and personal exemptions, the 40 percent rate would apply to income above $41,600. Two tax credits would be allowed: an earned income tax credit and a new tax credit for the social security tax paid by an employee.

The tax liability of businesses would be based on receipts less purchases (including investment in plant and equipment). Payments for wages and salaries, fringe benefits, interest, and dividends would not be deductible. Businesses would pay a flat rate of 11 percent. The impact of the nondeductibility of wages would be softened by the availability of a nonrefundable credit for business payments of social security taxes.

Savings incentives. In effect, the Nunn-Domenici plan would allow individuals to make unlimited IRA contributions with no restrictions on withdrawals, and thus would allow assets to accumulate at the pre-tax rate of return. Some families would boost their saving in response to this increase in the incentive to save. However, the overall response probably would not be very large because personal saving does not appear to be very sensitive to changes in the rate of return.

Complexity. The Nunn-Domenici plan is not a recipe for tax simplification. Almost all individual filers would find the new form more complicated to fill out than the current tax form. In addition to nearly all the information on income and deductions required under the current system, filers would have to report net acquisitions of assets and debt. Business tax compliance would likely be somewhat easier than under current law. Capital expensing would help in this regard, as would the elimination of most other deductions and the need to distinguish between equity and debt. However, there would still be plenty of room for disagreement between the IRS and taxpayers.

Winners and losers. Treasury has yet to release a full-blown distributional analysis of this proposal, but even if the designers of the plan succeeded in altering the overall distribution of the tax burden relatively little, there would certainly be winners and losers relative to current law. Winners would include those who save a lot, and lower-income wage earners with few fringe benefits (whose payroll taxes can far exceed Federal income tax liabilities). Losers would include those who save little or who dissave, those who receive a relatively large proportion of their compensation in the form of currently tax-favored fringe benefits, and middle-class retirees who would find themselves pushed into higher tax brackets. A box on the next page examines the distributional implications of the proposed plan in greater detail.

Transition rules. The transition rules for this plan are complicated in their own right. In part, this complication reflects the fact that the plan tries to avoid taxing consumption financed by the liquidation of previously accumulated assets (on the theory that the income used to purchase such assets had already been taxed once).

Conclusion. The Nunn-Domenici proposal is appealing to those analysts concerned about the low level of saving and investment currently undertaken in the United States. However, it might not be very successful in correcting those problems, and it certainly takes a big step away from tax simplification.

EYES ONLY

Nunn-Domenici vs. the Current Income Tax: Two Case Studies

A married couple with the following characteristics would just about break even under the Nunn-Domenici plan: two children, $65,000 in salary, $5,000 in capital income, $4,000 in fringe benefits, $10,000 in mortgage interest payments, $5,000 in state and local taxes, and $7,000 in saving. This family would pay about $7,200 under both current law and the proposed system. However, for each $1,000 less they save (or more they get in fringe benefits), their tax bill under the proposed plan rises $400.

Now consider a high roller: A married couple with no children, salary of $1,000,000, capital income of $10,000,000, fringe benefits of $40,000, mortgage interest of $50,000, charitable contributions of $1,000,000, state and local tax payments of $200,000, and saving of $9,000,000. This family would see their taxes slashed 90 percent, from almost $4 million to less than $400,000.

EYES ONLY

ARTICLE

A New Method of Estimating the Poverty Rate?

The current method of estimating the poverty rate has a number of serious problems. For example, a drastic reduction in the earned income tax credit (EITC) or in food stamps, such as some Republicans in Congress are proposing, would have no direct effect on the official poverty rate as currently calculated. A recent report from the National Research Council (NRC) proposes a new method that would solve the most serious of the problems afflicting the current measure.

Current practice. The poverty threshold was defined in the early 1960s as three times the minimum amount required at that time to purchase a balanced diet. (The figure of three was chosen because the average family was judged to allocate roughly one-third of its budget toward food). Since 1969, the threshold amount has been adjusted upward in nominal terms according to the increase in overall consumer prices. Thus, current methodology establishes a fixed goalpost, in the sense that the threshold is intended to represent the same standard of living today as it did in 1963. A family is defined to be poor if its before-tax cash income falls short of the threshold relevant for its family size.

Proposed changes. The NRC panel recommended three key changes in the methodology underlying the poverty rate:

Redefining family income: The panel proposed expanding the definition of family income to include the value of transfers such as food stamps, public housing, and the EITC, and to exclude taxes and other expenses over which the household may have little or no discretion, such as child support payments, health insurance and out-of-pocket health-care costs, and work-related expenses such as child care.

Allowing regional variation in the threshold: The panel proposed adjusting the poverty threshold for regional differences in housing costs.

Reengineering the annual adjustment of the threshold: The panel recommended moving the threshold up each year in line with the increase in the outlays of the median family for food, clothing, and housing. Thus, the panel recommended transforming the poverty line from a fixed to a moving goalpost: Outlays of the median family on food, clothing, and housing will increase over time not only because prices increase, but also because general living standards rise.

