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WEB April 1995

EYES ONLY

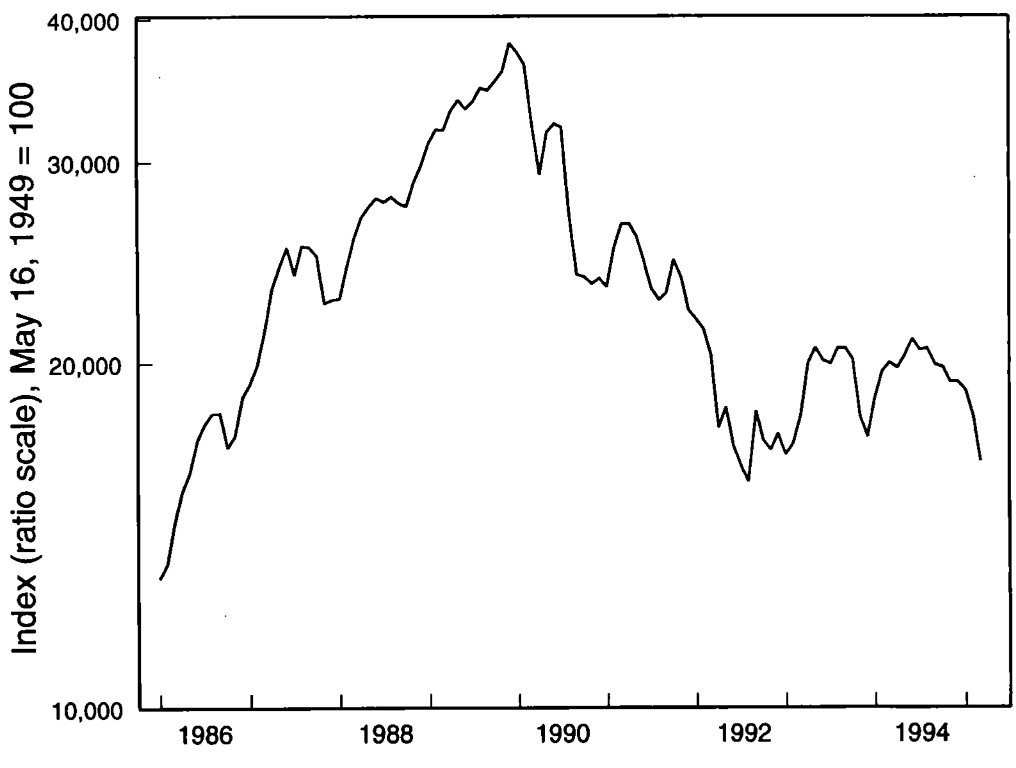
WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

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

April 24, 1995

CHART OF THE WEEK

The Japanese Stock Market



The Nikkei 225 index of stock prices has declined about 22 percent since the middle of 1994, reversing the runup that took place during the preceding six months or so. (By way of comparison, the S&P 500 index of U.S. stock prices dropped about 27 percent during the second half of 1987.) The recent decline in Japanese stock prices is partly a symptom of the weak performance of the Japanese economy. But it may also be contributing to that weakness by, for example, shrinking the capital of banks and thereby limiting their ability to extend loans.

EYES ONLY

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EYES ONLY

SPECIAL ANALYSIS

Reinventing Government Accounting, New Zealand Style

The government of New Zealand is apparently the only one in the world to use a full-blown accrual-based approach to accounting for its revenues and outlays. It is also unusual in estimating its own net worth—the difference between its assets and liabilities. One objective of those who introduced these practices was to make the country's fiscal situation more transparent to the public. In 1984 and again in 1990, an incoming government claimed that the fiscal affairs of the country were in worse order than the incumbent had admitted during the election campaign. Now, the government is required to publish financial statements every six months and immediately before general elections.

Another objective was to discourage manipulation of the fiscal accounts by the government. For example, under a system in which the focus is on a cash-based measure of the deficit, a government in fiscal trouble may have an incentive to sell off some of its assets because the proceeds would be credited as helping reduce the deficit. Under a system in which the focus is on the government's net worth, however, the government would have no such incentive because an asset sale would leave its net worth approximately unchanged.

Revenues and outlays. In a cash-based system, revenues are measured by looking at amounts actually received and disbursed. Thus, for example, in a cash-based system, outlays for pension benefits are calculated by measuring the value of benefits paid within the budget period. By contrast, an accrual-based system focuses on commitments to spend and promises of receipts. Accordingly, in an accrual-based system, outlays for pension benefits are calculated by measuring the cost of benefits earned during the budget period as well as the value of any benefits newly promised. The United States budget system is largely cash based, although it does include some elements of accrual accounting.

Assets and liabilities. New Zealand's government both owns assets (such as buildings and public forests) and owes liabilities (such as debt and pension liabilities). The difference between these two totals is the government's net worth. The New Zealand government's net worth is currently estimated at negative NZ$3.2 billion (about US$2.1 billion at the current exchange rate).

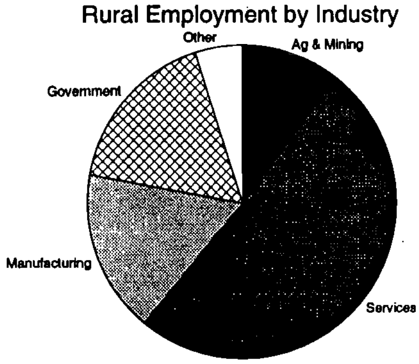
Analysis. Vice President Gore's National Performance Review called for the Federal government to adopt private-sector accounting practices and "provide an annual financial report to the public." The Federal Accounting Standards Advisory Board is drafting guidelines for the preparation of such reports. In the meantime, the Office of Management and Budget is publishing market-value-based balance sheets for the Federal government in the annual budget document. Federal net worth has been declining at a rapid rate since the early 1980s, and now stands at negative $2.9 trillion according to OMB's latest estimate.

EYES ONLY

TREND

The New Face of Rural America

The United States Department of Agriculture classifies some 2,300 of the nation's 3,141 counties as "rural." These counties account for 83 percent of the land area and 21 percent of the population of the country. Economic activity in these counties is surprisingly diverse, in the sense that the bulk of the jobs are not in the agricultural or mining sectors. The rural population is poorer than average, less educated, and aging, especially as younger residents migrate to urban areas.

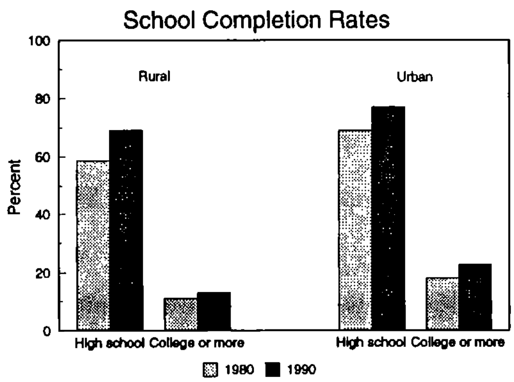


The rural economy is diverse. Only about 10 percent of rural jobs are attri-butable to agriculture or mining-related activities (see chart). The services and manufacturing sectors accounted for nearly 70 percent of all rural jobs in 1992. About one-fourth of all rural counties derive 20 percent or more of their total income from farming, and fewer than one-tenth of all counties derive 15 percent or more of their income from mining.

Population growth in rural areas has been sluggish. The rural population grew less than half as fast as the overall U.S. population in the 1980s (4.1 percent versus 9.8 percent). In large part, the slower growth of the rural population reflects outmigration from farming and mining-dependent areas, especially of younger workers. (During the 1980s, the average farming-dependent county lost 11 percent of its population to net outmigration, including 17 percent of persons between the ages of 18 and 34.) By contrast, the population of rural retirement destination counties (those that have the amenities that attract retirees) increased markedly during the 1980s, and accounted for 83 percent of all population growth in rural America (as well as 44 percent of all new rural jobs).

The income of rural families has stagnated. The median real pre-tax income of rural families showed virtually no growth during the 1980s, while metro family incomes rose slightly. By 1989, the gap between metropolitan and rural incomes had reached 27 percent—up from 22 percent 10 years earlier. The same factors that have been driving the slowdown of income growth for the nation as a whole appear to have been operating with particular force in the rural economy: The rural workforce is less educated (see below), and the average skill level of rural jobs is lower.

Rural poverty persists. Rural poverty rates increased slightly during the 1980s and—at 17 percent in 1992—were significantly higher than the metropolitan average (14 percent). The "persistently poor" rural counties (those with at least a 20 percent poverty rate in each of the last four decennial censuses) are concentrated in the South, Southwest, Appalachia, the Dakotas, and Alaska. Many of these counties (though not all) have smaller populations and are removed from urban centers. The residents of these counties are more often lacking a high school education, reside in female-headed households, and are ethnic minorities. Relative to other rural areas, these counties have higher unemployment rates (8.5 percent in 1990, compared with 6.6 percent for all rural areas), slower job growth (5 percent in the 1980s, compared with an overall non-metro rate of 12.3 percent) and, of course, lower per capita incomes ($2,500 less than rural America overall).



The rural-urban education gap persists. Rural high school and college completion rates increased during the 1980s, but so did metro-area rates. By 1990, 13 percent of the over-25 rural population had completed college, compared with 22.5 percent of the urban population (see chart).

Health care coverage is slightly less prevalent in rural areas. In 1991, 16.6 percent of the under-65 rural population had no health insurance coverage, compared with 15.8 percent of the metro population. Some indicators suggest that access to health care in rural areas has improved in recent years. For example, between 1981 and 1988, the number of physicians per capita increased 17 percent in rural areas, and by 1989 the number of doctor visits per capita was nearly as high in rural America as it was in metro areas. (Despite the increase in the number of physicians per capita in rural areas, this ratio was still less than half as high as it was in metro areas, possibly reflecting the fact that specialists are concentrated in metro areas.)

The farm workforce has been aging. During the 1980s, entry rates into farming fell by 50 percent among those 24 or younger, and by 35 percent among those aged 25 to 34. By 1990, 22 percent of farm operators were 65 or older. By contrast, only 3 percent of the U.S. workforce as a whole was 65 or older.

EYES ONLY

ARTICLE

Update on the Russian Economy

Russia's policymakers face several daunting challenges: high inflation, stagnant output, and ongoing confrontations over privatization. The most dramatic of these is inflation.

Inflation. While inflation has been brought down, it still is running in the neighborhood of 8 percent per month (see chart), or 150 percent per year. Now the Russians are making another assault on this problem, and there are several reasons for thinking they may be more successful this time around: The 1995 budget, signed into law by President Yeltsin on March 31, projects that the fiscal deficit will decline from 15 percent of GDP in 1993 and 10 percent in 1994 to 6 percent this year. In addition, the previous chairman of the central bank (who undermined past stabilization attempts by increasing the money supply at a furious rate) has been removed, and the central bank's discretion has been circumscribed by a new law. Finally, the International Monetary Fund recently approved a $6.8 billion loan. This loan will provide crucial non-inflationary financing of the budget deficit, and will serve as a strong signal to private investors.

Despite these encouraging factors, there are significant risks. The most ominous is that the budget and credit targets may not be implemented as planned. It may be particularly difficult to resist demands for agricultural subsidies during the harvest season. Also, some analysts doubt the feasibility of current plans for financing the budget deficit (the IMF loan will not cover the entire deficit for this year). And parliamentary elections in December, as well as presidential elections in mid-1996, will introduce political uncertainty. If fiscal policy is loosened, or if the central bank begins wantonly issuing credits again, Russia could lose its battle against inflation.

Privatization. The first wave of privatization dramatically expanded the scope of the private sector: As of mid-1994, 82 percent of all industrial workers were employed in private enterprises—up from just 1 percent in January 1993. But equity prices remain exceptionally low: The combined market capitalization of the 200 most widely traded firms was just $18 billion in March. (By contrast, the market capitalization of Microsoft is about $45 billion.) And privatization is not a panacea: The government may need to take steps to ensure effective competition, so that government monopolies are not merely transformed into private ones.

The Russians are now in the early phases of a second wave of privatization, and have published a list of more than 7,000 firms to be sold off during 1995. A recent proposal to give partial ownership of some of these firms to a consortium of banks, in exchange for a loan of about $1.8 billion, has generated much controversy.

Output and unemployment. While the fight against inflation continues, economic activity seems to have stabilized. Industrial production fell about 15 percent during the 12 months ending in October 1994, but has flattened out and may even have edged up a bit since then (see chart). Meanwhile, measured unemployment has been rising, albeit from low levels.

Summary. The Russian economy remains in a perilous state. Inflation, though falling, is still high. Economic activity is sluggish, and unemployment continues to rise. Nevertheless, if Russian policymakers stick to their targets, the current stabilization effort could dramatically reduce inflation and facilitate the growth already visible in other former communist countries.

The tight fiscal and monetary policies necessary to cut the rate of inflation will probably cause considerable temporary pain. But over the longer run, Russia should derive significant economic benefits from bringing inflation under control.

EYES ONLY

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

Fannie Mae, Freddie Mac Announce the McMortgage. Getting approval for a home loan may soon be as easy as getting lunch. The nation's two largest providers of mortgage funds, the Federal National Mortgage Association ("Fannie Mae") and the Federal Home Loan Mortgage Corporation ("Freddie Mac"), have unveiled computer systems that should greatly reduce the time and cost involved in getting a mortgage loan. Currently, loan approval can take a month or more, as the handwritten application is evaluated by underwriters who pull together credit information from a variety of sources and evaluate the credit risk. The new computer systems, by contrast, will tap into online financial information about the applicant and then make a judgement about whether to grant the loan—all within an hour or two in many cases. Costs should fall, too: The new systems should immediately reduce a lender's costs of loan origination by about $300 (out of a reported total of $2,500). Costs are expected to fall another $700 or so over the next several years. In the competitive business of home mortgage origination, consumers should see some of this cost reduction show up in lower fees.

The Salutary Effects of Expanding Medicaid Eligibility. Between 1984 and 1992, Congress and the states nearly doubled the percentage of children who were eligible for Medicaid benefits, from 16 percent at the beginning of the period to 31 percent in 1992. A recent paper published by the National Bureau of Economic Research concludes that this expansion substantially improved the health status of poor children. For example, eligibility for Medicaid reduced by 40 percent the probability that a child did not see a doctor within the previous year. And the 15 percentage-point increase in eligibility between 1984 and 1992 is estimated to have reduced child mortality by about 5 percent. Furthermore, expanded Medicaid coverage reduced racial disparities in health-care utilization.

New Crash Test Results: GM, Ford Are No Dummies. A new set of tests shows that when it comes to safety, Detroit's best can outperform even well-regarded import models. The Insurance Institute for Highway Safety, the lobbying and research arm of the nation's major auto insurers, recently released results from a new set of crash tests on fourteen midsize models which, together with their close relatives in the car market, account for 25 percent of the market. Among the tests to which the cars were subjected were a 40 mile-per-hour collision with a barrier (at an angle, rather than head-on as in government tests) and a series of 5 mile-per-hour impacts. Three cars earned the institute's highest grade: the relatively low-priced Chevrolet Lumina, which was the surprise winner; the popular Ford Taurus; and the Volvo 850. Although these two U.S. models outperformed the Toyota Camry, Honda Accord, and Saab 900, Detroit still has a little work to do—three of the six cars that received the institute's lowest rating were also produced by American companies.

EYES ONLY

RELEASES LAST WEEK

U.S. International Trade in Goods and Services

The goods and services trade deficit decreased to $9.0 billion in February from $12.0 billion in January.

Housing Starts

Housing starts declined 7.9 percent in March to 1.21 million units at an annual rate.

MAJOR RELEASES THIS WEEK

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

EYES ONLY

U.S. ECONOMIC STATISTICS

	1970–1993	1994	1994:2	1994:3	1994:4
Percent growth (annual rate)					
Real GDP	2.5	4.1	4.1	4.0	5.1
GDP deflator	5.5	2.3	2.9	1.9	1.3
Productivity					
Nonfarm business	1.2	1.4	–2.1	3.2	1.7
Manufacturing (1978-93)	2.1	4.6	5.6	3.5	3.1
Real compensation per hour	0.6	0.7	–1.8	–0.4	1.2
Shares of Real GDP (percent)					
Business fixed investment	11.0	12.6	12.4	12.7	13.0
Residential investment	4.7	4.3	4.4	4.3	4.3
Exports	8.0	12.3	12.1	12.4	12.8
Imports	9.2	14.4	14.2	14.6	14.8
Shares of Nominal GDP (percent)					
Personal saving	4.9	3.0	3.0	3.0	3.4
Federal surplus	–2.8	–2.4	–2.2	–2.3	–2.3

			Jan. 1995	Feb. 1995	Mar. 1995
Unemployment Rate	6.7*	6.1*	5.7	5.4	5.5

*Figures beginning 1994 are not comparable with earlier data.

			Jan. 1995	Feb. 1995	Mar. 1995
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

EYES ONLY

FINANCIAL STATISTICS

	1993	1994	Feb. 1995	Mar. 1995	April 20, 1995
Dow-Jones Industrial Average	3522	3794	3954	4063	4231
Interest Rates					
3-month T-bill	3.00	4.25	5.77	5.73	5.60
10-year T-bond	5.87	7.09	7.47	7.20	7.02
Mortgage rate, 30-year fixed	7.33	8.36	8.77	8.45	8.24
Prime rate	6.00	7.15	9.00	9.00	9.00

INTERNATIONAL STATISTICS

Exchange Rates	**Current level April 20, 1995**	**Percent Change from Week ago**	**Percent Change from Year ago**
Deutschemark-Dollar	1.387	0.1	–18.1
Yen-Dollar	83.25	–0.1	–19.3
Multilateral (Mar. 1973=100)	82.12	0.5	–12.7

International Comparisons	**Real GDP growth (last 4 quarters)**	**Unemployment rate**	**CPI inflation (last 12 months)**
United States	4.1 (Q4)	5.5 (Mar)	2.9 (Mar)
Canada	5.6 (Q4)	9.7 (Jan)	1.9 (Feb)
Japan	0.9 (Q4)	2.9 (Jan)	0.6 (Jan)
France	3.6 (Q4)	12.3 (Dec)	1.7 (Jan)
Germany	3.3 (Q4)	6.4 (Jan)	2.3 (Feb)
Italy	2.7 (Q4)	12.0 (Oct)	4.3 (Feb)
United Kingdom	4.2 (Q4)	8.7 (Jan)	3.4 (Feb)

EYES ONLY

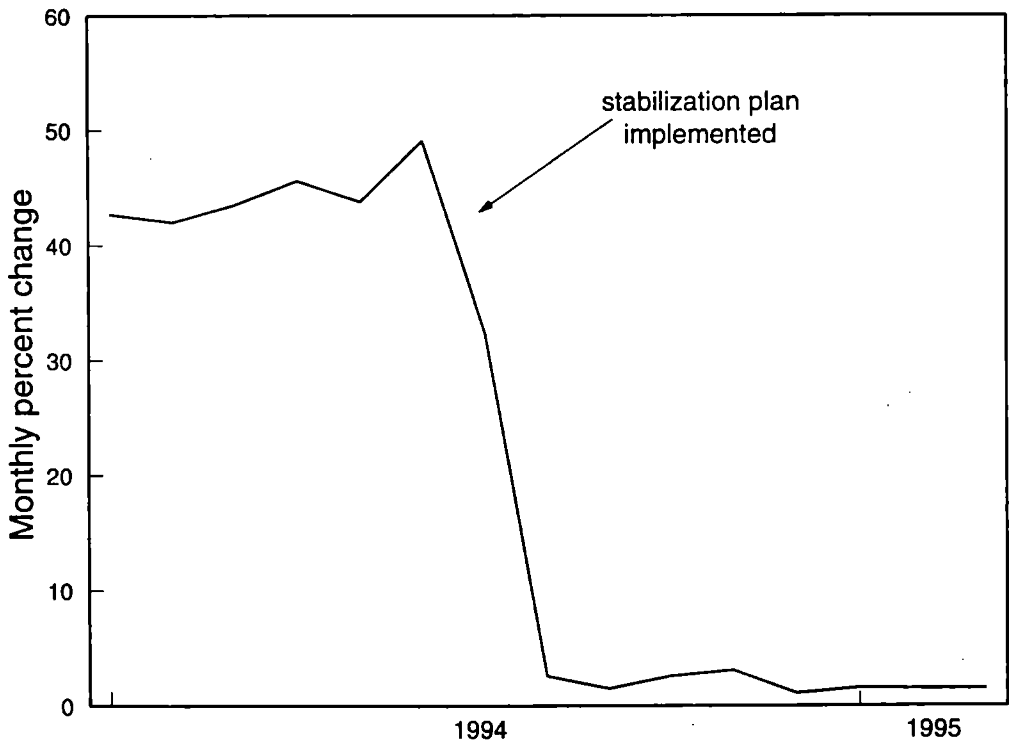
WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

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

April 17, 1995

CHART OF THE WEEK

Consumer Price Inflation in Brazil



During the first half of 1994, consumer prices in Brazil rose between 40 percent and 50 percent *per month* (more than 8,000 percent at an annual rate). After President Cardoso's stabilization plan was implemented, however, inflation fell sharply. As a prelude to President Cardoso's visit to Washington, the first item in this issue of the Weekly Economic Briefing examines the progress of and prospects for the Brazilian plan.