Analysis. The proposed revision to the definition of family income would provide a more accurate picture of the resources available to a family for the satisfaction of its basic needs. It would allow the effects of government transfer programs such as the EITC to be reflected in the poverty statistics. And it would tend to raise the measured poverty rate for families with workers (because work-related expenses would be deducted from family income), and lower it for welfare recipients (because non-cash benefits would be included in family income). It would also increase measured poverty rates in the North and West (where housing costs are relatively high), and lower them in the South and Midwest (where housing costs are low). There is widespread agreement that a shift toward a more comprehensive measure of resources, such as the one recommended by the panel, would be an important improvement.

On the other hand, there is considerable controversy over the issue of whether poverty should be measured with a fixed or moving goalpost. The greatest strength of a "fixed goalpost" type of poverty line is that it provides a natural benchmark for assessing the performance of the economy in improving the economic circumstances of society's least well-off members. The greatest weakness of such a standard is that it will be surpassed eventually by all (or nearly all) of the population, and it therefore could be used in the very long run to claim that the problem of poverty had been "solved."

The proposed "moving goalpost" would (loosely) tie the standard of living associated with the poverty line to the standard of living of the median family in society. Historically, households near the median of the income distribution have tended to increase spending on food, clothing, and shelter about 7 percent for every 10 percent increase in their overall income. Therefore, even under the proposed methodology, the gap between the standard of living of the median household and the standard of living associated with the poverty threshold would widen over very long timespans, though not as rapidly as it would if the threshold were to be left fixed.

Surveys indicate that public perceptions of a subsistence living standard typically are higher in more affluent nations and tend to rise over time within countries as general standards of living increase. Therefore, the proposed adjustment would move official methodology toward public sensibilities in this area. Nonetheless, this proposed change is controversial, and was one of the main reasons why one panel member dissented from the panel's final report.

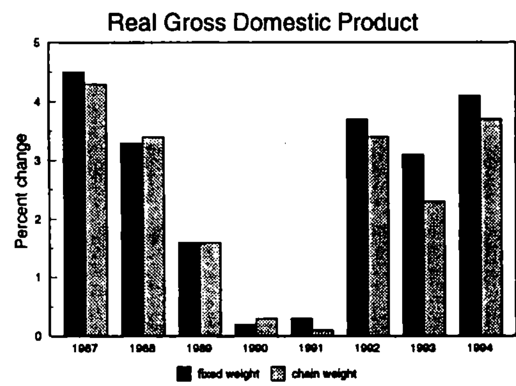
Implementation. The Office of Management and Budget is the final arbiter of the methodology that is used to produce the official statistics on poverty. The Department of Health and Human Services has authority over the definition of poverty that is used to determine eligibility for many Federal benefits. Both agencies will be studying the NRC report in coming months.

EYES ONLY

CURRENT DEVELOPMENT

Commerce Announces Plan for GDP Revision

On May 4, the Commerce Department formally announced its intention to emphasize a "chain-weight" measure as the primary gauge of real GDP growth, rather than the current "fixed-weight" series.



When this switch is implemented at the end of this year, GDP growth rates for the last few years will probably be revised downward significantly. Currently available data suggest that estimated growth in 1993 will be marked down 0.8 percentage point, while growth in 1994 will be reduced 0.4 percentage point (see chart).

Even if Commerce had not opted to change its focus to the chain-weight index, the GDP growth estimates for 1993 and 1994 would have been revised downward for technical reasons related to the characteristics of fixed-weight indexes.

Analysis. One important advantage of a chain-weight measure is that it provides a more accurate gauge of long-run trends. Chain-weight data were featured in the 1995 Economic Report of the President, which examined long-term trends in the growth of productivity. Another important advantage of a chain-weight measure is that, unlike its fixed-weight cousin, it will not be subject to downward revision once every five years.

There is widespread support among economists for the switch to a chain-weight index.

why - are these reasonable !! did they need to do this

is it worth it better

MACROECONOMIC UPDATE

On the Glide Path

Output and the labor market. The pace of economic growth has slowed considerably in the current quarter. Available indicators suggest that real GDP may increase between 1-1/2 percent and 2-1/2 percent at an annual rate this quarter—a shade below the rate many analysts see as sustainable over the long haul. A major factor in the recent slowing has been a sharp scaling back of auto and truck production schedules in response to weak sales and an uncomfortably high level of inventories. Home sales have also been weak, dampening builders' eagerness to start construction of new homes. And the most recent employment report pointed to a slackening in the demand for labor: The unemployment rate moved up 0.3 percentage point in April (see chart), and nonfarm payroll employment edged down slightly.

Note: Data after 1993 reflect the revised Current Population Survey.

The current pattern of production cutbacks in order to bring inventories in line with sales is typical of times when the pace of economic growth is slowing. No evidence exists that the size of the current inventory overhang is sufficient to tip the economy into recession. Moreover, substantial declines in long-term interest rates—roughly 40 basis points on both the 10-year bond rate and the mortgage interest rate during the last two weeks alone—should ultimately boost the demand for autos, housing and other consumer purchases, thereby limiting the necessary inventory correction. Indeed, more than 80 percent of the forecasters surveyed in the most recent Blue Chip roundup thought there would not be a recession before the next presidential election.

Wages and prices. Although increases in employee compensation remain surprisingly moderate, inflation—as measured by the Consumer Price Index and the Producer Price Index (as well as the core CPI and PPI)—has proceeded at a somewhat higher pace in the first four months of 1995 compared to 1994. As the economy slows, though, inflation rates should stabilize, as producers find that they have less latitude to widen their profit margins.

Conclusion. Despite recent signals of near-term weakness, the economy still appears to be on course for a soft landing. The latest Blue Chip report shows a consensus forecast for GDP growth over the four quarters of 1996 of 2.3 percent—close to estimates of the economy's potential growth rate.

EYES ONLY

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

The Beige Book: Slow and Steady Is the Pace. According to the latest survey of current economic conditions by the Federal Reserve, the economy continued to expand in most regions last month, but at a less vigorous pace. Manufacturing activity reportedly was up in most districts, but retail sales were described as sluggish, and auto sales were down. Forward momentum appeared to be greatest in the Midwest. Industrial and commodity prices are continuing to rise in most Districts, but for the most part these increases are still not being passed through to the retail level. Furthermore, wage pressures remain moderate, despite tight labor markets in a number of sectors and regions.

Giuliani Confronts Widening Deficit. Mayor Rudolph Giuliani of New York City unveiled his second budget on April 28. Absent any corrective action, the city is currently projected to run a deficit of $3.1 billion—or nearly $450 per resident—during the fiscal year beginning July 1. To narrow the gap, Giuliani has budgeted union concessions of $600 million, as well as cuts of $700 million from city spending on Medicaid and welfare programs, $224 million from the Board of Education, and $1.2 billion in other spending reductions and increases in state and Federal aid. (Total spending on Medicaid and welfare might decline by an additional $700 million or more, due to the loss of state and Federal matching monies.) Despite it all, the Mayor is simultaneously proposing nearly $200 million in tax cuts for businesses. Council Speaker Peter Vallone indicated less than total enthusiasm: "If just to cut taxes we destroy the quality of life for our middle class, if the trade-off is in the form of filthy streets and failing schools, then the cost is too high."

In Education, As in Other Things, Quality Matters. Educational attainment—the quantity of education that a worker obtains—has long been recognized as an important determinant of wages. A recent study from the National Bureau of Economic Research shows that the quality of that education matters too. The study defines a composite index of school quality based on teacher salaries, teacher/student ratios, counselor/student ratios, and book/student ratios. The study then shows that high school graduates who attended schools at the 75th percentile of the quality distribution earned 5 percent more, on average, than graduates of schools at the 25th percentile.

Welcome to the New Members of the Club. For the first time ever, Fortune included both industrial and service companies in its fabled list of the biggest American businesses. Nonindustrial giants wasted no time in making their presence felt: Wal-Mart, AT&T, and Sears ranked 4th, 5th, and 9th on the list, respectively. But some things never change: General Motors, No. 1 in the inaugural 1954 Fortune 500, was once again at the top of the heap in 1994. Business for the newly constituted list of 500 companies was good last year—very, very good: In the aggregate, these companies posted a 54 percent increase in profits.

EYES ONLY

RELEASES LAST WEEK

Consumer Price Index

****Embargoed until 8:30 a.m., Friday, May 12, 1995****

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

Retail Sales

Advance estimates show that retail sales decreased 0.4 percent in April following an increase of 0.8 percent in March. Excluding sales in the automotive group, retail sales rose 0.1 percent.

Producer Price Index

The producer price index for finished goods increased 0.5 percent in April. Excluding food and energy, producer prices rose 0.3 percent.

Productivity

Nonfarm business productivity increased 0.7 percent at an annual rate in the first quarter. Manufacturing productivity increased 3.6 percent.

MAJOR RELEASES THIS WEEK

Housing Starts (Tuesday)
Industrial Production and Capacity Utilization (Tuesday)
U.S. International Trade in Goods and Services (Thursday)

file with WEB file

EYES ONLY

U.S. ECONOMIC STATISTICS

	1970–1993	1994	1994:3	1994:4	1995:1
Percent growth (annual rate)					
Real GDP	2.5	4.1	4.0	5.1	2.8
GDP deflator	5.5	2.3	1.9	1.3	2.2
Productivity					
Nonfarm business	1.2	**2.0**	3.2	**4.0**	**0.7**
Manufacturing (1978-93)	2.1	**4.7**	3.5	**3.4**	**3.6**
Real compensation per hour	0.6	0.7	–0.4	1.2	**1.0**
Shares of Real GDP (percent)					
Business fixed investment	11.0	12.6	12.7	13.0	13.5
Residential investment	4.7	4.3	4.3	4.3	4.2
Exports	8.0	12.3	12.4	12.8	12.7
Imports	9.2	14.4	14.6	14.8	14.9
Shares of Nominal GDP (percent)					
Personal saving	4.9	3.0	3.0	3.4	3.9
Federal surplus	–2.8	–2.4	–2.3	–2.3	N.A.