EYES ONLY

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"My mistake was writing to the I.R.S. to thank them for not auditing me that year."

EYES ONLY

CURRENT DEVELOPMENT

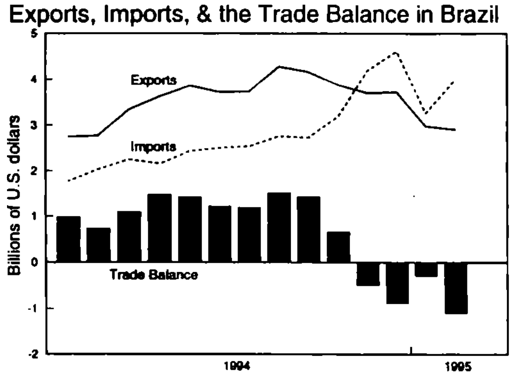
Progress Report on the Brazilian Stabilization Plan

President Cardoso will bring to Washington a record of significant accomplishment on the economic front. Under the stabilization plan he helped design, inflation has plummeted (see Chart of the Week), economic growth has strengthened, and foreign reserves have risen to a substantial level.

Analysis. Even so, students of the Brazilian economy point to several factors that may yet jeopardize the success of the stabilization plan:

The fiscal situation. President Cardoso is currently pressing several critical initiatives (including constitutional reforms to help curb spending by state governments) aimed at improving the budget outlook, but he may not obtain the approval of the Brazilian Congress.

Exports, Imports, & the Trade Balance in Brazil



The exchange rate and the trade balance. Since the implementation of the stabilization program, the Brazilian currency has appreciated at least 35 percent against the U.S. dollar in real terms. In line with that development, Brazil's balance of trade has swung from surplus into deficit (see chart).

Tariffs. In a serious reversal of previous moves toward trade liberalization, the government announced two weeks ago that it would impose tariffs as high as 70 percent on 100 consumer durable imports.

Financial sector. Prices in Sao Paulo's stock market are down about 40 percent since the beginning of the year. The government took over two big banks in December, and some analysts remain concerned about the viability of the banking system.

In light of these strains, difficult policy choices may yet lie ahead for President Cardoso and his team.

SPECIAL ANALYSIS

The British Penchant for Pension Privatization

The public system. The social security system in the United Kingdom consists of two tiers. The first tier provides a flat-rate basic pension (i.e., one that depends only on marital status and years of coverage). For example, a single person can currently receive up to $4,500 per year, depending on the number of years he/she made contributions to the system. The second tier provides an additional earnings-based pension (i.e., one that pays a higher benefit—up to a limit—to beneficiaries who had higher earnings and hence higher contributions). Both elements together are funded by an 18.8 percent payroll tax (combined employer and employee shares) on wages between specified thresholds.

This system has been partially privatized. Workers now have two methods available to them for opting out of the second tier of the public system.

The employer-based option. One option is to participate in a qualified pension or savings plan sponsored by his/her employer. If the employee exercises this option, the employer receives a rebate from the government equal to 4.8 percentage points of the payroll tax. (If the employer does not sponsor a qualified plan, the employee retains coverage under the second tier of the public plan.) Two types of employer-sponsored plans can qualify: defined-benefit plans paying retirement benefits at least as generous as those provided under the second tier of the public system; and defined-contribution plans where the employer contribution is at least as large as the rebate from the government.

The personal option. Since 1987, workers have alternatively been allowed to divert the 4.8 percentage points of payroll tax revenue into a personal pension plan managed by an authorized insurance company or bank. At retirement age, no less than three-fourths of the accumulated balance in a personal pension plan must be used to purchase an annuity; the remainder may be taken as a lump-sum payout. Additional contributions (beyond the 4.8 percentage points of payroll tax revenue) may be made into a personal pension plan, with fewer restrictions as to use at retirement. Disclosure rules and regulations for personal plan providers have recently been tightened after many workers who switched from employer-based plans found their pensions eroded by high commissions and fees.

Overall, about three-fourths of the British workforce have opted out of the second tier of the social security system—one-half into employer-sponsored plans and one-fourth into personal pension plans. Most of the employer-sponsored plans are of the defined-benefit type, though in recent years the number of workers covered by defined-contribution plans has increased.

Analysis. A common feature of social security systems around the world is that some classes of workers effectively provide subsidies to other classes of workers.

EYES ONLY

When a compulsory system is made voluntary, the incentive to opt out is strongest for those who have been on the giving end of the subsidy. Unless the rules of the voluntary system are carefully designed, the sponsoring government may be left with a significant liability.

The second tier of the British social security system provided some redistribution of resources from high-wage participants to low-wage participants before the opt-out provisions were introduced. Now, however, less redistribution is accomplished, because higher-income workers (the source of redistribution) can opt out. If the British government also privatizes the flat-rate component of the public retirement system, the system may accomplish no redistribution at all.

Under the original design of the opt-out feature, workers generally could increase their retirement benefits by leaving the public system when young and rejoining it as they neared retirement age. To bring the system more nearly into balance across age groups, the government now offers larger rebates for older workers.

EYES ONLY

Macroeconomic Update

On the Approach to a Soft Landing

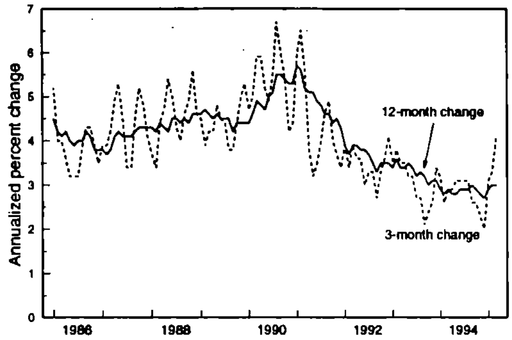
Recent data suggest that the economy is on track for a "soft landing." In particular, the growth of real GDP appears to be slowing, and by about the right amount: enough to bring it into the neighborhood of 2-1/2 percent—the maximum sustainable rate in the view of many analysts—but not so much as to raise the specter of recession. If the overall strength of the economy evolves as we hope and expect, the unemployment rate should remain near its current level and the rate of inflation should drift up only slightly.

Even if a soft landing is achieved, the taxi after touchdown may be bumpy. For example, growth in the current quarter could be on the sluggish side (below 2 percent at an annual rate) as producers move to correct the inventory overhang that appears to have developed recently in some sectors. But such a correction should not threaten the viability of the soft-landing scenario. Growth for the year still appears likely to come in close to the 2.4 percent rate anticipated in the Administration's forecast.

The key role of housing and autos. The slowdown in activity is most apparent in the interest-sensitive sectors—notably motor vehicles and new homes. Indeed, the slowdown in motor vehicle sales in January and February caused auto manufacturers to cut their production plans for the next few months in order to reduce their inventories. Similarly, sales of new and existing homes have been falling since last November, and home-builders have responded by sharply curtailing their activity. Over the next few quarters, the slowdown in the interest-sensitive sectors will probably spread to the rest of the economy, as cutbacks in auto production and housing construction reduce the incomes of auto and construction workers and suppliers of materials to those sectors, and this loss of income, in turn, causes spending on other goods and services to slacken.

Employment growth also appears to have slowed somewhat: The average increase in private nonfarm employment over the first three months of 1995 was 238,000, compared with an average monthly increase of 273,000 during 1994. Employment growth will probably slow further in coming months. Even so, the unemployment rate should remain near its current level because economic growth should generate the jobs needed to absorb the flow of new workers into the labor force.

Core Consumer Price Index



Note: Core CPI excludes food and energy prices.

An uptick in inflation. The last few monthly readings on the consumer price index have not been as favorable as the ones that were taken during 1994. Between December and March, the CPI excluding food and energy increased 4.1 percent at an annual rate during the first quarter, up from 2.6 percent over the 12 months of 1994 (see chart). The decline in the exchange value of the dollar against the currencies of our major trading partners (other than Canada and Mexico) will put some additional upward pressure on U.S. prices in coming months. Nevertheless, the uptick in inflation remains quite moderate given the strength of the economy in 1994, and we do not expect a sustained inflation problem in 1995 as growth moderates.

What fallout from the Mexican crisis? An obvious risk associated with achieving a soft landing is the impact on U.S. imports and exports of the economic instability in Mexico. U.S. exports to Mexico will be hurt by the absence of financing for Mexican importers, the reduction in Mexican real incomes, and the sharp depreciation of the peso. U.S. imports from Mexico—made much cheaper by the peso depreciation—could increase substantially. If U.S. exports to Mexico decline by one-half and U.S. imports from Mexico increase by one-third, net exports could fall by enough to shave roughly 1/2 percentage point off the growth of real GDP over the next year. Some analysts argue that net exports to Mexico could shrink by considerably more than this.

Summary. Although the Mexican situation poses a risk to the U.S. economy, the macroeconomic outlook is quite favorable. The key elements in this outlook are moderate growth, low unemployment, and only a modest increase in inflation.

EYES ONLY

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

Peddling Peso Futures. The Chicago Mercantile Exchange will open trading in a futures contract on Mexican pesos on April 25, making the peso the only developing-country currency whose futures are traded at the Merc. Reflecting concerns about the possible size of movements in the peso, the Merc has taken special precautions to ensure that trading in these futures will be orderly. For example, it has set margin requirements on the peso contract at about 10 times the usual level. The new market should help importers and exporters by allowing them to hedge their currency risks. Some observers fear that the introduction of the futures market will attract speculators and increase the volatility of the peso/dollar exchange rate. However, the introduction of trading in options on a stock does not appear to increase the volatility of the stock's price. The Mexico City stock exchange is reportedly planning to open its own peso futures market, but its plans are not yet finalized.

Temporary Workers: A Recent Snapshot. Do temps earn less than permanent employees? According to a new study published by the Federal Reserve Bank of Chicago, the answer may depend on the color of the worker's collar. White-collar workers hired on a temporary basis through "personnel supply services" earn an hourly wage 2 percent <u>higher</u> than that earned by permanent workers with comparable characteristics. But "pink-collar temps"—that is, temporaries working in administrative support—earn 10 percent less than do their permanent counterparts. And for blue-collar workers, the differential is a whopping 34 percent less for temps. The authors did not have data on benefits, but other studies have suggested that temporary workers are less likely to have health-care coverage than are other workers. Perhaps because of these labor cost differentials, firms hired 443,000 blue-collar temps in 1993—eight times as many as in 1983.

Keeping Negotiators Busy. According to the Bureau of Labor Statistics, 1995 is slated to be the busiest collective bargaining year on record. Of the 8.1 million workers under major collective bargaining agreements (those covering 1000 or more workers) in private industry and state and local government, 42 percent are scheduled to have their contracts expire or reopen during the year. This is the largest share in the 11 years that BLS has been keeping this data, and it comes on the heels of a record-low year in which contracts covering only 26 percent of workers expired or were reopened. Negotiators representing employees of state and local governments will be especially busy, as 56 percent of those workers will be involved in bargaining. June may be the most active month: Contracts covering nearly one-third of the affected workers are scheduled for expiration or reopening in June.

EYES ONLY

RELEASES LAST WEEK

Industrial Production and Capacity Utilization
****Embargoed until 9:15 a.m., Friday, April 14, 1995****

The Federal Reserve's index of industrial production fell 0.3 percent in March, following a 0.1 percent increase in February. Capacity utilization fell 0.5 percentage point to 84.9 percent.

Retail Sales

Advance estimates show that retail sales increased 0.2 percent in March, after decreasing 1.0 percent in February. Excluding sales in the automotive group, retail sales also increased 0.2 percent in March.

Consumer Price Index

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

Producer Price Index

The producer price index for all finished goods was unchanged in March. Excluding food and energy, producer prices increased 0.1 percent.

MAJOR RELEASES THIS WEEK

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

EYES ONLY

U.S. ECONOMIC STATISTICS

	1970–1993	1994	1994:2	1994:3	1994:4
Percent growth (annual rate)					
Real GDP	2.5	4.1	4.1	4.0	5.1
GDP deflator	5.5	2.3	2.9	1.9	1.3
Productivity					
Nonfarm business	1.2	1.4	−2.1	3.2	1.7
Manufacturing (1978-93)	2.1	4.6	5.6	3.5	3.1
Real compensation per hour	0.6	0.7	−1.8	−0.4	1.2
Shares of Real GDP (percent)					
Business fixed investment	11.0	12.6	12.4	12.7	13.0
Residential investment	4.7	4.3	4.4	4.3	4.3
Exports	8.0	12.3	12.1	12.4	12.8
Imports	9.2	14.4	14.2	14.6	14.8
Shares of Nominal GDP (percent)					
Personal saving	4.9	3.0	3.0	3.0	3.4
Federal surplus	−2.8	−2.4	−2.2	−2.3	−2.3
			Jan. 1995	**Feb. 1995**	**Mar. 1995**
Unemployment Rate	6.7*	6.1*	5.7	5.4	5.5

*Figures beginning 1994 are not comparable with earlier data.

	1970–1993	1994	Jan. 1995	Feb. 1995	Mar. 1995
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**

New or revised data in **boldface**.

EYES ONLY

FINANCIAL STATISTICS

	1993	1994	Feb. 1995	Mar. 1995	April 13, 1995
Dow-Jones Industrial Average	3522	3794	3954	4063	4208
Interest Rates					
3-month T-bill	3.00	4.25	5.77	5.73	5.58
10-year T-bond	5.87	7.09	7.47	7.20	7.03
Mortgage rate, 30-year fixed	7.33	8.36	8.77	8.45	8.37
Prime rate	6.00	7.15	9.00	9.00	9.00

INTERNATIONAL STATISTICS

Exchange Rates	**Current level**	**Percent Change from**	
	April 13, 1995	**Week ago**	**Year ago**
Deutschemark-Dollar	1.387	0.8	–18.9
Yen-Dollar	83.30	–2.5	–19.6
Multilateral (Mar. 1973=100)	81.75	–0.1	–13.6

International Comparisons	**Real GDP growth (last 4 quarters)**	**Unemployment rate**	**CPI inflation (last 12 months)**
United States	4.1 (Q4)	5.5 (Mar)	2.9 (Mar)
Canada	5.6 (Q4)	9.7 (Jan)	1.9 (Feb)
Japan	0.9 (Q4)	2.9 (Jan)	0.6 (Jan)
France	3.6 (Q4)	12.3 (Dec)	1.7 (Jan)
Germany	3.3 (Q4)	6.4 (Jan)	2.3 (Feb)
Italy	3.7 (Q3)	12.0 (Oct)	4.3 (Feb)
United Kingdom	4.1 (Q4)	8.7 (Jan)	3.4 (Feb)

EYES ONLY

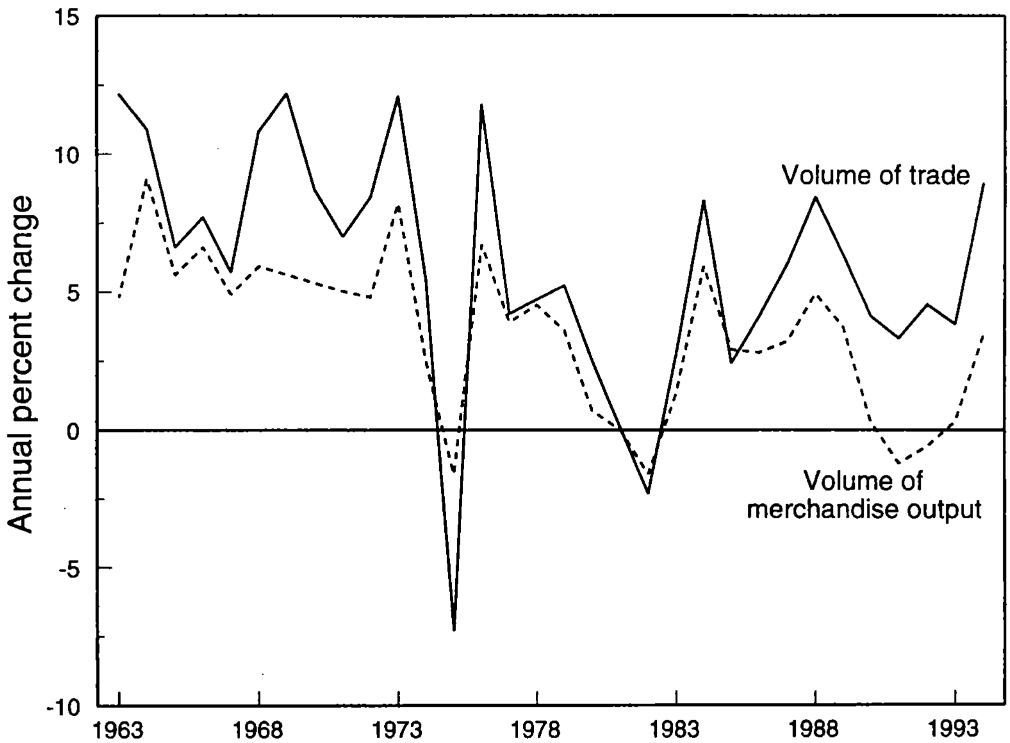
WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

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

April 10, 1995

CHART OF THE WEEK

World Merchandise Output and Trade



integration
growth -
trade vol

World trade in goods increased 9 percent last year—the biggest jump in nearly two decades (solid line in the chart). This strength reflected a pickup in world economic activity as evidenced, for example, by the upturn in the growth of global merchandise output (dashed line in the chart). But during the last few years, trade has grown noticeably faster than output (as shown by the gap between the two lines in the chart since 1985), suggesting that global integration of markets has also played a role.

EYES ONLY

CONTENTS

Quote of the Week

The Clinton Administration announced that it would be buying dollars on the open market for the first time in a month. Now, how do you buy dollars? What do you say to a guy? "Hey, those look pretty good; give me five bucks worth of those dollars. How much is that?"

Jay Leno

EYES ONLY

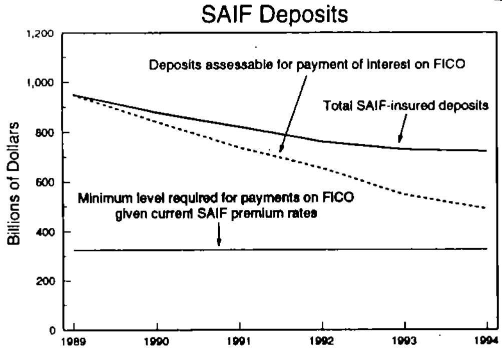
CURRENT DEVELOPMENT

The Death Spiral of the Thrift Insurance Fund

On January 31, the Federal Deposit Insurance Corporation (FDIC) announced its intention to cut the deposit insurance premium rates paid by banks while maintaining the rates paid by thrifts at their current levels. (Under current law, the FDIC was compelled to take this action because the Bank Insurance Fund, or BIF, which insures bank deposits, will achieve full capitalization later this year. By contrast, the Savings Association Insurance Fund, or SAIF, which insures thrift deposits, is not projected to achieve full capitalization until 2002.) If implemented, this action will put thrifts at a competitive disadvantage (see Weekly Economic Briefing, October 24, 1994).

In the last few weeks, several of the nation's largest thrifts have moved to apply for bank charters. Evidently, these parent ~~companies~~ intend to induce their depositors to shift their funds to the new bank units. Such maneuvers will accelerate the death spiral of SAIF. As the pool of thrift deposits dries up, the incentive for each remaining thrift to exit will increase. Already, the total volume of SAIF-insured deposits has shrunk 25 percent since 1989, and the volume of deposits assessable for purposes of servicing SAIF's debt to the Financing Corporation (FICO) has fallen by half (see chart).

SAIF Deposits



Note: Data are December values.

Analysis. The proposed gap between the thrift and bank insurance premium rates does not reflect any problem with the current health of the thrift industry (it is in good shape), but rather the fact that SAIF was established with no initial capital and with significant debt obligations related to the S&L debacle of the 1980s. Many ~~analysts believe that~~ the best achievable way to resolve the problem is to merge BIF and SAIF. The combined fund would have sufficient resources to assu~~me the remaining~~ obligations of SAIF, and would be fully capitalized in 1996 (only one year later than BIF on its own). At that time, premium rates of the combined fund would drop to about 6 cents per $100, or only about 2 cents more than if BIF were allowed to proceed on its own.

But banks say no

This approach would infuriate bankers because it would impose about $11 billion in costs on them that they might not otherwise bear. Bankers argue that they should not be saddled with these additional costs because they had nothing to do with creating the current situation. However, surviving thrifts can make the same argument; by definition, those most directly responsible for creating the situation are now out of business. Legislation will be required to implement virtually any of the solutions currently under discussion.