	1970–1993	1994	Feb. 1995	Mar. 1995	Apr. 1995
Unemployment Rate	6.7*	6.1*	5.4	5.5	5.8

*Figures beginning 1994 are not comparable with earlier data.

	1970–1993	1994	Feb. 1995	Mar. 1995	Apr. 1995
Payroll employment (thousands)					
increase per month			355	177	–9
increase since Jan. 1993					6315
Inflation (percent per period)					
CPI	5.8	2.7	0.3	0.2	**0.4**
PPI-Finished goods	5.0	1.7	0.3	0.0	**0.5**

New or revised data in **boldface**.
CPI data **embargoed until 8:30 a.m., Friday, May 12, 1995.**

EYES ONLY

FINANCIAL STATISTICS

	1993	1994	March 1995	April 1995	May 11, 1995
Dow-Jones Industrial Average	3522	3794	4063	4231	4411
Interest Rates					
3-month T-bill	3.00	4.25	5.73	5.65	5.66
10-year T-bond	5.87	7.09	7.20	7.06	6.68
Mortgage rate, 30-year fixed	7.33	8.36	8.45	8.32	7.87
Prime rate	6.00	7.15	9.00	9.00	9.00

INTERNATIONAL STATISTICS

Exchange Rates	**Current level May 11, 1995**	**Percent Change from Week ago**	**Percent Change from Year ago**
Deutschemark-Dollar	1.432	4.2	−14.0
Yen-Dollar	85.85	2.3	−17.5
Multilateral (Mar. 1973=100)	83.64	2.8	−10.2

International Comparisons	**Real GDP growth (last 4 quarters)**	**Unemployment rate**	**CPI inflation (last 12 months)**
United States	4.0 (Q1)	5.8 (Apr)	3.1 (Apr)
Canada	5.6 (Q4)	9.7 (Mar)	2.2 (Mar)
Japan	0.9 (Q4)	3.0 (Feb)	0.2 (Feb)
France	3.7 (Q4)	12.1 (Feb)	1.9 (Mar)
Germany	3.3 (Q4)	6.4 (Mar)	2.3 (Mar)
Italy	2.7 (Q4)	12.2 (Jan)	5.0 (Mar)
United Kingdom	3.9 (Q1)	8.6 (Mar)	3.5 (Mar)

EYES ONLY

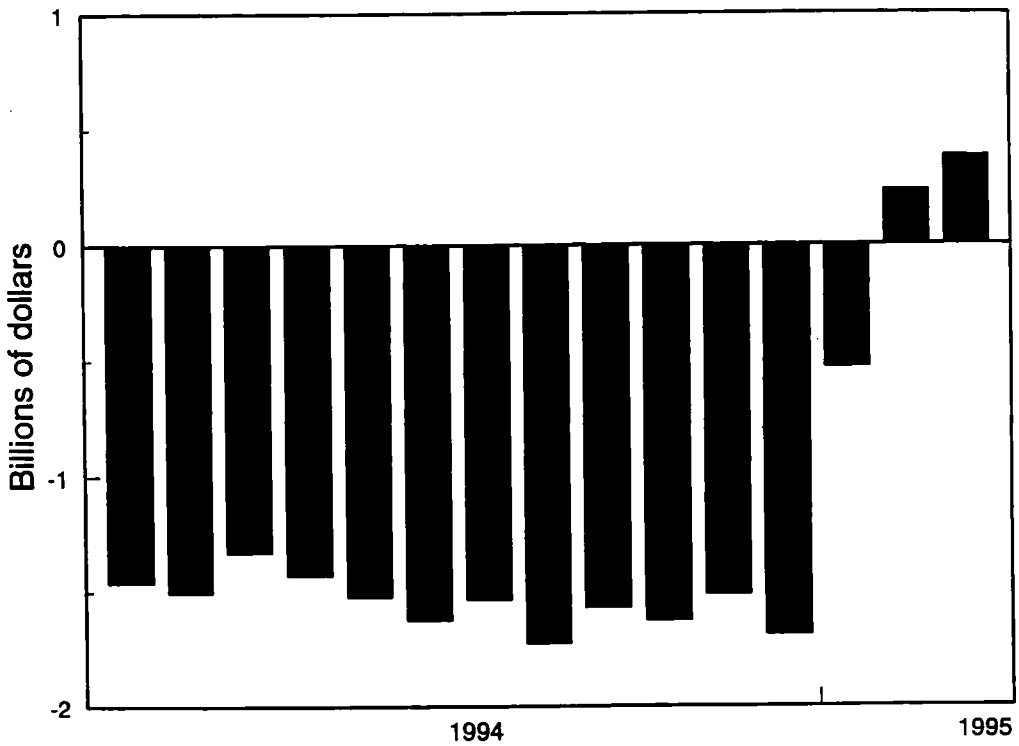
WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