A general problem for society -- cost should be imposed generally

EYES ONLY

CURRENT DEVELOPMENT

A Cloudy Forecast From the Trustees

The financial status of the Social Security and Medicare trust funds changed little during 1994, according to the Trustees' annual report released April 3rd:

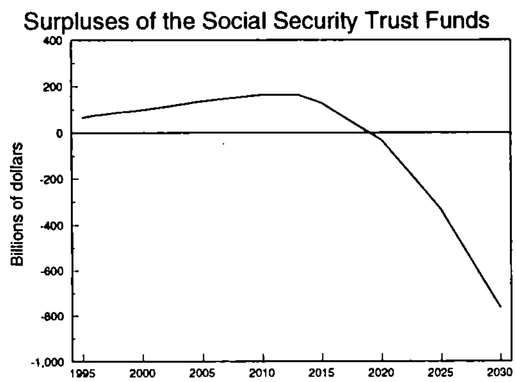
- rhetorical
- substantive response

- While most people focus on the Social Security Trust Fund, the more immediate problem is in the Medicare Hospital Insurance (HI) Trust Fund, which is projected to run dry only seven years from now (one year later than was projected last year).

- The Social Security Trust Fund (including both the Old Age and Survivors portion and the Disability portion) is projected to be depleted in 2030 (the comparable figure last year was 2029). Over the next 75 years, the deficit in this fund is now estimated at 2.17 percent of taxable payroll (the comparable figure last year was 2.13 percent). See Weekly Economic Briefing, March 6, 1995.

- Within the Social Security Trust Fund, the Disability Insurance (DI) portion is projected to be depleted in 2016. (Last year, the DI portion was projected to go bust in 1995, but Congress stepped in and boosted the share of the Social Security payroll tax going toward DI.)

Analysis. At present, the social security system is running a hefty surplus: Receipts (revenues from payroll taxes, and from income taxes on Social Security benefits, as well as interest on accumulated reserves) exceed payouts (primarily benefits) by about $65 billion. This surplus is credited to the various trust funds, where it accumulates interest and is available for payment of future benefits. (It also helps reduce the Federal unified budget deficit.) But according to current projections, the Social Security surplus will peak in 2013, at more than $160 billion; thereafter, it will decline rapidly, hitting zero in 2020, and reaching a deficit of more than $750 billion by 2030, when the trust fund runs dry.



Some analysts conclude from this projection that it would be prudent for the Social Security system to begin to reduce the cost of future benefits and/or increase future revenues sooner rather than later because the required policy changes would be smaller than if action were delayed.

EYES ONLY

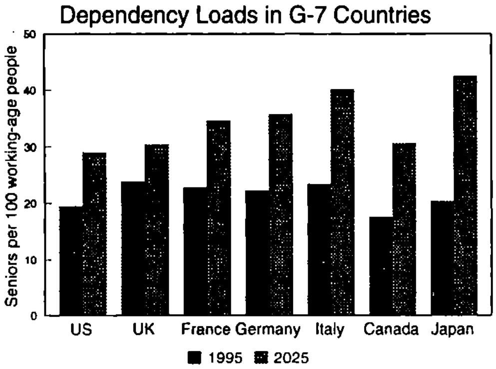
TREND

Growing Older Together

Currently, there are 19 persons of retirement age (age 65 and over) in the United States for every 100 persons of working age (15 through 64). With the graying of the baby-boom generation, however, this measure of "dependency load" ~~is~~ expected to climb to nearly 30 by 2025 (see chart).

Is Japan the highest in the world

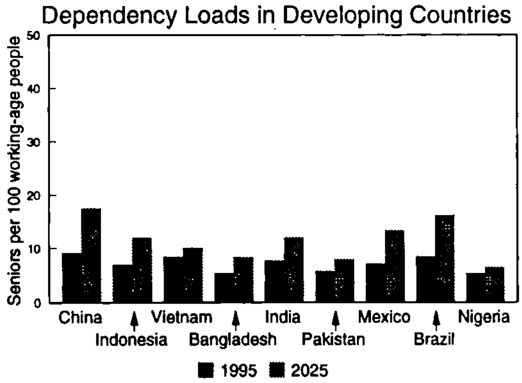
Dependency Loads in G-7 Countries



The demographic outlook is even bleaker in the other G-7 countries. Each of the other countries is projected to have a higher dependency load than the United States in 2025. And while the increase in the U.S. dependency load looks steep, five of the other six countries will undergo even sharper increases.

The view outside the G-7. The population of the developing world will also be growing older. To be sure, these countries have much lower dependency loads now than do the G-7 nations. But those loads are expected to climb sharply over the next three decades (see chart), particularly in countries such as China and Brazil where the demographic transition is furthest along.

Dependency Loads in Developing Countries



Measured against the experience of the G-7 countries, the demographic shifts in these developing countries will be quite rapid. Over the next 30 years, for example, China will experience an increase in the dependency load that took a full 47 years to occur in the United States. The strains imposed on such countries may be even greater than those endured by the developed countries.

EYES ONLY

ARTICLE

Work and Disability

Since 1989, the number of Americans receiving disability benefits from the Social Security Administration (SSA) has increased 46 percent, to 7.9 million, and program cost has jumped 50 percent in real terms. The total cost of disability benefits and associated health insurance is now more than $100 billion. According to current projections, the number of beneficiaries will continue to increase sharply during the next 10 years. These developments are symptoms of severe underlying problems with the existing disability insurance system.

why the dramatic ↑ in this time period

is the increase

The current list of "fast-track" disabilities is obsolete. The SSA equates disability (and hence eligibility for Social Security Disability Insurance (SSDI) and its accompanying Medicare benefits) with being unable to earn $500 per month net of impairment-related work expenses. The process of becoming certified for benefits under this definition can be lengthy. However, there are exceptions. The SSA maintains a list of conditions that are presumed to prevent an individual from engaging in any gainful activity. Unfortunately, this list has not been updated to take into account the impact of new technologies in the workplace. For example, special computer screens can magnify small print for the visually impaired.

education characts of those who apply

Eligibility of non-fast-track candidates is difficult to determine. Accurate measurement of many impairments can be obtained only with the full cooperation of the patient. For example, a patient claiming reduced lung capacity may or may not take a full breath on the testing apparatus. Even worse, medical impairment often bears only a weak correspondence to inability to earn; for example, it is difficult to know whether someone short of breath can be a shopkeeper, secretary, or programmer. These difficulties are compounded in the 40 percent of SSDI claims that are based on mental illness and musculoskeletal ailments such as lower back pain—categories where medical science has difficulty quantifying medical impairment.

40%!

has this % increased?

The result is an application process that often resembles a lottery. Researchers have found evidence that many truly disabled are denied benefits, and others who could work are granted benefits. About half of all denials of initial applications are appealed, and most of these appeals are successful. Furthermore, the success rate upon appeal varies dramatically from judge to judge, from as low as 30 percent to as high as 80 percent. Such divergences suggest a disturbing lack of accuracy in the system, and hence (among other consequences) a lack of equity across people with similar disabilities.

are there lawyers that specialize

The system does not deal well with temporary disabilities. Some disabilities such as certain forms of depression are debilitating when they strike, but can be controlled with proper medication. If the disability is recognized at the time of initial certification as possibly temporary, the file may be marked for an early

EYES ONLY

Continuing Disability Review. However, because of funding limitations and a backlog of applications and appeals, SSA is carrying out only a fraction of its statutorily mandated reviews. Moreover, even when reviews occur, the only course of action available to the SSA is to take away a lifetime benefit previously granted—a difficult process.

The system strongly discourages beneficiaries from returning to work. The difficulty in defining eligibility would not be too serious a problem if the system provided a strong incentive for beneficiaries to return to work. Unfortunately, the system does just the opposite. Indeed, under current rules, anyone who has worked even half-time at $6 per hour for nine months loses all of the SSDI stipend, and after four years of work Medicare benefits as well. Because disabled people typically cannot obtain medical insurance for their pre-existing conditions, loss of Medicare is a particularly strong barrier to returning to work.

These disincentives are illustrated by considering the case of a hypothetical single man receiving the typical SSDI cash payment, which is about $715 per month. If, as is common for many disabled people, he can work only part-time (say 20 hours per week), he would need to earn more than $8.50 per hour just to come out even on the cash stipend. Because most part-time jobs do not offer health insurance, the employee would need to purchase it. For three years he could purchase Medicare coverage for $3,700 per year (almost $4 per hour if working half-time). In total, this employee would need to earn about $12.50 per hour just to break even on a pre-tax basis if working half-time, or $6.25 per hour if working full-time. And after his Medicare privileges expire, he would need to find insurance that would cover a disabled person and his pre-existing condition on the private market. In light of these disincentives, it is not surprising that less than 1 percent of the SSDI population ever exit the SSDI rolls for employment. less than 1%

The Domestic Policy Council and the Office of Management and Budget have begun a review of this issue. Their preliminary recommendations should be available this summer.

EYES ONLY

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

Shining a Light on Zombie Airlines. What do Eastern, Braniff, Continental, Pan Am, Midway, America West, and TWA have in common? They all continued flying even while they were in Chapter 11 bankruptcy proceedings. Competitors and some independent observers have argued that such "living dead" airlines unfairly harmed other airlines. Because they were protected from their creditors, these zombies had nothing to lose from cutting prices to generate cash, say these critics. But a new study published by the National Bureau of Economic Research finds little evidence for this view. Other than Eastern, which slashed fares sharply, the major Chapter 11 airlines cut prices by less than 6 percent on average in the six months after filing for bankruptcy. And even including Eastern, the zombies apparently did little damage to their rivals: Competing airlines on average did not cut fares after the bankruptcies and did not lose market share to the zombies.

Central European Nations Lead the Pack in Transition. Among the 26 economies of Central and Eastern Europe and the former Soviet Union, Slovenia and the Czech Republic have the brightest prospects for medium-term growth, according to a new index developed by the Economist Intelligence Unit. The consulting firm, which regularly surveys business conditions in scores of countries, constructed the index using 10 indicators of growth potential. Included in the chosen indicators: physical infrastructure, education level, economic openness, political stability, and debt burden. Among other former socialist economies ranking relatively high on the index were Slovakia, Hungary, and the Baltic republics. Russia, by contrast, was far back in the pack—ahead of most of the Central Asian republics, but behind Serbia and Albania.

Any policy - do we want it

The Strong Yen Comes Home to Roost (In a Jeep). Taking advantage of the yen's strength, Chrysler and General Motors have cut prices on vehicles they sell in Japan. On March 30th, Chrysler announced that it was cutting the yen price of the Jeep Cherokee, its top-selling model in Japan, by 10 percent. And Chrysler will chop its prices for service parts by 30 percent. GM led the way back in November, when it reduced its Japanese prices for vehicles by an average of 8 percent. Ford, for its part, has no plans to follow suit: A spokesperson says that the automaker projects a yen/dollar exchange rate at the start of the model year, then lives or dies with that rate until the next year. What exchange rate did they project? Ford won't say, but the spokesperson confesses that it was substantially over 100 yen/dollar.

Tyson auto parts

EYES ONLY

RELEASES LAST WEEK

Employment and Unemployment

****Embargoed until 8:30 a.m., Friday, April 7, 1995****

In March, the unemployment rate rose to 5.5 percent from 5.4 percent in February. Nonfarm payroll employment rose by 203,000, following increases of 345,000 in February and 169,000 in January.

Personal Income and Expenditures

Personal income rose 0.5 percent in February (monthly rate). Disposable personal income also rose 0.5 percent. Personal consumption expenditures rose 0.1 percent.

Leading Indicators

The index of leading economic indicators decreased 0.2 percent in February. The index was unchanged in January.

MAJOR RELEASES THIS WEEK

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

EYES ONLY

U.S. ECONOMIC STATISTICS

	1970–1993	1994	1994:2	1994:3	1994:4
Percent growth (annual rate)					
Real GDP	2.5	4.1	4.1	4.0	5.1
GDP deflator	5.5	2.3	2.9	1.9	1.3
Productivity					
Nonfarm business	1.2	1.4	–2.1	3.2	1.7
Manufacturing (1978-93)	2.1	4.6	5.6	3.5	3.1
Real compensation per hour	0.6	0.7	–1.8	–0.4	1.2
Shares of Real GDP (percent)					
Business fixed investment	11.0	12.6	12.4	12.7	13.0
Residential investment	4.7	4.3	4.4	4.3	4.3
Exports	8.0	12.3	12.1	12.4	12.8
Imports	9.2	14.4	14.2	14.6	14.8
Shares of Nominal GDP (percent)					
Personal saving	4.9	3.0	3.0	3.0	3.4
Federal surplus	–2.8	**–2.4**	–2.2	–2.3	**–2.3**

			Jan. 1995	Feb. 1995	Mar. 1995
Unemployment Rate	6.7*	6.1*	5.7	5.4	**5.5**

*Figures beginning 1994 are not comparable with earlier data.

			Jan. 1995	Feb. 1995	Mar. 1995
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	N.A.
PPI-Finished goods	5.0	1.7	0.3	0.3	N.A.

New or revised data in **boldface**.
Employment and unemployment data **embargoed until 8:30 a.m., Friday, April 7, 1995**.

EYES ONLY

FINANCIAL STATISTICS

	1993	1994	Feb. 1995	Mar. 1995	April 6, 1995
Dow-Jones Industrial Average	3522	3794	3954	4063	4205
Interest Rates					
3-month T-bill	3.00	4.25	5.77	5.73	5.67
10-year T-bond	5.87	7.09	7.47	7.20	7.09
Mortgage rate, 30-year fixed	7.33	8.36	8.77	8.45	8.41
Prime rate	6.00	7.15	9.00	9.00	9.00

INTERNATIONAL STATISTICS

Exchange Rates	**Current level April 6, 1995**	**Percent Change from Week ago**	**Year ago**
Deutschemark-Dollar	1.375	–2.5	–19.8
Yen-Dollar	85.40	–4.5	–18.2
Multilateral (Mar. 1973=100)	81.81	–2.2	–14.1

International Comparisons	**Real GDP growth (last 4 quarters)**	**Unemployment rate**	**CPI inflation (last 12 months)**
United States	4.1 (Q4)	5.5 (Mar)	2.9 (Feb)
Canada	5.6 (Q4)	9.7 (Jan)	1.9 (Feb)
Japan	0.9 (Q4)	2.9 (Jan)	0.6 (Jan)
France	3.6 (Q4)	12.3 (Dec)	1.7 (Jan)
Germany	3.3 (Q4)	6.4 (Jan)	2.3 (Feb)
Italy	3.7 (Q3)	12.0 (Oct)	4.3 (Feb)
United Kingdom	4.1 (Q4)	8.7 (Jan)	3.4 (Feb)

EYES ONLY

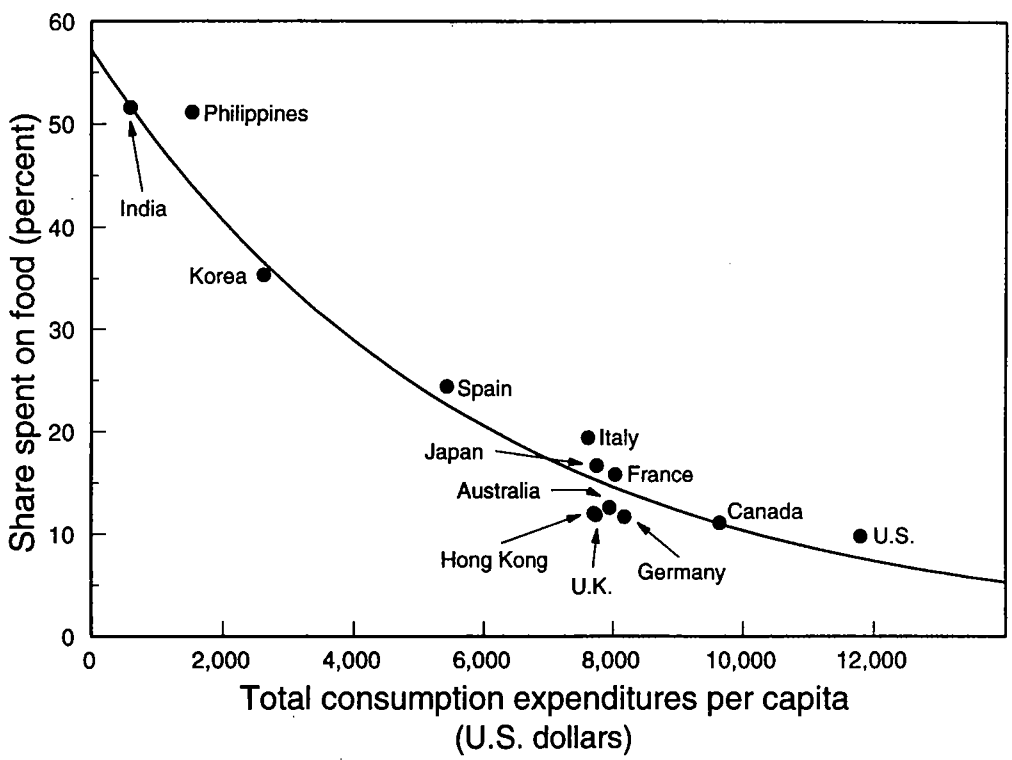
WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

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

April 3, 1995

CHART OF THE WEEK

Living Standards and the Share of
Personal Spending Devoted to Food in 1985



On average, American families devote only about 10 percent of their family budgets to food for consumption at home (measure the U.S. dot against the vertical axis). Families in other countries spend a larger portion of their budgets on such food. In large part, this fact is attributable to the high overall standard of living in the United States (measure the U.S. dot against the horizontal axis). As standards of living rise, households tend to devote a larger fraction of their spending to goods and services other than food. However, there are important differences even among wealthy countries. For example, the share of food in the average budget in Japan is about half again as large as it is in the United States.

EYES ONLY

CONTENTS

"Believe me, the E-check is in the E-mail."

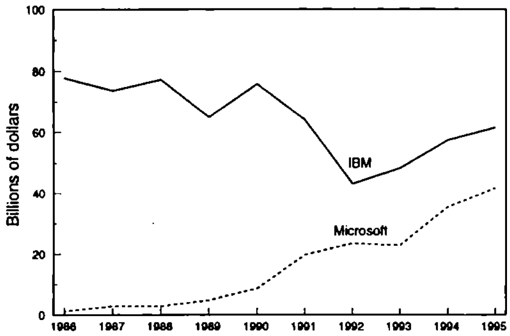
EYES ONLY

ARTICLE

Computers and Competition: Should We Fear a Microsoft Monopoly?

Thirty years ago, hardware firms were at the leading edge of the computer industry, and IBM was dominant among these firms. As the leading edge has shifted from hardware to software (see Weekly Economic Briefing, March 27, 1994), Microsoft has emerged as a major force, while IBM's standing has slipped (see chart).

Market Value of IBM and Microsoft



Note: Market value equals the value of each firm's debt and equity outstanding.

IBM Loses Its Way. During the 1960s, when mainframes still ruled the computer world, IBM accounted for roughly half of U.S. computer industry sales. IBM lost its leadership after a major innovation, the microprocessor, made personal computers possible. Initially, it appeared that the firm would be able to dominate the market for personal computers as it had the market for mainframes. IBM's decision to allow rivals such as Compaq to sell IBM-compatible "clones" helped it gain market leadership over Apple, which chose not to authorize such competition.

IBM-compatibility became the industry standard. Software developers wanted to write applications programs for the computer system most users owned, users wanted to learn the system most businesses employed and for which the most software had been written, and businesses wanted to acquire hardware that most users had learned to use and for which the most software was available. This self-reinforcing standardization process helped IBM stave off competition in the early years of the personal computer. In the 1980s, for example, wide acceptance of the IBM standard preserved the dominance of IBM-compatibility even when Apple introduced what some considered a superior personal computer, the Macintosh.

As time passed, however, the market for PC hardware became a "commodity" market, characterized by fierce competition among many producers of highly similar products. Today, although IBM remains successful in the still-large mainframe market, it manufactures only 9 percent of personal computers sold worldwide.

Microsoft Reaps What IBM Sowed. Even as hardware manufacturers have proliferated, Microsoft has maintained its position as the only supplier of the standard operating system. A rival operating system could have succeeded only if a critical mass of users and software developers had been willing to switch to a new standard. However, this has not happened. As a result, Microsoft has been able to enhance its bargaining position relative to IBM and has probably been able to claim an increasing share of the profits from the establishment of an industry standard.