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

May 1, 1995

CHART OF THE WEEK

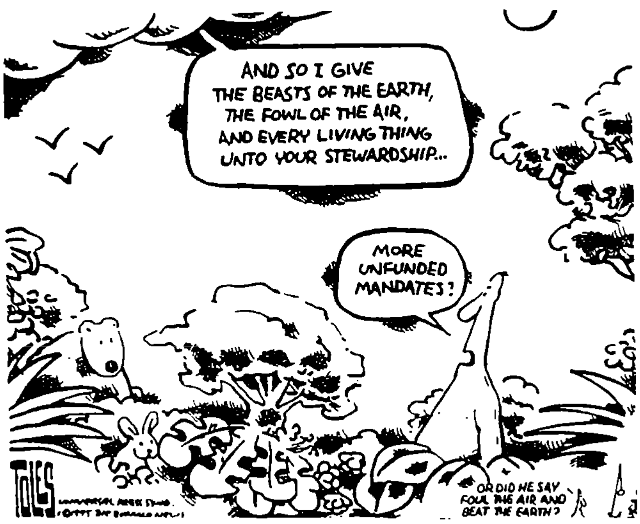
Mexico's Balance of Trade



Mexico posted a trade surplus for the second consecutive month in March, after incurring a string of deficits before the onset of the economic crisis last December. This adjustment has been accomplished through a sharp increase in exports and a sharp reduction in imports of consumer and capital goods. Many analysts view the increase in exports as having taken place remarkably quickly, but are less surprised by the reduction in imports in light of the difficulty that Mexican importers have encountered in obtaining financing.

EYES ONLY

CONTENTS



EYES ONLY

CURRENT DEVELOPMENT

GDP Scorecard: First Quarter of 1995

Real GDP increased 2.8 percent at an annual rate in the first quarter—considerably more slowly than in the fourth quarter of 1994 (when growth was 5.1 percent at an annual rate) but still a shade higher than many analysts' estimate of the sustainable rate of growth of GDP. A fair amount of the increase in output during the first quarter was absorbed into inventories; real final sales (real GDP less inventory accumulation) increased 1.8 percent at an annual rate. The following scorecard gives the growth of major GDP components during the first quarter and indicates factors affecting their recent performance or outlook.

Component	Growth*	Comments
Consumer expenditures on motor vehicles	−17.6%	With the reduction in auto sales during the first quarter, the auto inventory-sales ratio swelled to its highest level since 1989.
Other consumer expenditures	2.6%	Total consumer spending increased at an annual rate of 1.4 percent in the first quarter, down from 3.5 percent over the four quarters of 1994.
Producers' durable equipment	20.8%	Purchases of capital equipment remained surprisingly healthy.
Housing	−6.6%	Higher interest rates took a bite out of housing investment. However, mortgage rates have declined by about 100 basis points since the beginning of the year.
Nonresidential structures	14.1%	Nonresidential structures continued to recover from the deep decline of the early 1990s.
Inventories (change, billions of 1987$)	$63.0	Inventories have accumulated at a rapid pace during the past four quarters. Although the first-quarter change in real inventories was the largest since 1984, some analysts had expected an even larger buildup.
Government purchases	−1.6%	Federal defense purchases fell while federal non-defense purchases increased slightly.
Exports	−0.6%	After a strong 1994, exports were virtually unchanged in the first quarter. The dropoff in demand from Mexico likely held down first-quarter exports.
Imports	5.9%	Import growth slowed considerably relative to 1994's pace of 13.8 percent.

*Percent real growth in the first quarter at annual rates (except inventories). These preliminary figures are subject to substantial revision.

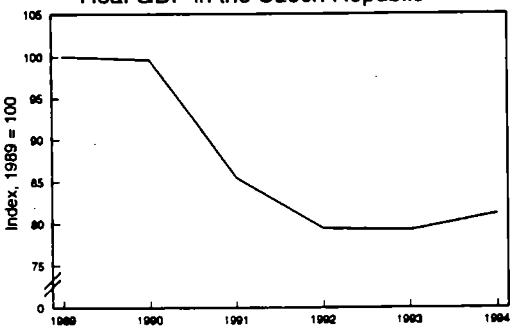
EYES ONLY

SPECIAL ANALYSIS

Update on the Transformation of the Czech Economy

Output in the Czech Republic increased in 1994 for the first time since the Czechs began their transition to a market economy (see chart). Unemployment remains low, and inflation has stabilized in the neighborhood of 10 percent.

Real GDP in the Czech Republic



Note: Observations for 1989 and 1990 are not strictly comparable to those for later years.

Analysis. Since the "velvet revolution" in late 1989, the Czech approach has been viewed as a model for economic reform. The hallmarks of this approach include:

- A restrictive fiscal policy that has moved the budget into surplus.
- A tight monetary policy, focused on linking the local currency to the mark and the dollar, that has kept inflation relatively low.
- A voucher-based privatization scheme that has succeeded in transferring 80 percent of the economy to the private sector.

The Czechs have also benefitted from the fact that, on the eve of liberalization in 1989, the country had relatively little foreign and government debt. Separation from Slovakia in 1993 freed the Czech Republic of a hefty burden of transfer payments as well as some of Czechoslovakia's less productive plant and equipment. And some Czechs may still remember the highly developed and fairly liberal economy that existed before the country was assimilated into the Soviet bloc in 1948.

International investors have responded to the recent Czech success by voting with their funds. The resulting inflows have helped finance the modernization of the Czech economy, but increasingly are viewed as posing difficulties for Czech authorities, particularly in light of Mexico's recent experience. To reduce the chances of a potentially devastating capital outflow, Czech authorities took steps in late April to inhibit foreign exchange transactions.

EYES ONLY

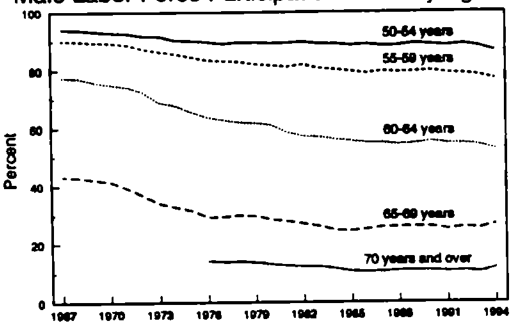
TREND

The Economic Status of the Elderly

Over the past three decades, three important changes in the demographic and economic status of the elderly have taken place: First, the elderly now make up a larger fraction of the population. Second, the labor force participation of older men has dropped sharply, while that of women has increased. And third, poverty among the elderly has become much less prevalent—indeed, slightly less prevalent than among the rest of the population.

Demographics. In 1940, the first year in which Social Security benefits were available, only 6.8 percent of the population was 65 or older. By 1994, this fraction had nearly doubled, to 12.7 percent. And by 2030 it is expected to rise to 20 percent. The aging of the population is one of the key factors generating the projected deterioration in the financial condition of the Social Security system over the next 30 years or so.

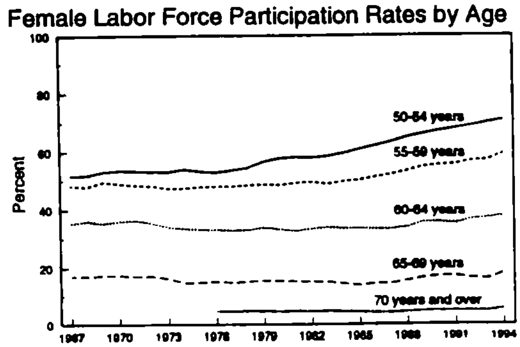
Male Labor Force Participation Rates by Age



Note: Observations for 1994 are not strictly comparable with earlier data due to the revision of the Current Population Survey.

Labor force participation. Between the mid-1960s and the mid-1980s, the labor force participation of older men shifted down markedly (see chart). Although this decline was widespread across age groups, the most dramatic reduction occurred among men aged 60-64. In 1967, 78 percent of such men were in the labor force, but by 1985 only 56 percent were. In part, this trend toward earlier retirement may reflect the fact that men aged 62-64 first became eligible for a reduced level of Social Security benefits in 1961. Since the mid-1980s, the trend toward earlier retirement appears to have abated.

Female Labor Force Participation Rates by Age

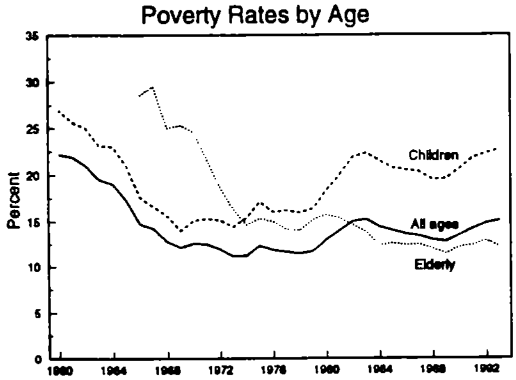


Note: Observations for 1994 are not strictly comparable with earlier data due to the revision of the Current Population Survey.

Labor force participation trends for older women have been dramatically different (see chart). Participation rates among women 60 and over changed little on net during the past three decades, while rates among women in their 50s trended up markedly. Greater labor force attachment should bode well for the retirement income security of some of these women who are currently (or will soon be) reaching retirement age. For others, however, it may have little effect. For example, some women will qualify for a larger Social Security benefit based on their husbands' earnings history rather than their own earnings history. For these women, additional years in the labor force do little or nothing to boost Social Security benefits.