How Entrenched is Microsoft's Position? The Micro~~soft operating~~ systems—MS-DOS and its successor, Windows—account for 82 percent of personal computer operating system sales in the United States. (Microsoft also captures 60 percent or more of the markets for leading types of applications software such as spreadsheet and word processing packages.) For fear of violating Microsoft's copyrights, potential competitors cannot offer a rival operating system that is too similar to MS-DOS. But offering a product that is too dissimilar might be no more successful for several reasons: It might not run existing DOS-compatible applications packages; there might not be sufficient applications available to run on it; and users might not want to take the trouble to learn to use it. As a result, Microsoft's market position may be quite secure, at least until another major industry innovation comparable to the development of the microprocessor dramatically changes the structure of the industry. Even now, however, Microsoft faces some limited competition in operating system software and has an incentive to keep prices low in order to attract buyers new to the personal computer market (who will later purchase Microsoft's operating systems upgrades and applications software).

microprocessor
⇓
MS DOS

Looking to the future. Microsoft expects to introduce in the near future a new operating system—known as Windows 95—intended as the successor to both MS-DOS and Windows. The firm hopes that Windows 95 will facilitate the creation of an enormous network of personal computer users, and give them access to relatively new—and potentially vast—markets for commercial and financial services. Microsoft's ownership of copyrights to what is likely to become the new standard o~~perating system so~~ftware for personal computers may eventually allow it to charge monopoly prices for access to network services, once it has achieved substantial market penetration. In turn, monopoly control of these markets could result in higher prices, reduced choice, and less innovation. On the other hand, domination by Microsoft could also lead to wider availability of on-line services, lower production costs, and higher quality. Moreover, it is far from certain that Microsoft will be able to accumulate significant power in these new on-line markets. It will likely face competition from a plethora of financial-service, retail and communications behemoths such as Citibank, Merrill Lynch, American Express, AT&T, and Sears.

Even if the Federal government were to decide that the social costs of Microsoft's market position exceeded the benefits, it might have difficulty addressing the problem through antitrust actions (see Current Development, this issue).

EYES ONLY

CURRENT DEVELOPMENT

Judge Questions Microsoft Antitrust Settlement

monopoly in opeating ⇒
monopoly in applications --
Nod. No concern

Last July, the Department of Justice charged Microsoft with unfairly maintaining its near-monopoly of operating systems software (such as MS-DOS and Windows), and simultaneously filed a consent settlement. (See Weekly Economic Briefing, July 22, 1994).

In February of this year, however, Judge Stanley Sporkin rejected the proposed settlement, partly because he was concerned that Microsoft may have unfairly used its monopoly in operating systems to gain market power in the market for applications software. Judge Sporkin was also concerned that Microsoft may have used premature product announcements (so-called "vaporware") to preserve unfairly its market position by keeping customers from switching to rivals. Neither of these issues was addressed in the original Justice Department complaint. Justice has appealed the ruling, arguing that the court has no authority to examine charges other than the ones leveled in the complaint.

Analysis. Antitrust law allows firms to exercise monopoly power so long as that power was achieved and maintained by providing a superior product. (This approach ensures that the law does not have the perverse effect of punishing successful innovation, and avoids turning judges into price regulators.) Justice may have chosen not to pursue the issues raised by Judge Sporkin because the line between "unfair" and "fair" use of market power is difficult to draw, and Microsoft did not clearly step over that line.

If the Judge's ruling is overturned on appeal (as many analysts expect), and if the government were to decide to attack Microsoft's potential ability to leverage its market power, its only remedy might be legislation requiring the company to separate its operating systems and applications software businesses or limiting the scope of copyright protection for operating system software.

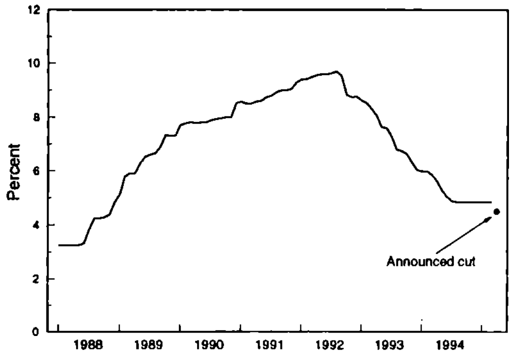
EYES ONLY

CURRENT DEVELOPMENT

The Monetary Tide Ebbs Further in Europe

The Bundesbank—Germany's central bank—eased the stance of its monetary policy on March 30, reducing its key interest rate 0.35 percentage point. At 4.5 percent, this rate is now more than 5 percentage points below its peak level of September 1992 (see chart).

Bundesbank's "Tender" Rate



This easing was somewhat surprising. Prices of basic production and imported goods have accelerated significantly over the past year. Moreover, settlements in Germany's annual national labor bargaining sessions have been higher than anticipated. And strong growth last year has put the economy operating near its "full employment" level of activity.

Analysis. In explaining its move, the Bundesbank cited a decline in the money supply as well as the restraining effect of the mark's recent appreciation on economic activity and prices. (Because imports and exports are larger relative to GDP in Germany than in the United States, most analysts believe that currency fluctuations there have a greater impact on the domestic economy than they do in the United States.)

The reduction in German interest rates may help shore up the dollar. Austria, Belgium, the Netherlands, and Switzerland followed Germany's lead and cut interest rates as well. And the Bundesbank action may increase the likelihood of a similar move by the Bank of Japan in the near future.

so far no discernible effect on the market

EYES ONLY

SPECIAL ANALYSIS

The Long Arm of State Income Tax Law Reaches Retirees

Historically, pension income has been taxed at the state level only by the state in which the retiree is currently residing. Many retirees have taken account of this fact in deciding where they should reside during their retirement. Recently, however, several states (including California, Idaho, Kansas, Massachusetts, New York, and Oregon) have reached outside their own borders to tax the pension income of non-residents who earned their pension benefits while residing in-state. (One motive for this move could be that these states suffer a net outflow of residents at retirement.) This development may become a serious point of conflict between states because it threatens to undermine the efforts of some states to structure their tax systems so as to appeal to retirees (e.g., by not having an income tax). In response, several members of Congress have introduced legislation that would prohibit states from taxing the retirement incomes of non-residents. (Senator Reid of Nevada has had such a bill before Congress every year since 1989.) What are the arguments for and against allowing states to tax the pension benefits of non-resident retirees?

The case for. Pensions can be viewed as deferred compensation. State governments forgo the taxation of this compensation when it is earned (providing workers an incentive to save) , but they do not intend to forgo the taxation of it forever. According to this logic, states should be entitled to tax pension income when it is paid, regardless of where the recipient may be residing. An argument can be made that allowing states to tax pension income of non-residents prevents a "race to the bottom" in which states compete by lowering taxes on the elderly and skimping on services provided to the rest of the population.

also tax pay on sh[illegible] services on [illegible]

The case against. Pension income often is subject to taxation by the state in which the recipient is residing. If, in addition, that income is subject to taxation by the state in which the recipient earned the benefits, the same income stream may be taxed twice. This problem is mitigated if the state of residence allows an income tax credit for taxes paid to other states. A second drawback of allowing states to tax the pension benefits of former residents is that it may impose significant administrative burden on both pension recipients and employers, who would have to allocate pension income to states where these benefits were earned. (Imagine the annual agony at tax time of a retiree who had lived in a different state every year of his/her working lifetime!)

mobile population ?

Is this matter r[illegible] to m[illegible]away from income tax?

Conclusion. State competition for revenue dollars is likely to intensify in the future. One battleground may be the pension benefits of state emigrants. The first shots have already been fired by states like California. Federal action may be necessary to clarify the situation. At a minimum, clear rules need to be established so that taxpayers and firms will know how to maintain the appropriate records needed to comply with the various state income tax regimes.

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

For Poor Children, Clothes Dryers Are Up, But So Is Crime. Are poor children better or worse off than they were 25 years ago? A recent study offers a new perspective on this issue by focusing on specific indicators of material well-being, rather than taking the usual approach of attempting to measure total income. The evidence from these indicators is mixed. On the whole, the housing situation of poor children seems to have improved since the early 1970s: Fewer children in low-income households live in overcrowded housing, for example, while more have indoor plumbing and central heating. In addition, more of those ~~households own major appliances such as clothes~~ dryers and dishwashers, and poor children visit the doctor more regularly. ~~But~~ at least a few indicators suggest a worsening of the conditions in which poor children live. Poor households are now less likely to own their own homes: only 23 percent owned in 1990, down from 36 percent in 1970. And more poor children live in neighborhoods identified by their parents as having a crime problem. Lastly, a poor child is now more likely to live in a household that does not own a car.

which of these material improvements are the result of gov't policy - housing? medicare?

USAir, Pilots Reach Tentative Agreement. After eight months of negotiations, USAir and its pilots' union have hammered out an accord. In return for a share of the company's profits and a seat on its board, the union has reportedly agreed to a 20 percent pay cut for its members in addition to other concessions, provided the airline is able to win similar agreements from other groups of workers. But USAir is not out of the woods yet. The contract must still be approved by USAir's share-holders and its rank-and-file pilots. Unless the airline achieves significant additional cost reductions, it is probably not viable in the long run (see Weekly Economic Briefing, May 6, 1994). Still, Wall Street seems relieved: On the first day of trading after the announcement, USAir's share price jumped 22 percent.

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EYES ONLY

RELEASES LAST WEEK

Gross Domestic Product

****Embargoed until 8:30 a.m., Friday, March 31, 1995****

According to revised estimates for the fourth quarter, real gross domestic product grew at an annual rate of 5.1 percent.

Consumer Confidence

Consumer confidence, as measured by the Conference Board, rose 1.6 index points in March, to 101.0 (1985=100).

MAJOR RELEASES THIS WEEK

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

EYES ONLY

U.S. ECONOMIC STATISTICS

	1970–1993	1994	1994:2	1994:3	1994:4
Percent growth (annual rate)					
Real GDP	2.5	**4.1**	4.1	4.0	**5.1**
GDP deflator	5.5	2.3	2.9	1.9	1.3
Productivity					
Nonfarm business	1.2	1.4	−2.1	3.2	1.7
Manufacturing (1978-93)	2.1	4.6	5.6	3.5	3.1
Real compensation per hour	0.6	0.7	−1.8	−0.4	1.2
Shares of Real GDP (percent)					
Business fixed investment	11.0	12.6	12.4	12.7	13.0
Residential investment	4.7	4.3	4.4	4.3	**4.3**
Exports	8.0	12.3	12.1	12.4	**12.8**
Imports	9.2	14.4	14.2	14.6	**14.8**
Shares of Nominal GDP (percent)					
Personal saving	4.9	3.0	3.0	3.0	3.4
Federal surplus	−2.8	N.A.	−2.2	−2.3	N.A.

			Dec. 1994	Jan. 1995	Feb. 1995
Unemployment Rate	6.7*	6.1*	5.4	5.7	5.4

*Figures beginning 1994 are not comparable with earlier data.

			Dec. 1994	Jan. 1995	Feb. 1995
Payroll employment (thousands)					
increase per month			231	176	318
increase since Jan. 1993					6117
Inflation (percent per period)					
CPI	5.8	2.7	0.2	0.3	0.3
PPI-Finished goods	5.0	1.7	0.4	0.3	0.3

New or revised data in **boldface**.
GDP data **embargoed until 8:30 a.m., Friday, March 31, 1995**.

EYES ONLY

FINANCIAL STATISTICS

	1993	1994	Jan. 1995	Feb. 1995	March 30, 1995
Dow-Jones Industrial Average	3522	3794	3872	3954	4173
Interest Rates					
3-month T-bill	3.00	4.25	5.71	5.77	5.70
10-year T-bond	5.87	7.09	7.78	7.47	7.18
Mortgage rate, 30-year fixed	7.33	8.36	9.15	8.77	8.38
Prime rate	6.00	7.15	8.50	9.00	9.00

INTERNATIONAL STATISTICS

Exchange Rates	**Current level**	**Percent Change from**	
	March 30, 1995	**Week ago**	**Year ago**
Deutschemark-Dollar	1.411	0.7	−15.7
Yen-Dollar	89.45	1.6	−13.1
Multilateral (Mar. 1973=100)	83.64	0.3	−10.6

International Comparisons	**Real GDP growth (last 4 quarters)**	**Unemployment rate**	**CPI inflation (last 12 months)**
United States	4.1 (Q4)	5.4 (Feb)	2.9 (Feb)
Canada	5.6 (Q4)	9.7 (Jan)	1.9 (Feb)
Japan	1.1 (Q3)	2.9 (Jan)	0.6 (Jan)
France	3.6 (Q4)	12.3 (Dec)	1.7 (Jan)
Germany	3.3 (Q4)	6.4 (Jan)	2.3 (Feb)
Italy	3.7 (Q3)	12.0 (Oct)	4.3 (Feb)
United Kingdom	3.9 (Q4)	8.7 (Jan)	3.4 (Feb)

EYES ONLY

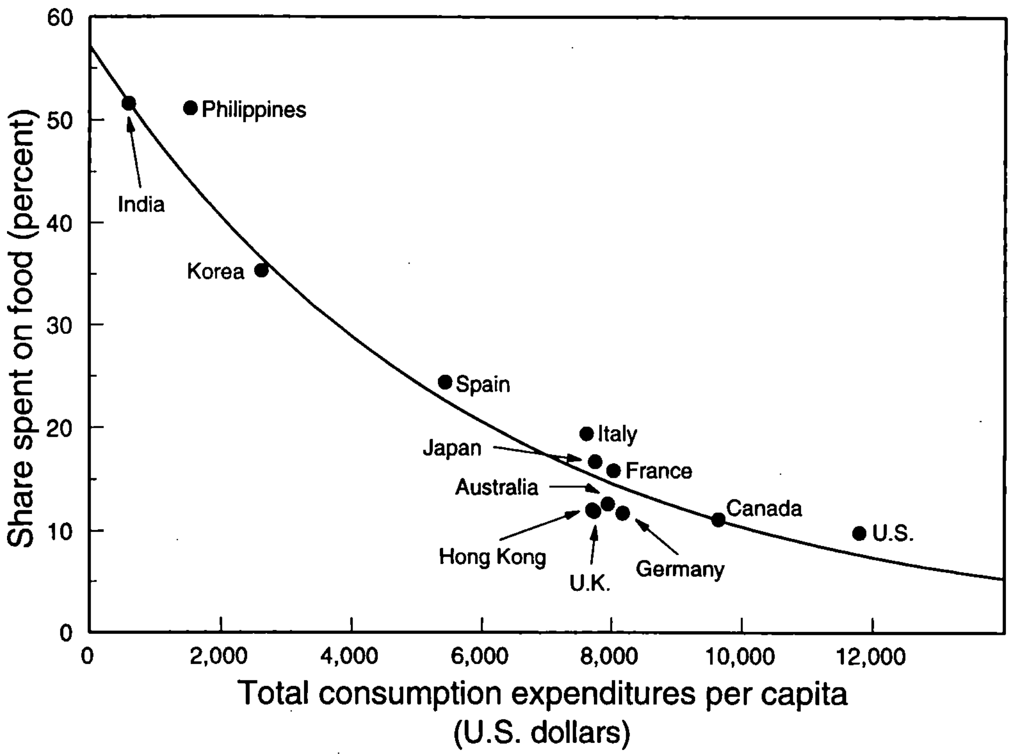
WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

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

April 3, 1995

CHART OF THE WEEK

Living Standards and the Share of
Personal Spending Devoted to Food in 1985



On average, American families devote only about 10 percent of their family budgets to food for consumption at home (measure the U.S. dot against the vertical axis). Families in other countries spend a larger portion of their budgets on such food. In large part, this fact is attributable to the high overall standard of living in the United States (measure the U.S. dot against the horizontal axis). As standards of living rise, households tend to devote a larger fraction of their spending to goods and services other than food. However, there are important differences even among wealthy countries. For example, the share of food in the average budget in Japan is about half again as large as it is in the United States.

EYES ONLY

CONTENTS

"Believe me, the E-check is in the E-mail."

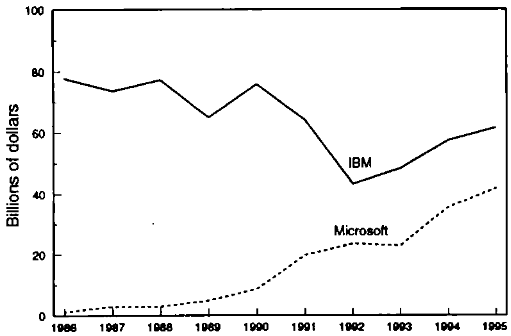
EYES ONLY

ARTICLE

Computers and Competition: Should We Fear a Microsoft Monopoly?

Thirty years ago, hardware firms were at the leading edge of the computer industry, and IBM was dominant among these firms. As the leading edge has shifted from hardware to software (see Weekly Economic Briefing, March 27, 1994), Microsoft has emerged as a major force, while IBM's standing has slipped (see chart).

Market Value of IBM and Microsoft



Note: Market value equals the value of each firm's debt and equity outstanding.

IBM Loses Its Way. During the 1960s, when mainframes still ruled the computer world, IBM accounted for roughly half of U.S. computer industry sales. IBM lost its leadership after a major innovation, the microprocessor, made personal computers possible. Initially, it appeared that the firm would be able to dominate the market for personal computers as it had the market for mainframes. IBM's decision to allow rivals such as Compaq to sell IBM-compatible "clones" helped it gain market leadership over Apple, which chose not to authorize such competition.

IBM-compatibility became the industry standard: Software developers wanted to write applications programs for the computer system most users owned, users wanted to learn the system most businesses employed and for which the most software had been written, and businesses wanted to acquire hardware that most users had learned to use and for which the most software was available. This self-reinforcing standardization process helped IBM stave off competition in the early years of the personal computer. In the 1980s, for example, wide acceptance of the IBM standard preserved the dominance of IBM-compatibility even when Apple introduced what some considered a superior personal computer, the Macintosh.

As time passed, however, the market for PC hardware became a "commodity" market, characterized by fierce competition among many producers of highly similar products. Today, although IBM remains successful in the still-large mainframe market, it manufactures only 9 percent of personal computers sold worldwide.

Microsoft Reaps What IBM Sowed. Even as hardware manufacturers have proliferated, Microsoft has maintained its position as the only supplier of the standard operating system. A rival operating system could have succeeded only if a critical mass of users and software developers had been willing to switch to a new standard. However, this has not happened. As a result, Microsoft has been able to enhance its bargaining position relative to IBM and has probably been able to claim an increasing share of the profits from the establishment of an industry standard.

How Entrenched is Microsoft's Position? The Microsoft operating systems—MS-DOS and its successor, Windows—account for 82 percent of personal computer operating system sales in the United States. (Microsoft also captures 60 percent or more of the markets for leading types of applications software such as spreadsheet and word processing packages.) For fear of violating Microsoft's copyrights, potential competitors cannot offer a rival operating system that is too similar to MS-DOS. But offering a product that is too dissimilar might be no more successful for several reasons: It might not run existing DOS-compatible applications packages; there might not be sufficient applications available to run on it; and users might not want to take the trouble to learn to use it. As a result, Microsoft's market position may be quite secure, at least until another major industry innovation comparable to the development of the microprocessor dramatically changes the structure of the industry. Even now, however, Microsoft faces some limited competition in operating system software and has an incentive to keep prices low in order to attract buyers new to the personal computer market (who will later purchase Microsoft's operating systems upgrades and applications software).

Looking to the future. Microsoft expects to introduce in the near future a new operating system—known as Windows 95—intended as the successor to both MS-DOS and Windows. The firm hopes that Windows 95 will facilitate the creation of an enormous network of personal computer users, and give them access to relatively new—and potentially vast—markets for commercial and financial services. Microsoft's ownership of copyrights to what is likely to become the new standard operating system software for personal computers may eventually allow it to charge monopoly prices for access to network services, once it has achieved substantial market penetration. In turn, monopoly control of these markets could result in higher prices, reduced choice, and less innovation. On the other hand, domination by Microsoft could also lead to wider availability of on-line services, lower production costs, and higher quality. Moreover, it is far from certain that Microsoft will be able to accumulate significant power in these new on-line markets. It will likely face competition from a plethora of financial-service, retail and communications behemoths such as Citibank, Merrill Lynch, American Express, AT&T, and Sears.

Even if the Federal government were to decide that the social costs of Microsoft's market position exceeded the benefits, it might have difficulty addressing the problem through antitrust actions (see Current Development, this issue).

EYES ONLY

CURRENT DEVELOPMENT

Judge Questions Microsoft Antitrust Settlement

Last July, the Department of Justice charged Microsoft with unfairly maintaining its near-monopoly of operating systems software (such as MS-DOS and Windows), and simultaneously filed a consent settlement. (See Weekly Economic Briefing, July 22, 1994).

In February of this year, however, Judge Stanley Sporkin rejected the proposed settlement, partly because he was concerned that Microsoft may have unfairly used its monopoly in operating systems to gain market power in the market for applications software. Judge Sporkin was also concerned that Microsoft may have used premature product announcements (so-called "vaporware") to preserve unfairly its market position by keeping customers from switching to rivals. Neither of these issues was addressed in the original Justice Department complaint. Justice has appealed the ruling, arguing that the court has no authority to examine charges other than the ones leveled in the complaint.