The nature of retirement. Many workers retire in stages, moving from a career job to a bridge job, and from there to full retirement. Less than three-fourths of all wage and salary workers and only half of all self-employed workers retire in one fell swoop. In many cases, a bridge job involves a change of industry and occupation from the career job, and commonly requires a lower level of skill. Phased retirement may be most common among poor workers, who cannot afford immediate full retirement, and more affluent workers, who face broader opportunities for enriching and enjoyable part-time work.

Poverty Rates by Age



Poverty. According to official statistics, poverty rates among the elderly have declined sharply since the mid-1960s (see chart). Indeed, for the last decade or so measured poverty rates have been slightly lower for the elderly than for the population as a whole. Most of the reduction in poverty among the elderly took place in the late 1960s and early 1970s, coincident with large increases in the real value of social security benefits. In contrast to the experience of the elderly, children have suffered a marked increase in poverty rates since the 1970s. Today, the poverty rate among children is 50 percent higher than it was in 1970.

Despite the substantial reduction in the overall poverty rate of the elderly, significant pockets of poverty remain. For example, the rate among elderly Hispanics is twice as high as the rate for non-Hispanic whites, while the rate for blacks is three times as high. The rate for elderly people living alone (80 percent of whom are women) is 25 percent, compared with only 6 percent for married couples. And the rate for those 85 and older is about 20 percent—roughly twice the rate for those age 65-74. In addition, a disproportionate number of the elderly are near-poor, even if not below the official poverty line.

EYES ONLY

ARTICLE

Managed Exchange Rates For the G-3?

Since the beginning of the year, the German and Japanese currencies have appreciated 11 percent and 16 percent, respectively, against the U.S. dollar. Some observers have reacted to these and other fluctuations in exchange rates by advocating that the United States, Germany, and Japan commit to keeping their exchange rates within formal target bands. Indeed, some have suggested that such a move be taken at the Halifax summit. However, as of this writing, this proposal has not made its way onto the summit agenda.

Perspectives on the merits (and demerits) of target bands. Some analysts believe that markets do as well as can be done in setting exchange rates. Accordingly, these analysts believe that governments have no role to play in actively managing the exchange values of their currencies.

Other analysts believe that market-determined exchange rates can deviate from the values dictated by economic fundamentals and, at times, can even be destructive. For example, a temporarily overvalued exchange rate (such as Germany and Japan may be experiencing currently, and such as the United States experienced during the mid-1980s) may unnecessarily damage export-oriented industries. Adherents of this view tend to be more sympathetic to the idea that governments can outperform the markets in identifying appropriate values for exchange rates.

Exchange rate volatility in itself may inhibit trade and investment. Some advocates of managed regimes argue that target bands may reduce this volatility and hence may induce an improvement in economic performance. The force of this argument may have been attenuated in recent years as markets have moved to provide insurance from exchange rate risk, in the form of derivative instruments such as futures and swaps.

A third view is that, even if governments could outperform the markets, they have little leverage in foreign exchange markets in light of the staggering volume of transactions conducted there on a daily basis and the limited resources that governments can devote to this purpose.

Analysis. Target bands can be maintained only if each participating country is willing to subordinate domestic economic goals to the promotion of the common exchange rate policy. For example, if the United States were party to such a policy currently, we might well be required to raise our interest rates. But such a move would cause our economy to slow further, and increase the odds of an unnecessary recession. Countries tend to be more amenable to international cooperation when the actions called for by domestic and international considerations coincide—as is presently the case in Germany and Japan.

A fixed exchange rate system is an extreme form of a target band (extreme in the sense that the bandwidth has been shrunk to zero). Past experience with fixed exchange rate systems has been mixed: Such systems tend to fall apart except when the various parties adopt a common currency. One can view the various states of the United States as having adopted a common currency, and hence a fixed exchange rate system.

In any system short of full monetary union, exchange rates must adjust in response to changing economic circumstances. A key question is whether such adjustments are best accomplished through occasional abrupt jumps in the exchange rate—as often occur when a fixed exchange rate comes under speculative attack—or through the ongoing decisions of the market. Many observers believe that the more continuous approach is the less destructive.

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

CO_2 Emissions Expected to Soar. World emissions of carbon dioxide will rise 30 to 40 percent by 2010, according to the Paris-based International Energy Agency (IEA). The IEA expects China alone to account for more than a quarter of this increase, and other non-OECD countries to account for nearly a half. If these projections are borne out, the OECD share of world emissions—currently nearly one-half—will fall to 40 percent by 2010. But OECD residents should not congratulate themselves too much for their "greenness": On a *per capita* basis, OECD emissions will still substantially exceed emissions from the rest of the world.

Less Risky Business. According to an annual survey of U.S. companies, business spending per dollar of revenue for protection against lawsuits, fires, workers' injury claims, and other corporate misfortunes declined 7 percent in 1993, marking the first drop in such outlays in more than a decade. The Risk and Insurance Management Society, the New York organization of corporate and nonprofit risk managers that conducted the survey, attributed the reduction to big savings on workers' comp. Employers reportedly benefitted not only from new safety and back-to-work programs but also from state tort reforms that have cut firms' exposure to lawsuits. Unlike workers' comp costs, liability costs (insurance premia and uninsured losses) continued to rise in 1993; still, at 5 percent, their growth rate was far less than the 18 percent rate of a year earlier.