Analysis. Antitrust law allows firms to exercise monopoly power so long as that power was achieved and maintained by providing a superior product. (This approach ensures that the law does not have the perverse effect of punishing successful innovation, and avoids turning judges into price regulators.) Justice may have chosen not to pursue the issues raised by Judge Sporkin because the line between "unfair" and "fair" use of market power is difficult to draw, and Microsoft did not clearly step over that line.

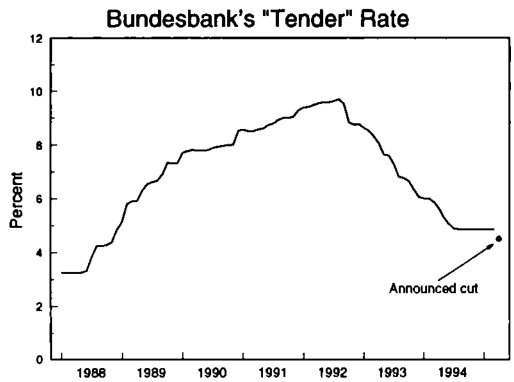
If the Judge's ruling is overturned on appeal (as many analysts expect), and if the government were to decide to attack Microsoft's potential ability to leverage its market power, its only remedy might be legislation requiring the company to separate its operating systems and applications software businesses or limiting the scope of copyright protection for operating system software.

EYES ONLY

CURRENT DEVELOPMENT

The Monetary Tide Ebbs Further in Europe

The Bundesbank—Germany's central bank—eased the stance of its monetary policy on March 30, reducing its key interest rate 0.35 percentage point. At 4.5 percent, this rate is now more than 5 percentage points below its peak level of September 1992 (see chart).



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SPECIAL ANALYSIS

The Long Arm of State Income Tax Law Reaches Retirees

Historically, pension income has been taxed at the state level only by the state in which the retiree is currently residing. Many retirees have taken account of this fact in deciding where they should reside during their retirement. Recently, however, several states (including California, Idaho, Kansas, Massachusetts, New York, and Oregon) have reached outside their own borders to tax the pension income of non-residents who earned their pension benefits while residing in-state. (One motive for this move could be that these states suffer a net outflow of residents at retirement.) This development may become a serious point of conflict between states because it threatens to undermine the efforts of some states to structure their tax systems so as to appeal to retirees (e.g., by not having an income tax). In response, several members of Congress have introduced legislation that would prohibit states from taxing the retirement incomes of non-residents. (Senator Reid of Nevada has had such a bill before Congress every year since 1989.) What are the arguments for and against allowing states to tax the pension benefits of non-resident retirees?

The case for. Pensions can be viewed as deferred compensation. State governments forgo the taxation of this compensation when it is earned (providing workers an incentive to save) , but they do not intend to forgo the taxation of it forever. According to this logic, states should be entitled to tax pension income when it is paid, regardless of where the recipient may be residing. An argument can be made that allowing states to tax pension income of non-residents prevents a "race to the bottom" in which states compete by lowering taxes on the elderly and skimping on services provided to the rest of the population.

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Conclusion. State competition for revenue dollars is likely to intensify in the future. One battleground may be the pension benefits of state emigrants. The first shots have already been fired by states like California. Federal action may be necessary to clarify the situation. At a minimum, clear rules need to be established so that taxpayers and firms will know how to maintain the appropriate records needed to comply with the various state income tax regimes.

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EYES ONLY

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Leading Indicators (Wednesday)
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EYES ONLY

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Productivity					
Nonfarm business	1.2	1.4	–2.1	3.2	1.7
Manufacturing (1978-93)	2.1	4.6	5.6	3.5	3.1
Real compensation per hour	0.6	0.7	–1.8	–0.4	1.2
Shares of Real GDP (percent)					
Business fixed investment	11.0	12.6	12.4	12.7	13.0
Residential investment	4.7	4.3	4.4	4.3	**4.3**
Exports	8.0	12.3	12.1	12.4	**12.8**
Imports	9.2	14.4	14.2	14.6	**14.8**
Shares of Nominal GDP (percent)					
Personal saving	4.9	3.0	3.0	3.0	3.4
Federal surplus	–2.8	N.A.	–2.2	–2.3	N.A.

			Dec. 1994	Jan. 1995	Feb. 1995
Unemployment Rate	6.7*	6.1*	5.4	5.7	5.4

*Figures beginning 1994 are not comparable with earlier data.

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increase per month			231	176	318
increase since Jan. 1993					6117
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New or revised data in **boldface**.
GDP data **embargoed until 8:30 a.m., Friday, March 31, 1995**.

EYES ONLY

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Germany	3.3 (Q4)	6.4 (Jan)	2.3 (Feb)
Italy	3.7 (Q3)	12.0 (Oct)	4.3 (Feb)
United Kingdom	3.9 (Q4)	8.7 (Jan)	3.4 (Feb)

WEB Mar. 1995

EYES ONLY

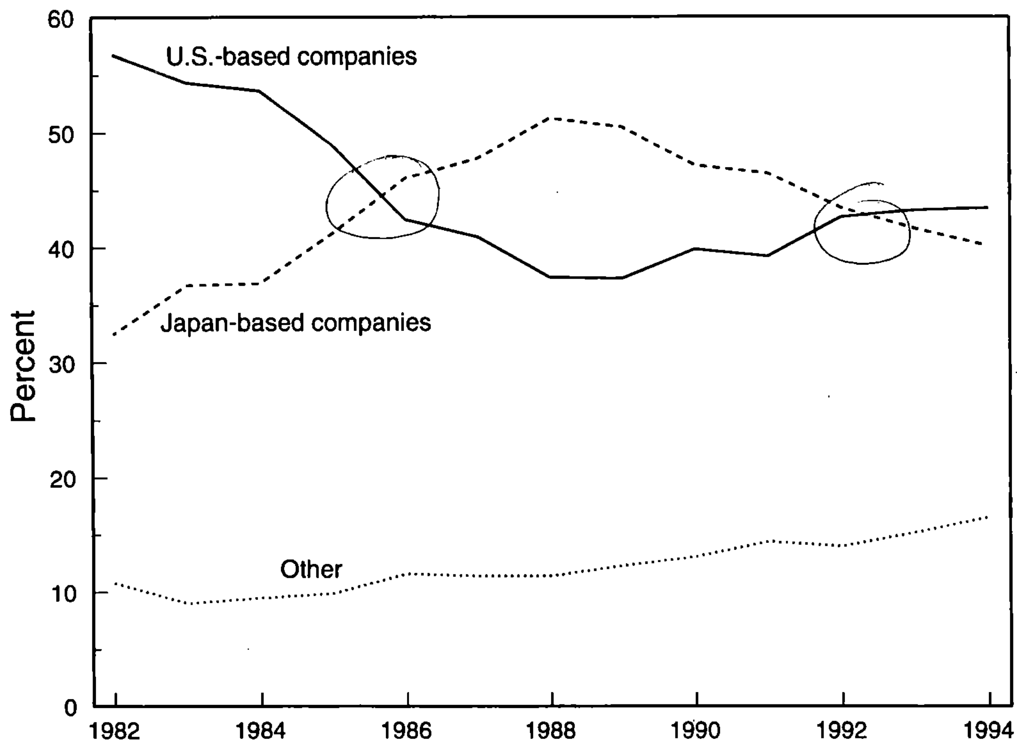
WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

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

March 27, 1995

CHART OF THE WEEK

U.S. Semiconductor Producers Regain Global Market Share

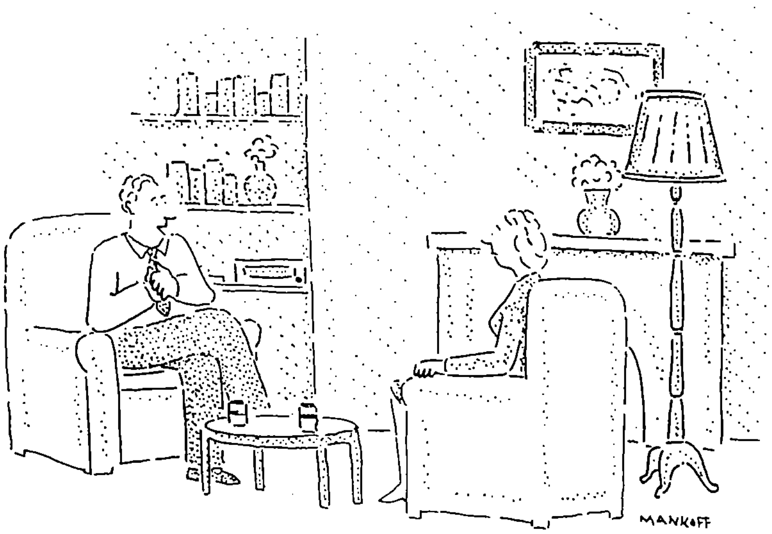


Role of policy and technology -
- trade
- access
- DRAM chip
- Sematech ?

The U.S. economic recovery, a Japanese recession, and the recent success of Korean firms in a commodity memory chip market dominated by Japanese firms contributed to the relative resurgence of U.S.-based chipmakers after 1991. U.S. firms lead in designing customized microprocessors with embedded software, while Japanese firms have an advantage in high-volume semiconductor manufacturing processes (especially for commodity memory chips)—but the differences are narrowing.

EYES ONLY

CONTENTS



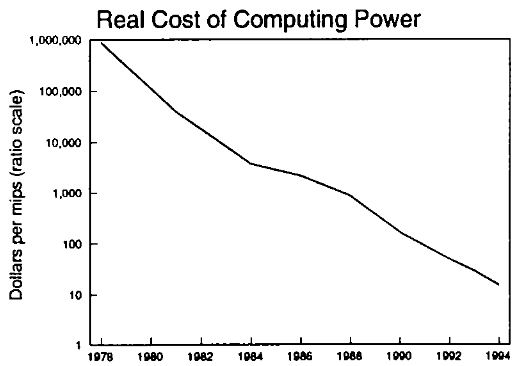
"Look, all I'm asking is that we let market forces bring a greater degree of efficiency into our marriage."

EYES ONLY

INDUSTRY STUDY

Computer Industry Trends Favor U.S. Firms

Six of the world's ten largest-selling computer software companies and four of the top five makers of personal computers are U.S. firms. Will the U.S. computer industry continue to lead the world in the network and multimedia era? Prospects for continued success are strong, because the growth of networks and multimedia applications are likely to reinforce the importance of packaged software—a sector in which U.S. firms excel.



Note: "Mips" refers to millions of instructions per second.

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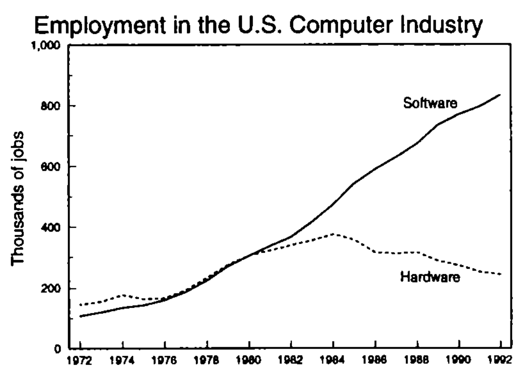

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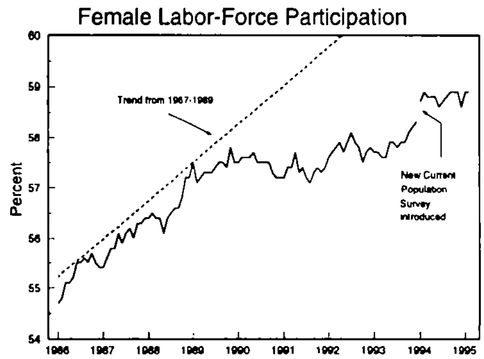

Analysis. Some interpret the post-1989 data as evidence that the postwar expansion of the role of women in the labor force has come to a close. Others argue the halt is temporary, reflecting declining job availability during the 1990-91 recession and an increasing number of new mothers. The jury remains out, in part because the data are clouded by the introduction of a redesigned Current Population Survey at the beginning of 1994.

Why is this important? In the short run, low labor-force growth could reduce the unemployment rate. In the long run, however, low labor-force growth limits the increase in the economy's productive capacity. If women's labor-force participation grows at a slow rather than a moderate pace—not returning even partway to the growth rate seen in earlier decades—by 2005 GDP could be as much as 1.4 percentage points lower than otherwise.

EYES ONLY

SPECIAL ANALYSIS

Valuing a Tree That Falls When Nobody Hears It

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Put your money where your mouth is

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EYES ONLY

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The goods and services trade deficit rose to $12.2 billion in January from $7.3 billion in December.

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

EYES ONLY

U.S. ECONOMIC STATISTICS

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Real GDP	2.5	4.0	4.1	4.0	4.6
GDP deflator	5.5	2.3	2.9	1.9	1.3
Productivity					
Nonfarm business	1.2	1.4	−2.1	3.2	1.7
Manufacturing (1978-93)	2.1	4.6	5.6	3.5	3.1
Real compensation per hour	0.6	0.7	−1.8	−0.4	1.2
Shares of Real GDP (percent)					
Business fixed investment	11.0	12.6	12.4	12.7	13.0
Residential investment	4.7	4.3	4.4	4.3	4.2
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Personal saving	4.9	3.0	3.0	3.0	3.4
Federal surplus	−2.8	N.A.	−2.2	−2.3	N.A.
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Unemployment Rate	6.7*	6.1*	5.4	5.7	5.4

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increase per month			231	176	318
increase since Jan. 1993					6117
Inflation (percent per period)					
CPI	5.8	2.7	0.2	0.3	0.3
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EYES ONLY

FINANCIAL STATISTICS

	1993	1994	Jan. 1995	Feb. 1995	March 22, 1995
Dow-Jones Industrial Average	3522	3794	3872	3954	4083
Interest Rates					
3-month T-bill	3.00	4.25	5.71	5.77	5.73
10-year T-bond	5.87	7.09	7.78	7.47	7.21
Mortgage rate, 30-year fixed	7.33	8.36	9.15	8.77	8.38
Prime rate	6.00	7.15	8.50	9.00	9.00

INTERNATIONAL STATISTICS

Exchange Rates	**Current level March 22, 1995**	**Percent Change from Week ago**	**Year ago**
Deutschemark-Dollar	1.400	0.8	−16.7
Yen-Dollar	88.68	−1.0	−16.3
Multilateral (Mar. 1973=100)	83.43	0.4	−11.4

International Comparisons	**Real GDP growth (last 4 quarters)**	**Unemployment rate**	**CPI inflation (last 12 months)**
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Canada	5.6 (Q4)	9.7 (Jan)	0.3 (Dec)
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France	3.6 (Q4)	12.3 (Dec)	1.7 (Dec)
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EYES ONLY

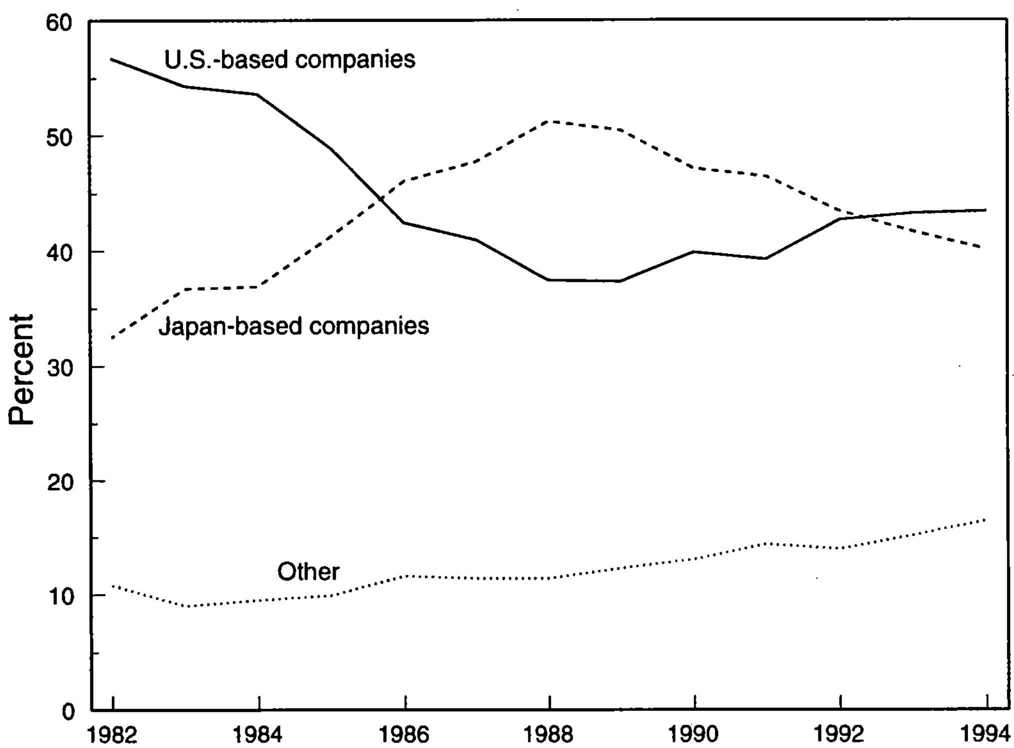
WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

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

March 27, 1995

CHART OF THE WEEK

U.S. Semiconductor Producers Regain Global Market Share



The U.S. economic recovery, a Japanese recession, and the recent success of Korean firms in a commodity memory chip market dominated by Japanese firms contributed to the relative resurgence of U.S.-based chipmakers after 1991. U.S. firms lead in designing customized microprocessors with embedded software, while Japanese firms have an advantage in high-volume semiconductor manufacturing processes (especially for commodity memory chips)—but the differences are narrowing.

EYES ONLY

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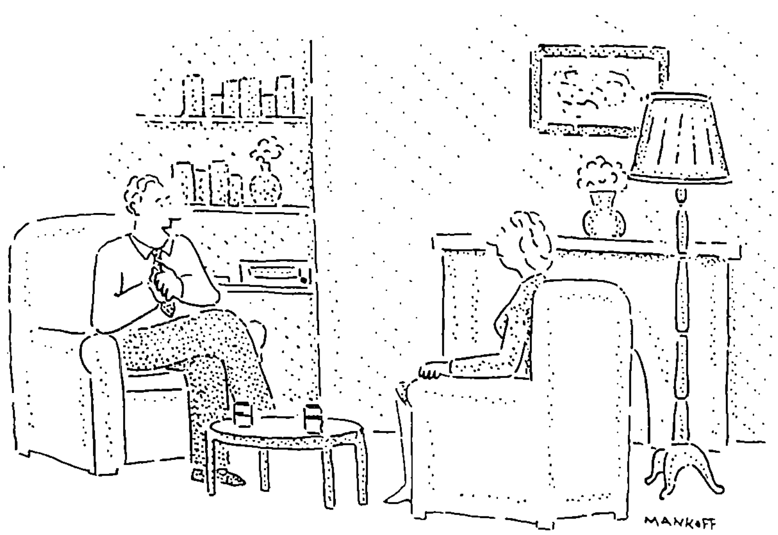


"Look, all I'm asking is that we let market forces bring a greater degree of efficiency into our marriage."

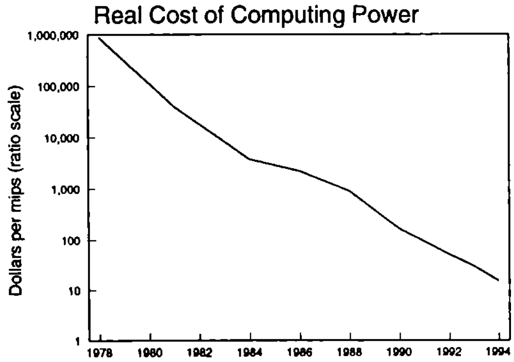
EYES ONLY

INDUSTRY STUDY

Computer Industry Trends Favor U.S. Firms

Six of the world's ten largest-selling computer software companies and four of the top five makers of personal computers are U.S. firms. Will the U.S. computer industry continue to lead the world in the network and multimedia era? Prospects for continued success are strong, because the growth of networks and multimedia applications are likely to reinforce the importance of packaged software—a sector in which U.S. firms excel.

Real Cost of Computing Power



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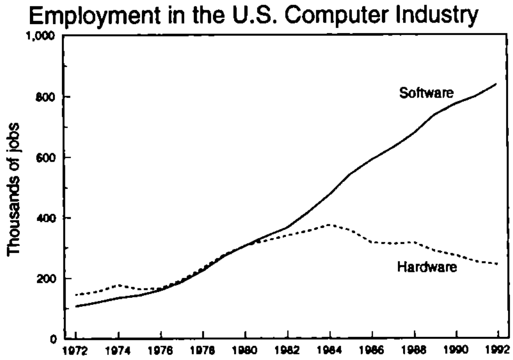
Employment in the U.S. Computer Industry



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EYES ONLY

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EYES ONLY

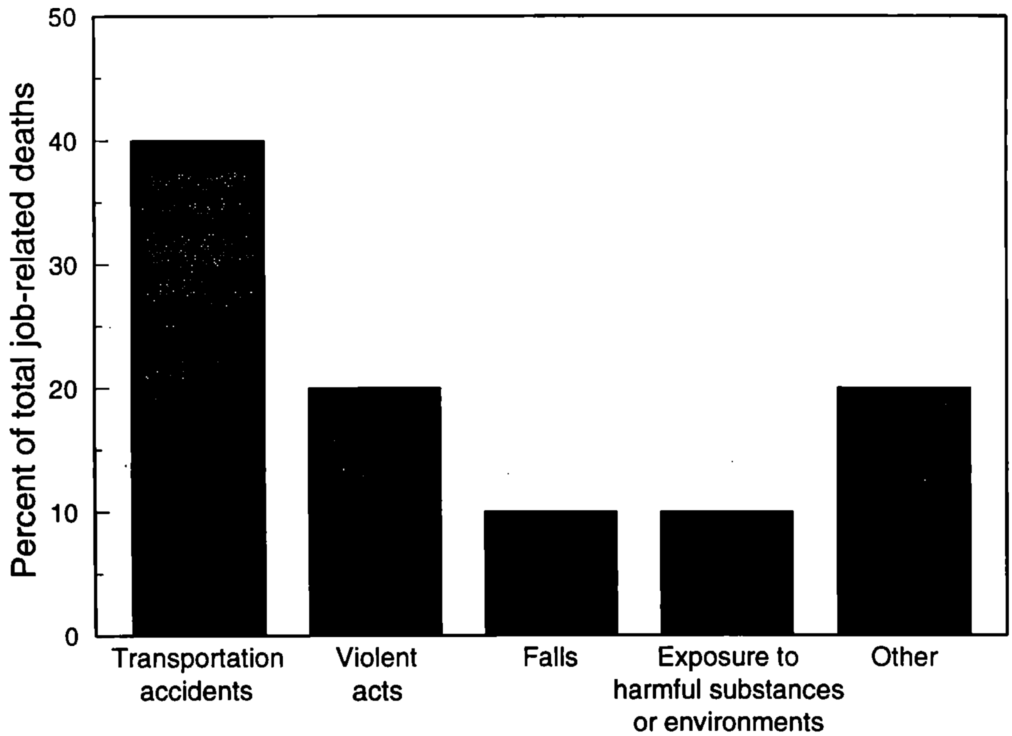
WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

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

March 20, 1995

CHART OF THE WEEK

Causes of On-the-Job Deaths in 1992



More than 6,000 workers died on the job in 1992 (latest data available). Ten percent of these deaths were caused by falls, and another 10 percent by exposure to harmful substances or environments. Transportation accidents accounted for a full 40 percent of job-related deaths, and violent acts (homicides or self-inflicted wounds) accounted for another 20 percent. The Article in this issue of the Weekly Economic Briefing examines issues related to workplace safety.

EYES ONLY

CONTENTS

EYES ONLY

CURRENT DEVELOPMENT

Assessing Argentina's Financial Situation

Since the financial collapse in Mexico, investors have become nervous about the financial outlook for Argentina. As a result, stock prices there have fallen about 40 percent in U.S. dollar terms. Last week, capital flowed out of the country at a rate of between $100 million and $300 million per day.

Threats to the Banking System. Argentina's banking system faces threats from three sources:

- Sky-rocketing short-term interest rates, which rose above 70 percent recently, have caused many loans to go bad.
- Argentina has no domestic "lender of last resort" (analogous to the Federal Reserve in the United States) capable of providing liquidity to troubled banks. In addition, there is only limited deposit insurance. These facts have made depositors skittish. Indeed, 14 percent of bank deposits have been withdrawn since the beginning of the crisis.
- The smaller provincial banks in Argentina have a heavy concentration of non-performing loans.

These factors may be sufficient to undermine the Argentine banking system even though regulatory oversight of banks there is, in some respects, better than in Mexico.

Policy Response. President Menem last week instituted a serious economic stabilization package, which was greeted favorably by the financial markets. The package includes support for the banking system. Equally important for the banks, liquidity problems have eased, and short-term interest rates have fallen to 20 percent. IMF funding is likely to be approved next week.

EYES ONLY

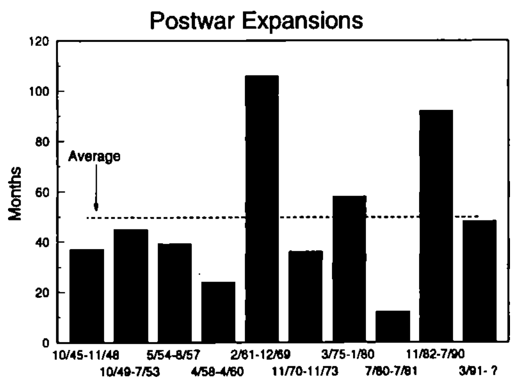
TREND

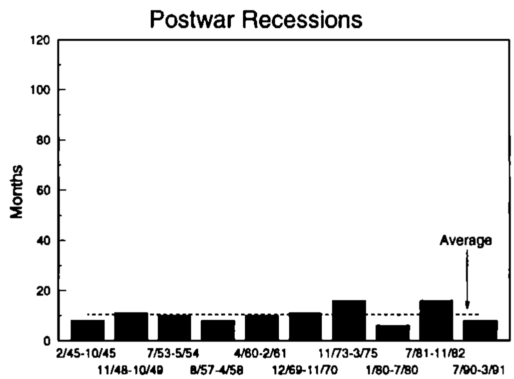
The Current Expansion: Waiting for the Fuse to Blow?

This month the current economic expansion celebrates its fourth anniversary. The average postwar expansion has lasted only 4 years and 2 months. Is the next recession just around the corner?

In one respect, economic expansions are similar to the old-style fuses found in many American homes. Fuses do not "blow" simply because they have grown old, but rather for electrical reasons such as a short in the system.

Similarly, recent statistical research indicates that expansions are no more likely to end simply because they have grown old. The ten postwar expansions have been highly variable in length (see left chart). Recessions, on the other hand, are more likely to end the older they become. The ten postwar recessions have been very similar in length (see right chart).





Analysis. Expansions end for economic reasons, not statistical ones. Capacity may become too tight, inflation may begin to rise, and the Federal Reserve may increase interest rates too much. On several occasions, a sharp increase in oil prices has played an important role in short-circuiting an expansion.

EYES ONLY

SPECIAL ANALYSIS

Privatizing Social Security: The Chilean Experience

Around the world, industrialized and developing countries alike are reexamining their approaches to public provision of retirement income. The reforms of one Latin American country in particular have generated a great deal of interest: Chile has shifted from a pay-as-you-go social security system to a mandatory program of private savings. By 1991, the assets of the system had cumulated to 35 percent of Chile's GDP.

Economic rationale. The main justification for government involvement in provision of retirement income is that many people seem to be short-sighted and save too little for retirement. Traditionally, many public systems (including the Social Security system in the United States) have been run essentially on a "pay-as-you-go" basis. However, these systems are vulnerable to demographic shifts that reduce the number of contributing workers per beneficiary. By contrast, systems in which workers' contributions fund their own retirement benefits are much less vulnerable to such shifts.

Although pay-as-you-go schemes probably cannot be privatized in any meaningful sense, fully funded systems can be. The downside of private management is the risk of mismanagement and the possibility of higher operating costs (if, for example, significant resources are expended in advertising campaigns). The upside is the possibility that a privately run system may generate higher investment returns.

Structure. The Chilean plan requires workers to contribute 10 percent of earnings for their own retirement benefits, and between 2.5 percent and 3.7 percent for survivor's benefits and disability insurance. (In the United States, taxes equal to 12.4 percent of payroll provide for similar coverage.) These contributions are paid into a privately managed pension fund chosen by the worker. The balance in the fund is paid out beginning at the time of retirement. The government guarantees a minimum pension of between 22 percent and 25 percent of the national average wage to members who have contributed for at least 20 years. In addition, it provides a social assistance benefit of 12 percent of the national average wage to those who are not otherwise covered.

Regulation. Two approaches to regulation of funds are possible: one based on market incentives, the other based on oversight. Chile emphasized the former approach. Anyone other than a bank can establish a pension fund management company. The stockholders of such companies must put some of their own capital at risk (no less than 1 percent of assets under management) by investing it in exactly the same way as they invest worker contributions. Initially, the pension funds invested most of their holdings in government bonds. Over time, however, the funds have diversified their portfolios as privatization and growth in the

Chilean stock market have increased the range of private-sector securities available.

Funds are required to establish "profitability reserves," which are designed to ensure that the return on any individual fund can deviate no more than 2 percentage points (or 50 percent, whichever is closer) from the national average. If a fund does better than that, the excess is placed in the reserve; if it does worse, the deficit is withdrawn from the fund. If the profitability reserve proves insufficient, the fund must tap into its own capital. And when that capital is exhausted, the government is liable for the remainder. This device discourages maverick management, but it also discourages differentiation between funds and therefore limits the effective range of choice available to workers.

Transition issues. Initially, participation in the private savings plan was voluntary. Older workers already vested in the social security system were given 5 years to choose between the old and new systems. Anyone who chose the new scheme was compensated for benefits already earned with bonds paying a 4 percent annual real rate of return until retirement, at which time they are folded in with the balances accumulated from the worker's contributions into the new system.

During the transition period, the Chilean government experienced a large deficit in the pay-as-you-go system, as new monies were diverted into private pension funds and were no longer available to fund benefits paid under the old system. The government offset part of this deficit by selling off several public enterprises.

Downsides and risks. In general, redistribution of resources toward low-wealth households is more difficult to accomplish in a fully funded system than in a pay-as-you-go system. As a separate issue, the Chilean government could face significant liability in the event of very poor investment performance, fund mismanagement, or widespread evasion by workers who had met the 20-year requirement for the minimum benefit but had not contributed enough to earn more than the guaranteed amount. Analysts estimate that this liability could range between 1/2 percent and 1 percent of Chilean GDP per year.

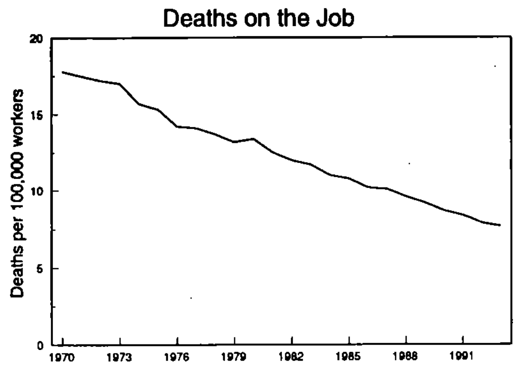
The Kerrey Commission

Among the initiatives studied by the Kerrey Commission for entitlements reform was the possibility of allowing workers the option of paying 1.5 percent of their earnings into a personal saving plan rather than into the Social Security system. If implemented, this possibility would take the United States part way down the road traveled by Chile over the past 15 years.

ARTICLE

Reinventing Safety Regulation

In 1992 (latest data available), 2.3 million Americans suffered work-related injuries or illnesses leading them to lose time from work, and 6,200 were killed on the job, according to estimates from the Bureau of Labor Statistics. The number of job-related fatalities has dropped by half in the last 20 years (see chart). In contrast, the reported rate of job-related injuries has not fallen in recent years. However, anecdotal evidence suggests that a larger fraction of such injuries is being reported now than was the case 20 years ago, so the absence of a downtrend in injury rates may be a misleading gauge of actual improvement in workplace safety.



Note: Numbers are not directly comparable with BLS data.

The Federal Occupational Safety and Health Administration (OSHA) and state-level OSHAs are the main regulators of workplace safety. These regulators focus on practices and procedures in the workplace rather than on outcomes. Market incentives for safety are also present to the extent that employers with bad safety records pay higher workers' compensation insurance premia. At present, state and Federal OSHAs only have about 2,400 safety inspectors to police the nation's 6 million workplaces. But increasing the number of inspectors is probably not the right answer: OSHA is one of the most hated agencies of the Federal government. Business groups accuse OSHA of having overly detailed and intrusive regulations, and anti-business inspectors who heavily penalize even minor violations.

Self-regulation is an alternative to government inspection. Employers could be given a choice: Implement a high-quality safety program or be subject to OSHA safety regulation and inspections. Federal regulatory effort would shift from inspecting the workplace itself to ensuring the good-faith implementation of company-based safety programs.

Company-based safety programs can improve workplace safety.

Mandatory programs. About a dozen states currently require employers in some or all sectors to sponsor safety committees or other forms of safety-related employee involvement. Preliminary evidence on the effectiveness of such committees is fairly favorable. In Oregon, for example, injuries resulting in at least one day of lost time fell dramatically after safety committees were required. Although Oregon's lost-time injury rate was falling even before the committee requirement was imposed, many analysts believe that at least some of the improvement has been attributable to the mandate.

Voluntary programs. In a pilot program, OSHA targeted the 203 companies in Maine with the highest number of injury claims. Each company in this group was allowed to choose either to undergo an immediate and detailed safety inspection or to create a safety program meeting certain minimum quality standards. Almost all companies opted to create a safety program. Results thus far have been impressive. Participating companies identified and eliminated 55,000 hazards in the program's first year—as many hazards as OSHA identified in the entire state during the previous eight years. And the injury rate declined at 59 percent of these companies, in some cases dramatically so. OSHA is currently proposing to expand this program to any state that will help it identify the companies with the worst safety records.

Safety Program Standard. Regulators, employers, and employee representatives now consider a shift toward self-regulation to be a priority (although they differ on key aspects of the issue). A new system along these lines would require OSHA to determine indicators of an adequate safety program. One such indicator might be that both management and employees are involved in the safety program; this would ensure that all parties have a significant impact on safety and health at the workplace. Other such indicators might include that companies maintain safety training and that they achieve a good safety record.

In addition to these indicators, the workers' compensation system might provide the means for inducing employers to maintain a safe workplace.

- Workers' compensation insurers are at risk for higher payouts if they agree to insure an unsafe workplace. Therefore, their word should be taken as credible if they certify a workplace as safe.

- Employers themselves face higher expenses if their workplaces are unsafe, because workers' compensation insurance premia are experience-rated. Therefore, an unusually generous supplement to the standard workers' compensation package is a credible signal that the employer believes his/her workplace to be safe.

EYES ONLY

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

Beige Book Shows Growth Moderating. The most recent survey of business conditions by the Federal Reserve corroborates indications that the pace of expansion has begun to slow. Fully half of the Fed districts report slower growth over the past 2 months; economic conditions were described as "mixed" in the remaining districts. The moderation in growth does not extend to California, which has seen a recent pick-up in its "still moderate recovery." Retail sales and residential construction have weakened across much of the country, but manufacturing maintains some momentum and labor markets remain tight. These observations are consistent with the picture sketched out by recent macroeconomic data. On the price front, the Beige Book identified no immediate problems. Although commodity prices are still rising, their rate of increase has slowed in several districts. And neither tight labor markets nor sizeable increases in commodity prices appear to have translated into much upward pressure on wages or finished-goods prices.

End of an Era. The Resolution Trust Corporation announced last week that it had sold off the last thrift still under its conservatorship. This means that for the first time in a decade, there are no savings and loans under government control. It also means that in completing the sale of the Carteret Federal Saving Bank of New Jersey, the RTC has largely worked itself out of a job. A few loose ends remain, however: The agency still has about $25 billion in assets to dispose of, including $2 billion from Carteret Federal. The RTC expects that by the time it goes out of existence at the end of 1995, only $10 billion of these assets will remain in government hands; responsibility for the remaining assets—along with RTC staff—will shift over to the Federal Deposit Insurance Corporation. The total cost of the S&L bailout, which was estimated by the Reagan Administration at under $30 billion (1994 dollars) in 1988, is now projected by the Congressional Budget Office to be about $170 billion.

Throwing Stones at Glass Ceilings: A How-To Guide. The top echelons of corporate America still consist overwhelmingly of white males. However, according to a fact-finding report released this week by the Glass Ceiling Commission, some far-sighted companies (including Xerox, Proctor and Gamble, and IBM) have mapped out strategies for shattering the glass ceiling. Among the key ingredients cited by the report: Strong and sustained CEO support; an inclusive approach that does not leave out white males; a willingness to confront preconceptions and stereotypes head-on; accountability and clear tracking of progress toward diversity goals; and a comprehensive approach to recruiting, training, mentoring, and promoting women and minorities. The result at Xerox: 20 percent of vice presidents are minorities and 12 percent are women.

EYES ONLY

RELEASES LAST WEEK

Retail Sales

Advance estimates show that retail sales fell 0.5 percent in February following a 0.6 percent increase in January. Excluding sales in the automotive group, retail sales fell 0.4 percent.

Producer Price Index

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

Industrial Production and Capacity Utilization

The Federal Reserve's index of industrial production rose 0.5 percent in February. Capacity utilization rose 0.2 percentage point to 85.7 percent.

Consumer Price Index

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

Housing Starts

Housing starts fell 2.6 percent in February to a seasonally adjusted annual rate of 1.32 million units.

MAJOR RELEASES THIS WEEK

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

EYES ONLY

U.S. ECONOMIC STATISTICS

	1970–1993	1994	1994:2	1994:3	1994:4
Percent growth (annual rate)					
Real GDP	2.5	4.0	4.1	4.0	4.6
GDP deflator	5.5	2.3	2.9	1.9	1.3
Productivity					
Nonfarm business	1.2	1.4	–2.1	3.2	1.7
Manufacturing (1978-93)	2.1	4.6	5.6	3.5	3.1
Real compensation per hour	0.6	0.7	–1.8	–0.4	1.2
Shares of Real GDP (percent)					
Business fixed investment	11.0	12.6	12.4	12.7	13.0
Residential investment	4.7	4.3	4.4	4.3	4.2
Exports	8.0	12.3	12.1	12.4	12.9
Imports	9.2	14.4	14.2	14.6	14.9
Shares of Nominal GDP (percent)					
Personal saving	4.9	3.0	3.0	3.0	3.4
Federal surplus	–2.8	N.A.	–2.2	–2.3	N.A.

			Dec. 1994	Jan. 1995	Feb. 1995
Unemployment Rate	6.7*	6.1*	5.4	5.7	5.4

*Figures beginning 1994 are not comparable with earlier data.

			Dec. 1994	Jan. 1995	Feb. 1995
Payroll employment (thousands)					
increase per month			231	176	318
increase since Jan. 1993					6117
Inflation (percent per period)					
CPI	5.8	2.7	0.2	0.3	**0.3**
PPI-Finished goods	5.0	1.7	0.4	0.3	**0.3**

New or revised data in **boldface**.

EYES ONLY

FINANCIAL STATISTICS

	1993	1994	Jan. 1995	Feb. 1995	March 16, 1995
Dow-Jones Industrial Average	3522	3794	3872	3954	4069
Interest Rates					
3-month T-bill	3.00	4.25	5.71	5.77	5.74
10-year T-bond	5.87	7.09	7.78	7.47	7.05
Mortgage rate, 30-year fixed	7.33	8.36	9.15	8.77	8.38
Prime rate	6.00	7.15	8.50	9.00	9.00

INTERNATIONAL STATISTICS

Exchange Rates	**Current level March 16, 1995**	**Percent Change from**	
		Week ago	**Year ago**
Deutschemark-Dollar	1.396	0.5	−17.3
Yen-Dollar	90.10	−0.2	−14.9
Multilateral (Mar. 1973=100)	83.49	0.7	−11.4

International Comparisons	**Real GDP growth (last 4 quarters)**	**Unemployment rate**	**CPI inflation (last 12 months)**
United States	4.0 (Q4)	5.4 (Feb)	2.9 (Feb)
Canada	5.6 (Q4)	9.7 (Jan)	0.3 (Dec)
Japan	1.1 (Q3)	2.9 (Jan)	0.7 (Dec)
France	3.6 (Q4)	12.3 (Dec)	1.7 (Dec)
Germany	3.3 (Q4)	6.4 (Jan)	2.3 (Jan)
Italy	3.7 (Q3)	12.0 (Oct)	3.8 (Jan)
United Kingdom	3.9 (Q4)	8.7 (Jan)	3.3 (Jan)

EYES ONLY

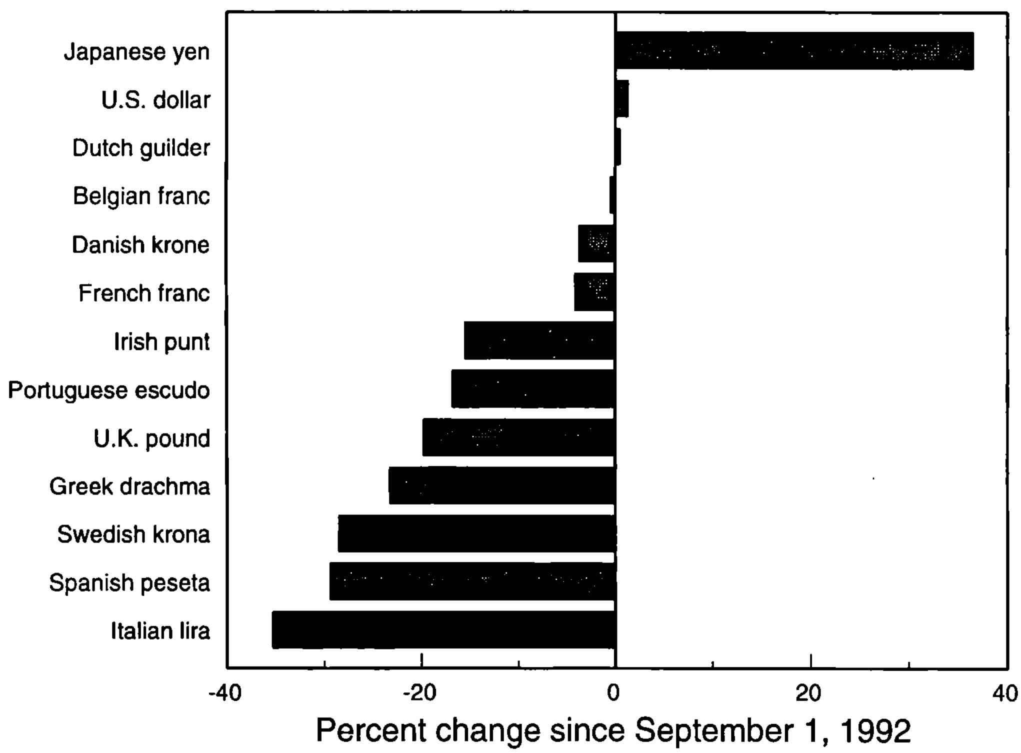
WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

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

March 13, 1995

CHART OF THE WEEK

Exchange Rate Changes Relative to the German Mark



Since the onset of tensions within the European Exchange Rate Mechanism (ERM) in September 1992, the value of the U.S. dollar has changed little against the German mark, on net, even taking into account the sharp depreciation of the last few weeks. By contrast, a number of European currencies have depreciated significantly against the mark. Indeed, some have left the ERM altogether (e.g., the Italian lira) or changed their parities relative to the mark (e.g., the Spanish peseta). Over the same time period, the Japanese yen appreciated sharply against the mark.