Flow of Funds to Developing Countries Expected to Abate Further. Net capital flows to emerging markets will fall for the second consecutive year in 1995 according to the Institute of International Finance (IIF), an international organization of banks and other financial institutions. These markets are still feeling the effects of the 19 percent reduction in total flows sustained last year. With investor confidence weakened by Mexican economic difficulties, the IIF expects private flows to retreat sharply in 1995, dragging total net flows down to a four-year low. Latin America is likely to be hardest-hit by the blow to confidence: Net private-sector flows, which fell from $76 billion in 1993 to $61 billion to 1994, are projected to drop to essentially nothing this year. Official flows (from both governments and international institutions such as the World Bank and IMF) are expected to triple from last year's level. But because official flows are so much smaller than private-sector flows, the increase in official flows will offset less than half of the reduction in private-sector flows.

EYES ONLY

RELEASES LAST WEEK

Gross Domestic Product

****Embargoed until 8:30 a.m., Friday, April 28, 1995****

According to advance estimates for the first quarter of 1995, real gross domestic product grew at an annual rate of 2.8 percent.

Employment Cost Index

The employment cost index for private industry workers increased 2.9 percent for the 12-month period ending in March.

Consumer Confidence

Consumer confidence, as measured by the Conference Board, rose 5.3 index points in April, to 105.5 (1985=100).

Advance Durable Orders

Advance estimates show that new orders for durable goods increased 0.6 percent in March.

MAJOR RELEASES THIS WEEK

Personal Income (Monday)
Leading Indicators (Wednesday)
Employment (Friday)

EYES ONLY

U.S. ECONOMIC STATISTICS

	1970–1993	1994	1994:3	1994:4	1995:1
Percent growth (annual rate)					
Real GDP	2.5	4.1	4.0	5.1	**2.8**
GDP deflator	5.5	2.3	1.9	1.3	**2.2**
Productivity					
Nonfarm business	1.2	1.4	3.2	1.7	N.A.
Manufacturing (1978-93)	2.1	4.6	3.5	3.1	N.A.
Real compensation per hour	0.6	0.7	–0.4	1.2	N.A.
Shares of Real GDP (percent)					
Business fixed investment	11.0	12.6	12.7	13.0	**13.5**
Residential investment	4.7	4.3	4.3	4.3	**4.2**
Exports	8.0	12.3	12.4	12.8	**12.7**
Imports	9.2	14.4	14.6	14.8	**14.9**
Shares of Nominal GDP (percent)					
Personal saving	4.9	3.0	3.0	3.4	**3.9**
Federal surplus	–2.8	–2.4	–2.3	–2.3	N.A.
			Jan. 1995	**Feb. 1995**	**Mar. 1995**
Unemployment Rate	6.7*	6.1*	5.7	5.4	5.5
Payroll employment (thousands)					
increase per month			169	345	203
increase since Jan. 1993					6340
Inflation (percent per period)					
CPI	5.8	2.7	0.3	0.3	0.2
PPI-Finished goods	5.0	1.7	0.3	0.3	0.0

*Figures beginning 1994 are not comparable with earlier data.

New or revised data in **boldface**.
GDP data **embargoed until 8:30 a.m., Friday, April 28, 1995.**

EYES ONLY

FINANCIAL STATISTICS

	1993	1994	Feb. 1995	Mar. 1995	April 27, 1995
Dow-Jones Industrial Average	3522	3794	3954	4063	4315
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3-month T-bill	3.00	4.25	5.77	5.73	5.69
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Mortgage rate, 30-year fixed	7.33	8.36	8.77	8.45	8.26
Prime rate	6.00	7.15	9.00	9.00	9.00

INTERNATIONAL STATISTICS

Exchange Rates	**Current level April 27, 1995**	**Percent Change from**	
		Week ago	**Year ago**
Deutschemark-Dollar	1.376	−0.8	−17.9
Yen-Dollar	83.58	0.4	−18.7
Multilateral (Mar. 1973=100)	81.46	−0.8	−12.8

International Comparisons	**Real GDP growth (last 4 quarters)**	**Unemployment rate**	**CPI inflation (last 12 months)**
United States	**4.0** (Q1)	5.5 (Mar)	2.9 (Mar)
Canada	5.6 (Q4)	9.7 (Jan)	2.2 (Mar)
Japan	0.9 (Q4)	2.9 (Jan)	0.2 (Feb)
France	3.6 (Q4)	12.3 (Dec)	1.9 (Mar)
Germany	3.3 (Q4)	6.4 (Jan)	2.3 (Mar)
Italy	2.7 (Q4)	12.0 (Oct)	5.0 (Mar)
United Kingdom	3.9 (Q1)	8.7 (Jan)	3.5 (Mar)