EYES ONLY

CONTENTS

"Oh come on, it's your job to dream of things that never were and ask 'why not?' and it's my job to tell you."

EYES ONLY

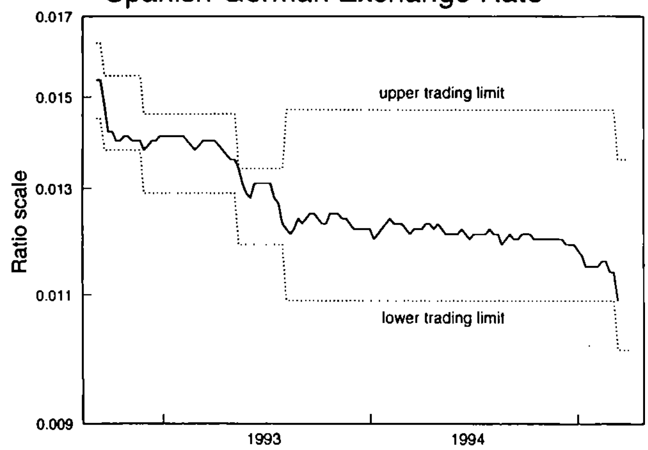
CURRENT DEVELOPMENT

Spain and Portugal Realign Their Currencies

Effective Monday, March 6, the Spanish peseta and Portuguese escudo were devalued 7 percent and 3-1/2 percent, respectively, against the other currencies in the Exchange Rate Mechanism (ERM) of the European Monetary System. The peseta had come under fire due to political scandal and tensions over Spain's high level of government debt (see Weekly Economic Briefing, February 27, 1995).

Despite the realignment, the Spanish currency has remained under pressure. By Friday, the peseta was already only about 7 percent away from the new lower limit of its ±15 percent trading band relative to the German mark (see chart).

Spanish-German Exchange Rate



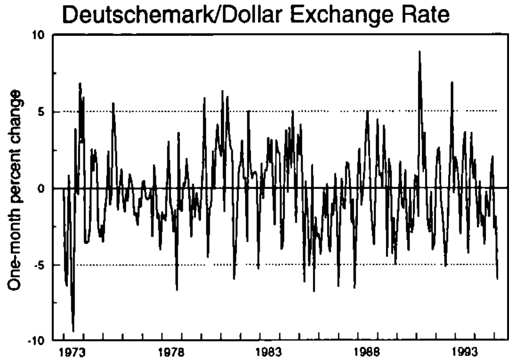
Analysis. Since September 1992, the ERM has experienced substantial turbulence. The British and the Italians have withdrawn from the arrangement entirely. Ireland's punt has been devalued once, Portugal's escudo three times, and Spain's peseta four times. In addition, the limits on nearly all bilateral exchange rate fluctuations have been widened. The upcoming French election in late April will put the issue of European monetary union in the spotlight once again. That election and the continued pressure on the peseta suggest that turmoil in the ERM may well continue.

TREND

Dollar Fluctuations in Perspective

The value of the dollar has declined more than 7 percent against the German mark and the yen over the past month. Are exchange rate changes of this magnitude unusual?

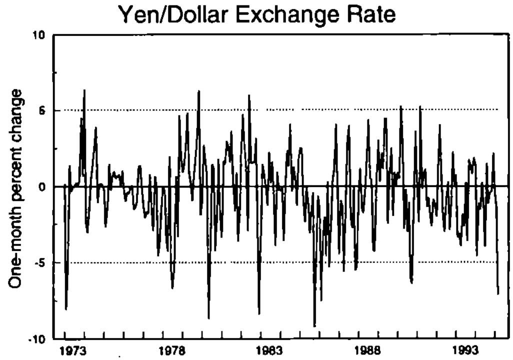
Deutschemark/Dollar Exchange Rate



Note: Observation for March 1995 uses March 10 data.

Since 1973 the value of the dollar has changed by 5 percent or more in either direction in one month 27 times relative to the German mark and 21 times relative to the yen (see charts). Viewed from this perspective, exchange rate changes of the magnitude that have occurred over the past month, while large, are far from unprecedented.

Yen/Dollar Exchange Rate



Note: Observation for March 1995 uses March 10 data.

Analysis. Exchange rates have been volatile, but there is no evidence that volatility has increased recently. Such volatility as there has been does not appear to have adversely affected trade flows over the past two decades. In part this is because firms can insulate themselves from this short-term volatility by using financial instruments such as forward contracts, futures contracts, and options. Longer-term exchange rate movements—such as the dollar's large and sustained appreciation against most currencies between 1980 and 1985 and its subsequent reversal—can, however, cause severe disruption.

EYES ONLY

TREND

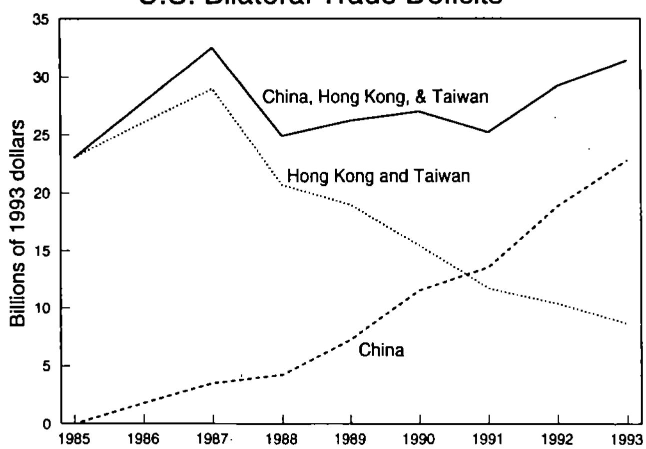
U.S. Trade With China: Appearances and Reality

According to official Commerce Department data, the United States ran a \$22.8 billion trade deficit with China in 1993—up from essentially nothing in the early 1980s. For several reasons, however, these data probably substantially overstate the deterioration in our trade position *vis à vis* the Chinese.

- Some production of labor-intensive goods such as shoes, garments, and toys has been relocated from Hong Kong and Taiwan to China, to take advantage of lower wages. This shift has held down our trade deficits with Hong Kong and Taiwan while inflating our deficit with China.
- As much as one-fourth of U.S. exports to China are shipped through Hong Kong. Currently, U.S. statistics credit Hong Kong with absorbing these exports, and hence understate U.S. exports to China.
- The bulk of U.S. imports from China (perhaps as much as 70 percent) are shipped through Hong Kong. U.S. statistics recognize China as the country of origin of these goods, but fail to adjust for the fact that their value is enhanced in Hong Kong (for example, through the addition of marketing and distribution services). As a result, U.S. statistics overstate U.S. imports from China.

Analysis. These measurement problems have no implications for the overall U.S. trade deficit—only for the allocation of that deficit among our trading partners. The Department of Commerce is currently working with their Chinese counterparts to improve these data. That process will, however, take several more years to complete. In the meantime, questions about our trade position relative to China can probably best be answered by looking at data for the aggregate of China, Hong Kong, and Taiwan. Such data show little trend in our trade imbalance with these countries over the past decade.

U.S. Bilateral Trade Deficits



EYES ONLY

ARTICLE

Issues in Risk Assessment and Benefit-Cost Analysis

Executive Order 12866 committed the Administration to consistent use of risk assessment and benefit-cost analysis as part of the regulatory development process. Such analyses can point up differences in the cost-effectiveness of various regulatory strategies for achieving a particular objective (e.g., reducing air pollution from cars). They can also help in choosing between competing objectives, by highlighting the most efficient means of reducing a certain type of risk. (For example, in order to reduce the risk of death in a car crash, should regulators focus more on side-impact or head-on collisions?) In principle, the outcome of a well-executed risk assessment and benefit-cost analysis is a regulation that targets the right objective and achieves it in an efficient manner.

Republican legislation currently making its way through the Congress would advance well beyond the principles spelled out in the Executive Order. It would require regulations to pass strict numerical benefit-cost tests before promulgation, and would open agency analyses to judicial review. The Republican approach should be rejected because benefit-cost analysis and risk assessment are imprecise, evolving tools that involve art as well as science. Even disinterested scientists can legitimately disagree about the methods and outcomes of such studies. Rigid formulae for judging regulations and extensive provisions for judicial review would therefore lead to numerous legal challenges of the risk assessment and benefit-cost analyses behind regulations, resulting in tremendous procedural snarls.

Current methodological challenges. At present, a number of thorny problems confront analysts seeking to conduct risk and benefit-cost analyses:

<u>Divergences in public and expert opinions</u>. In the late 1980s, the Environmental Protection Agency compared risk assessments obtained from public opinion polls with experts' assessments of the same risks. According to the opinion polls, the public was most concerned about hazardous waste sites, exposure to workplace chemicals, and industrial pollution of waterways. The experts ranked these risks as medium-to-low, high, and low, respectively. Indoor air pollution and radon exposure were ranked 23rd and 25th (out of a total of 26 considered) by the public but ranked high in the expert scale. These divergences indicate both the general lack of knowledge about risk among members of society and the tension that may be inherent in trying to design a regulatory policy that is both scientifically based and responsive to the concerns of the public.

<u>Changes in mortality risk</u>. Some experts argue that reductions in the risk of premature death should be measured in terms of the expected number of life-years extended rather than the expected number of lives saved. For example, this alternative approach would place greater emphasis on measures to reduce risks of

childhood leukemia than on measures to reduce the risk of long-gestation cancers that mainly afflict the elderly.

Balancing the present against the future. Analysis of issues with very long-term consequences, such as climate change and stratospheric ozone depletion, requires that tradeoffs be made between the interests of different generations. Some economists argue that market-based measures of discount rates are fundamentally inappropriate for weighing the equity of such tradeoffs. These experts argue for a much lower discount rate than the rate typically used in analyses of shorter-term (within-one-generation) policies, perhaps 1.5 percent versus the 7 percent currently used by OMB. A lower discount rate places more emphasis on long-term costs of environmental degradation. For example, the present value of any particular environmental damage 50 years from now is about 14 times larger with a 1.5 percent discount rate than with a 7 percent rate.

Gaps in scientific knowledge. Huge gaps remain in our knowledge about the hazards posed by different substances and practices, the interactions among such hazards, and the value of risk reduction to different groups of individuals. For example, relatively little is known about the long-term impact of many contaminants on human health and the environment. Reasonable efforts to characterize and evaluate risks are useful even with limited information, but the uncertainties inherent in such assessments must be acknowledged.

Analysis. A wealth of analyses suggests that consistent and conscientious use of benefit-cost analysis can contribute greatly to improved public policy. Lack of perfection should not become the enemy of the good: Even imprecise analyses can place bounds around the potential sizes of benefits and costs stemming from particular regulatory actions. However, expectations about the capacities of risk and benefit-cost analysis must be realistic. The current system may err in sometimes allowing execution of bad analyses and implementation of bad policies. The Republican alternative would be much costlier in providing the means for even the best analyses and regulations to be brought down or delayed for long periods by procedural requirements and judicial review.

EYES ONLY

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

Pay More, Puff Less. Even smokers appear to be susceptible to the laws of supply and demand. A new study from the National Bureau of Economic Research examines the smoking behavior of 18,000 college students and concludes that each 10 percent rise in cigarette prices causes them to smoke 14 percent less. About half of the induced drop in consumption is due to lower demand from those who persist in smoking, while the other half is attributable to students who quit smoking altogether. Because other research has shown that smokers with less education and lower income are <u>more</u> responsive to price, the overall drop for college-age youth probably is even greater. The bottom line: The study estimates that the 75-cent-per-pack cigarette tax increase proposed in the Health Security Act would have cut the number of smokers aged 18 to 24 by 1.8 million. For that age cohort alone, this could have meant a reduction of almost half a million in the number of premature deaths.

A New Profile of Welfare Mothers. A new Census study sheds light on the demographic characteristics of young welfare mothers (aged 15 to 44). *On welfare mothers and marriage:* About 48 percent of AFDC mothers of childbearing age in 1993 had never married (compared with 8 percent of non-AFDC mothers). Another 30 percent of AFDC mothers were currently married, although in many cases separated from their husbands, and the remaining 23 percent were widowed or divorced. *On welfare and out-of-wedlock births:* More than two-thirds of welfare mothers bore their first children outside of marriage. *On welfare dependence among the foreign-born:* Foreign-born mothers are no more likely to be on welfare than are native-born mothers. *On education and welfare:* Welfare mothers have relatively little education. Of the 3.8 million mothers on AFDC in 1993, 44 percent had not finished high school (compared with 15 percent of non-AFDC mothers), and 38 percent had only a high school degree; the remaining 19 percent had one or more years of college.

European Union Widens the Door for Turkey. Under the terms of an agreement reached last week, Turkey will be allowed to form a customs union with the European Union in January 1996. Turkey has been an associate member of the EU since the early 1960s, but has not had tariff-free access to European markets. If ratified by the European Parliament, Turkey's new status will represent a large step toward full membership in the Union. In a related move, the EU would also unblock $800 million in frozen aid to the Turkish government. Partly in protest over the 1974 Turkish invasion of Cyprus, Greece has long vetoed further EU integration with Turkey, as well as disbursement of the aid. But the Greek government has reportedly now relented, in exchange for an EU pledge to set a timetable for eventual membership of (Greek) Cyprus.

EYES ONLY

RELEASES LAST WEEK

Employment and Unemployment

In February, the unemployment rate fell to 5.4 percent from 5.7 percent in January. Nonfarm payroll employment rose by 318,000 in February.

Productivity

Nonfarm business productivity increased 1.7 percent at an annual rate in the fourth quarter. Manufacturing productivity increased 3.1 percent.

Auto Sales

Domestic autos were sold at an annual rate of 6.8 million units in February.

MAJOR RELEASES THIS WEEK

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

EYES ONLY

U.S. ECONOMIC STATISTICS

	1970–1993	1994	1994:2	1994:3	1994:4
Percent growth (annual rate)					
Real GDP	2.5	4.0	4.1	4.0	4.6
GDP deflator	5.5	2.3	2.9	1.9	1.3
Productivity					
Nonfarm business	1.2	1.4	–2.1	3.2	**1.7**
Manufacturing (1978-93)	2.1	4.6	5.6	3.5	**3.1**
Real compensation per hour	0.6	0.7	**–1.8**	–0.4	**1.2**
Shares of Real GDP (percent)					
Business fixed investment	11.0	12.6	12.4	12.7	13.0
Residential investment	4.7	4.3	4.4	4.3	4.2
Exports	8.0	12.3	12.1	12.4	12.9
Imports	9.2	14.4	14.2	14.6	14.9
Shares of Nominal GDP (percent)					
Personal saving	4.9	3.0	3.0	3.0	3.4
Federal surplus	–2.8	N.A.	–2.2	–2.3	N.A.
			Dec. 1994	**Jan. 1995**	**Feb. 1995**
Unemployment Rate	6.7*	6.1*	5.4	5.7	**5.4**

*Figures beginning 1994 are not comparable with earlier data.

			Dec. 1994	Jan. 1995	Feb. 1995
Payroll employment (thousands)					
increase per month			**231**	**176**	**318**
increase since Jan. 1993					**6117**
Inflation (percent per period)					
CPI	5.8	2.7	0.2	0.3	N.A.
PPI-Finished goods	5.0	1.7	0.4	0.3	N.A.

New or revised data in **boldface**.

EYES ONLY

FINANCIAL STATISTICS

	1993	1994	Jan. 1995	Feb. 1995	March 9, 1995
Dow-Jones Industrial Average	3522	3794	3872	3954	3983
Interest Rates					
3-month T-bill	3.00	4.25	5.71	5.77	5.73
10-year T-bond	5.87	7.09	7.78	7.47	7.30
Mortgage rate, 30-year fixed	7.33	8.36	9.15	8.77	8.62
Prime rate	6.00	7.15	8.50	9.00	9.00

INTERNATIONAL STATISTICS

Exchange Rates	**Current level March 9, 1995**	**Percent Change from**	
		Week ago	**Year ago**
Deutschemark-Dollar	1.389	−3.6	−18.6
Yen-Dollar	90.30	−5.3	−14.7
Multilateral (Mar. 1973=100)	82.91	−2.5	−12.6

International Comparisons	**Real GDP growth (last 4 quarters)**	**Unemployment rate**	**CPI inflation (last 12 months)**
United States	4.0 (Q4)	5.4 (Feb)	2.8 (Jan)
Canada	5.6 (Q4)	9.7 (Jan)	0.3 (Dec)
Japan	1.1 (Q3)	2.9 (Jan)	0.7 (Dec)
France	3.6 (Q4)	12.3 (Dec)	1.7 (Dec)
Germany	3.3 (Q4)	6.4 (Jan)	2.3 (Jan)
Italy	3.7 (Q3)	12.0 (Oct)	3.8 (Jan)
United Kingdom	3.9 (Q4)	8.7 (Jan)	3.3 (Jan)

EYES ONLY

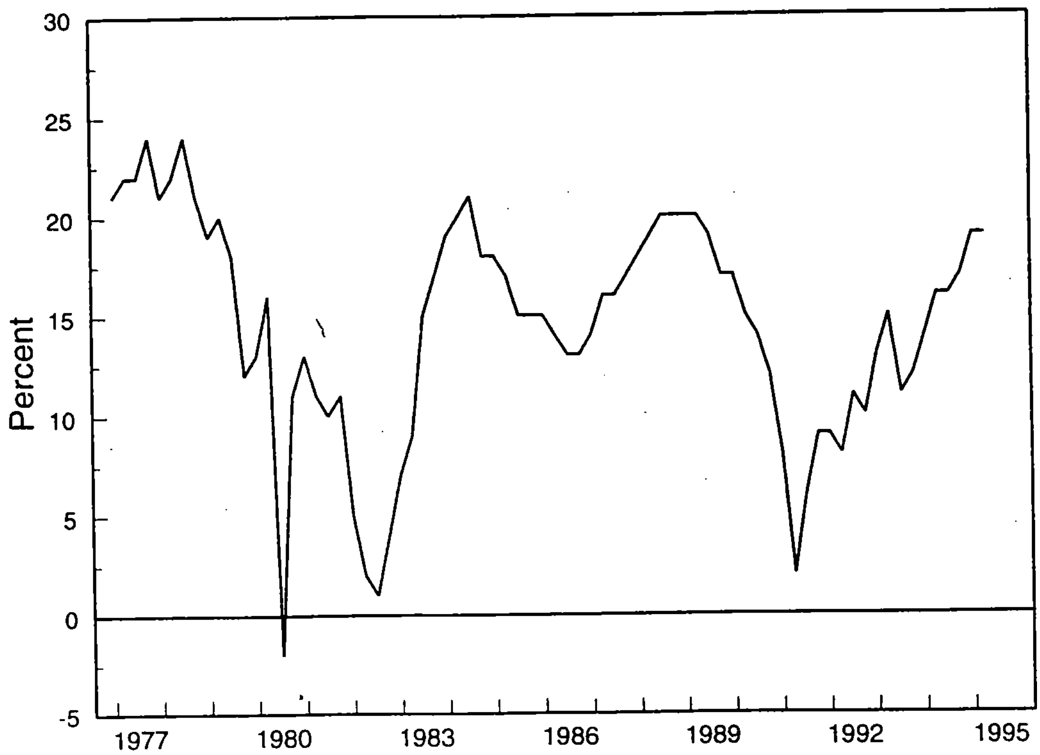
WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

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

March 6, 1995

CHART OF THE WEEK

Net Fraction of Businesses Planning to Increase Employment



According to the most recent survey by Manpower Inc., the net fraction of U.S. businesses planning to increase employment during the second quarter of this year is 19 percent—the same as in the previous survey and otherwise the strongest reading since the third quarter of 1989. By region, hiring plans are strongest in the Midwest and weaker in the Northeast and West, continuing a pattern that has prevailed throughout the current economic expansion.

EYES ONLY

CONTENTS

"Well, how about this: We take from the rich and ***invest!****"*

EYES ONLY

CURRENT DEVELOPMENT

Barings Bad Tidings

Barings—England's oldest investment bank—was brought down this week by the actions of a single trader. The details of how this disaster was accomplished remain obscure, with different and contradictory stories emerging by the day. According to available reports, the trader placed a huge wager that the Nikkei 225 index of Japanese stock prices would rise. Instead, the index fell sharply following the Kobe earthquake in mid-January, causing the bank to sustain losses in excess of $400 million as of last week. Barings was required to cover these losses on a daily basis as they occurred. To generate the cash required for this purpose, the trader apparently sold options on the very same index of stock prices, saddling the bank with yet more exposure to the index.

The Bank of England attempted to organize a consortium of banks to rescue Barings. However, the consortium was unwilling to assume the risk of further losses on the original wagers. Reportedly, the Sultan of Brunei initially indicated a willingness to absorb that risk in return for £200 million, but later changed his mind. Barings was then allowed to fail, leaving the Singapore exchange responsible for meeting Barings's obligations.

Analysis. Observers cite two major violations of standard risk management procedures that contributed to this sequence of events. First, the same person who executed the original wagers reportedly also performed the separate function of informing the bank of its exposure in the trades. This dual role probably enhanced his ability to conceal the true exposure of the bank. The American commercial banking industry states that they have more stringent mechanisms for controlling risk than are prevalent in other countries.

The Japanese and Singapore exchanges have also been faulted for their failure to question Barings's extraordinarily large position in the Japanese stock index. The exchange authorities may have believed that the large position was taken on behalf of the bank's customers rather than the bank itself. Or they may have thought that Barings had hedged its position—making a bet on the Osaka exchange that the stock index would go up and making the opposite bet on the Singapore or another exchange. Under U.S. Commodity Futures Trading Commission procedures, an open position of 50 or more contracts by any one purchaser in any one commodity generates an immediate inquiry from the exchanges (the Barings trader held at least 20,000 contracts on the Japanese stock index). However, the Nikkei 225 futures contract is traded on at least three exchanges worldwide, and a clever trader can probably hinder detection of a large position by trading in more than one market because information is not fully shared across all exchanges. Moreover, trading in options can take place outside of exchanges, a fact apparently exploited by the Barings trader.

EYES ONLY

SPECIAL ANALYSIS

How Tight is the Labor Market?

A tight labor market yields both benefits and costs. On the benefit side of the ledger, a tight labor market causes an improvement in worker skills to the extent that skills improve with experience and employers provide on-the-job training. A tight labor market may also help reduce discrimination on the basis of gender or race if it raises the costs to employers of engaging in such discrimination. And the experience of the late 1980s suggests that a tight labor market helps narrow the distribution of income (see Chart of the Week, Weekly Economic Briefing, October 24, 1994). On the cost side, tight labor markets put upward pressure on inflation.

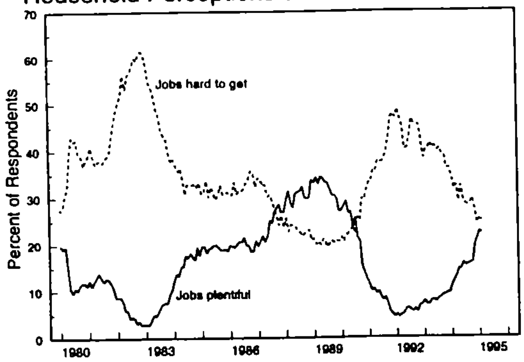
So how tight is the labor market currently? A tight national labor market may be reflected in many different phenomena. For example, the unemployment rate may be low, compensation may be rising rapidly, businesses may report difficulty in finding qualified candidates to fill vacancies, and individuals may experience little difficulty in finding new employment.

- As measured by the employment cost index (generally regarded as the most reliable indicator of labor cost trends), nominal compensation in the private sector decelerated throughout 1994. However, the absence of a recent pickup in compensation inflation may not be very revealing of labor market conditions in the second half of 1994, because compensation trends generally are thought to lag changes in labor market conditions.

- During late 1994, the unemployment rate declined sharply, into a range that was associated with tight labor markets during the late 1980s (see Weekly Economic Briefing, January 23, 1995). Still, the best guess is that the unemployment rate is not as low currently as it was during 1989 and early 1990 (the uncertainty being introduced by the recent redesign of the Current Population Survey), and it has not yet persisted at a low level for nearly as long.

- Surveys of employers also point to a recent strengthening of conditions in labor markets. On the basis of its most recent survey of small businesses, the National Federation of Independent Businesses concluded that "The data indicated the tightest labor market in years.... Owners are hoping to avoid raising compensation, but tightening labor markets and growing shortages of skilled employees may alter their plans." A survey by Michigan State University indicated that job prospects for new college graduates will be better in 1995 than in 1994—the second consecutive year of improvement following four years of deterioration. And Manpower Inc.'s latest survey of hiring plans yielded the strongest reading since mid-1989 (see Chart of the Week).

Household Perceptions of the Labor Market



- The Conference Board's survey of households suggests that, from the worker's perspective, labor market conditions improved noticeably last year. Toward the end of the year, many more households responded that "jobs are plentiful" and fewer that "jobs are hard to get" (see chart). Even so, the readings are somewhat less robust than they were during the late 1980s.

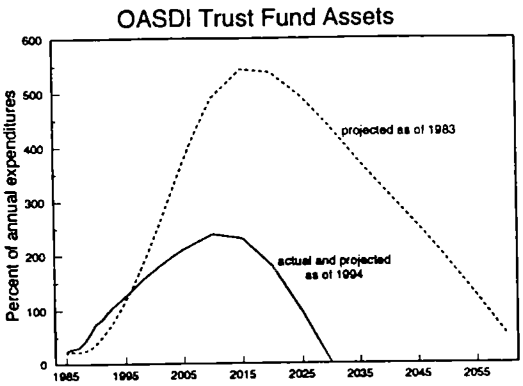
Conclusion. Available indicators seem to be sending a reasonably consistent message: Labor market conditions tightened considerably during 1994. Although they do not appear to be as tight now as they were during the late 1980s, labor markets may still be sufficiently tight to generate a slight acceleration in compensation, as is implicit in the Administration's current forecast. Over the long haul, the Administration's emphasis on human capital investment could be helpful in this regard, to the extent that it creates the potential for additional economic growth without a buildup of inflationary pressures.

EYES ONLY

ARTICLE

Those Fascinating Social Security Trust Fund Projections

In 1983, Congress enacted legislation based on the recommendations of the Greenspan Commission. At the time, it was asserted that those recommendations were sufficient to keep the Social Security Trust Fund solvent for 75 years. However, updated projections presented in the 1994 Board of Trustees Report show the Trust Fund going bust in 2029, nearly 30 years ahead of the 1983 schedule (see chart). (All projections referenced here are the so-called intermediate projections. The 1995 Trustees report is expected to be published in the spring.)



Key forecast parameters. As part of the projection process, Social Security actuaries must make assumptions about the future course of many variables. The most important of these include: fertility and labor force participation (to determine the number of workers supporting each retiree); productivity and its effect on wages (to determine the aggregate wage base subject to payroll taxes); inflation and mortality (to determine the aggregate amount of benefits to be paid); and interest rates (to determine how fast the trust fund builds).

Many economists attempt to forecast these parameters, but generally over only a relatively short time horizon (e.g., 5 or 10 years). Because the uncertainty surrounding any forecast generally increases with the number of years into the future that the forecast goes, the "confidence interval" surrounding the 75-year projections made by the Social Security actuaries is probably very wide. One thing is clear:

The forecast is very sensitive to the assumptions. According to current projections, the Trust Fund on average over the next 75 years will run a deficit equal to 2.1 percent of average taxable payroll during the period (measured in present-value terms). Translated into English, this means that, according to current projections, an increase in Social Security payroll taxes of 2.1 percentage points would return the Trust Fund to 75-year solvency, assuming no behavioral change in response to the higher tax rates. (Of course, the funding problem could also be addressed by other means such as boosting retirement ages or increasing the taxation of benefits.)

If the economy performs more favorably than the actuaries have assumed, then the funding problem would be alleviated. For example, if real wages were to increase

1.5 percent per year on average over the next 75 years rather than 1.0 percent as the actuaries have assumed, the 75-year funding gap would be equivalent to 1.6 percent of taxable payroll.

Similarly, if the fertility rate over the next 75 years were to average 2.1 children per woman rather than 1.9 children as assumed by the actuaries, the 75-year funding gap would be reduced to 1.8 percent of taxable payroll. And if death rates drop 25 percent from today's levels rather than 35 percent as projected by the actuaries, the 75-year funding gap would be equivalent to 1.7 percent of taxable payroll.

In sum, it is possible that the economy and the demography of the Nation will evolve in such a manner that the Social Security funding problem will turn out to be less severe than is currently anticipated in the baseline forecast. However, there is probably a roughly equal risk that the problem will turn out to be more severe than the actuaries have assumed (as is indicated by the deterioration in the outlook for the Trust Fund since 1983). The table on the next page specifies in greater detail the sensitivity of the funding situation to changes in various assumptions as estimated by the actuaries.

EYES ONLY

Trust Fund Sensitivity Analysis

Social Security actuaries have estimated the sensitivity of the average imbalance between revenues and outlays of the Social Security Trust Fund over the next 75 years to many key parameters. The sensitivities in the table below are expressed as a percent of taxable payroll over the projection period. For example, each 0.5 percentage point increase in the rate of real wage growth is estimated to cause the Trust Fund deficit to decline by 0.54 percent of average taxable payroll. (Recall that, according to current projections, the annual average deficit in the Trust Fund over the next 75 years will be an estimated 2.13 percent of average taxable payroll.)

Parameter	1994 Forecast	Effect of change on long-run Trust Fund balance (percent of taxable payroll)
Real wage growth	1.0 percent	0.5 percent increase leads to 0.54 percent of taxable payroll improvement
Fertility	1.9 children per woman	0.1 child increase leads to 0.15 percent improvement
Death rate	35 percent lower than current death rate over 75 years	10 percent further reduction leads to 0.39 percent worsening
Immigration	850,000 net immigrants per year	100,000 more net immigrants leads to 0.07 percent improvement
Consumer prices	4.0 percent annual increase	1.0 percentage point increase leads to 0.22 percent improvement
Real interest rates	2.3 percent	0.5 percentage point increase leads to 0.30 percent improvement

EYES ONLY

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

Canada Cuts Back, But Leaves Safety Net Largely Intact. Canada's Liberal government this week presented its proposed 1995-96 budget. The result should please deficit hawks: Even under the budget's conservative economic assumptions, the deficit is projected to fall from 5.1 percent of GDP in 1994-95 to 3 percent of GDP in 1996-97. This improvement will be achieved largely through deep cuts in spending, with budgets falling across the board. The government workforce is slated to plummet 14 percent over the next 3 years, while business subsidies (primarily for transportation and agriculture) will fall 60 percent. The budget also puts all federal transfers to the provinces for health, education, and welfare into a single block grant, and it cuts spending for these purposes substantially from levels projected earlier. Although the budget raises several taxes, the business community had been braced for heftier increases, according to press reports.

Under IMF Pressure, Russian Reform Plows Ahead. Russia's government this week unveiled a series of market-oriented reforms designed to put the country in the International Monetary Fund's good graces. Three decrees already signed would: cancel various tax and import duty exemptions, which should help shore up government finances; liberalize a range of prices still under government control; and increase the powers of the state anti-monopoly and capital-market regulators. The decrees also strengthen the fiscal hand of the president, by placing all spending decisions under presidential control. Finally, a decree still in the works will eliminate some major export controls. Observers believe that the new reforms will convince the IMF later this month to sign off on a $6.4 billion standby loan—the largest Fund loan yet to Russia.

Poor Marks for Child Care Centers. Goal number one under Goals 2000 states that "by the year 2000, all children in America will start school ready to learn." But that goal may be difficult to achieve: The child care provided at most centers in the United States is poor to mediocre, with almost half of the infants and toddlers left in rooms that fail to meet even minimal standards of health, safety, and support. These are the conclusions of a new study of 400 randomly chosen child-care centers in four states (California, Colorado, Connecticut, and North Carolina). The researchers found that only 14 percent of all centers, and only 8 percent of infant and toddler rooms, offer care that is "developmentally appropriate"—meaning that children are kept safe, treated with affection, and encouraged to learn. Predictably, these high-quality centers on average offered higher staff-to-child ratios and had more educated staffs. (The National Association for the Education of Young Children recommends that center directors have at least a bachelor's degree in a relevant field and that teachers have a "child development certificate," obtainable through 9 months of study.) Children in the high-quality centers were judged to have higher language abilities, pre-math skills, and social skills than those in low-quality centers.

EYES ONLY

RELEASES LAST WEEK

Leading Indicators

****Embargoed until Friday, March 3, 1995 at 8:30 a.m.****

The index of leading economic indicators was unchanged in January following increases of 0.2 percent in December and 0.1 percent in November.

Personal Income and Expenditures

Personal income rose 0.9 percent in January (monthly rate). Disposable personal income rose 0.7 percent. Personal consumption expenditures rose 0.4 percent.

Gross Domestic Product

According to revised estimates for the fourth quarter, real gross domestic product grew at an annual rate of 4.6 percent.

Consumer Confidence

Consumer confidence, as measured by the Conference Board, decreased 2.4 index points in February, to 99.0 (1985=100).

MAJOR RELEASES THIS WEEK

Productivity (Wednesday)
Employment (Friday)

EYES ONLY

U.S. ECONOMIC STATISTICS

	1970–1993	1994	1994:2	1994:3	1994:4
Percent growth (annual rate)					
Real GDP	2.5	4.0	4.1	4.0	**4.6**
GDP deflator	5.5	2.3	2.9	1.9	**1.3**
Productivity					
Nonfarm business	1.2	1.4	–2.1	3.2	1.8
Manufacturing (1978-93)	2.1	4.6	5.6	3.5	2.8
Real compensation per hour	0.6	0.7	–2.0	–0.4	1.4
Shares of Real GDP (percent)					
Business fixed investment	11.0	12.6	12.4	12.7	**13.0**
Residential investment	4.7	4.3	4.4	4.3	4.2
Exports	8.0	12.3	12.1	12.4	**12.9**
Imports	9.2	14.4	14.2	14.6	**14.9**
Shares of Nominal GDP (percent)					
Personal saving	4.9	3.0	3.0	3.0	3.4
Federal surplus	–2.8	N.A.	–2.2	–2.3	N.A.
			Nov. 1994	**Dec. 1994**	**Jan. 1995**
Unemployment Rate	6.7*	6.1*	5.6	5.4	5.7

*Figures beginning 1994 are not comparable with earlier data.

	1970–1993	1994	Nov. 1994	Dec. 1994	Jan. 1995
Payroll employment (thousands)					
increase per month			534	210	134
increase since Jan. 1993					5578
Inflation (percent per period)					
CPI	5.8	2.7	0.1	0.2	0.3
PPI-Finished goods	5.0	1.7	0.6	0.4	0.3

New or revised data in **boldface**.

EYES ONLY

FINANCIAL STATISTICS

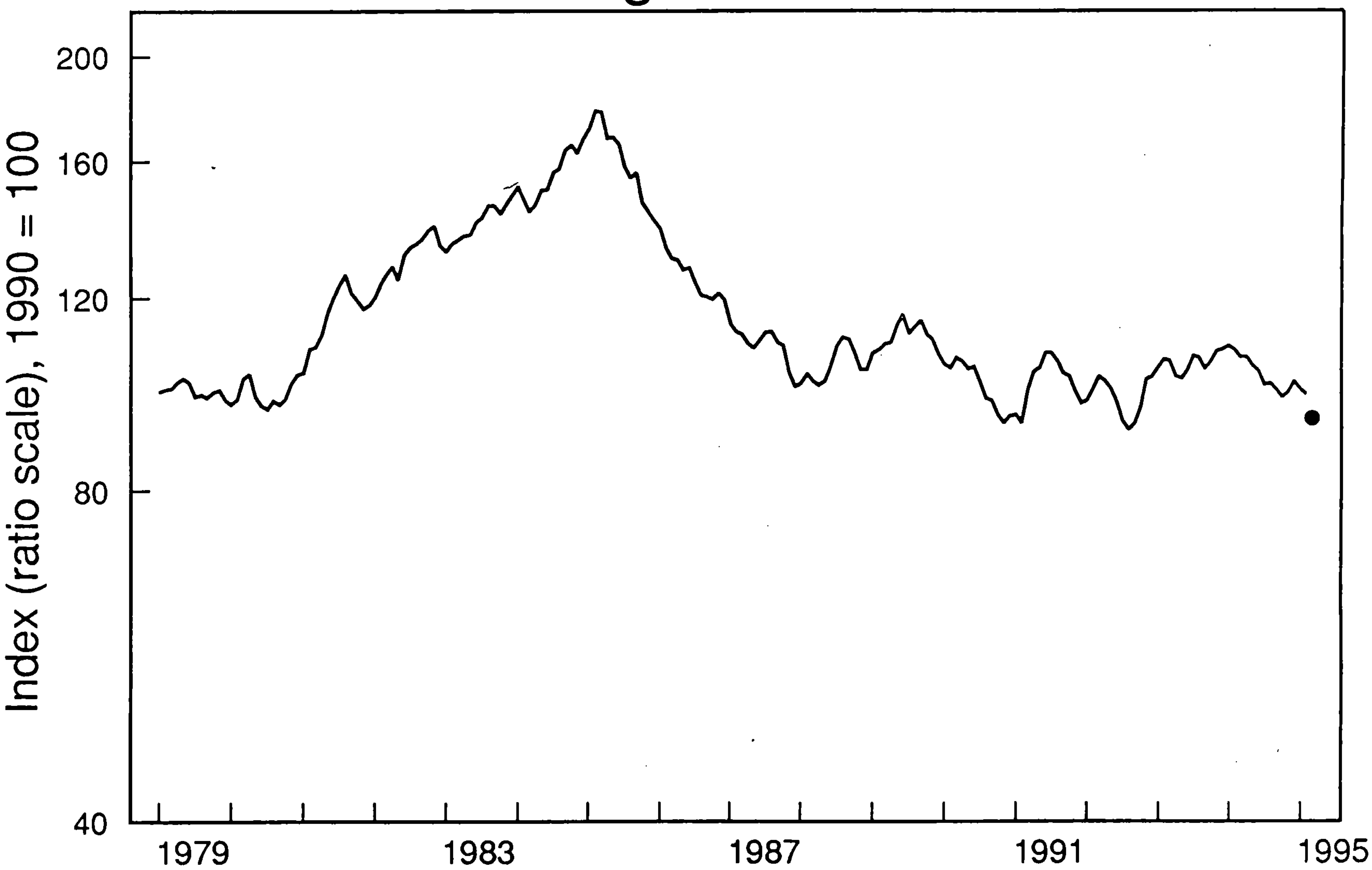
	1993	1994	Jan. 1995	Feb. 1995	March 2, 1995
Dow-Jones Industrial Average	3522	3794	3872	3954	3980
Interest Rates					
3-month T-bill	3.00	4.25	5.71	5.77	5.75
10-year T-bond	5.87	7.09	7.78	7.47	7.30
Mortgage rate, 30-year fixed	7.33	8.36	9.15	8.83	8.53
Prime rate	6.00	7.15	8.50	9.00	9.00

INTERNATIONAL STATISTICS

Exchange Rates	**Current level March 2, 1995**	**Percent Change from**	
		Week ago	**Year ago**
Deutschemark-Dollar	1.441	−1.9	−15.3
Yen-Dollar	95.33	−1.5	−8.2
Multilateral (Mar. 1973=100)	85.05	−1.1	−10.0

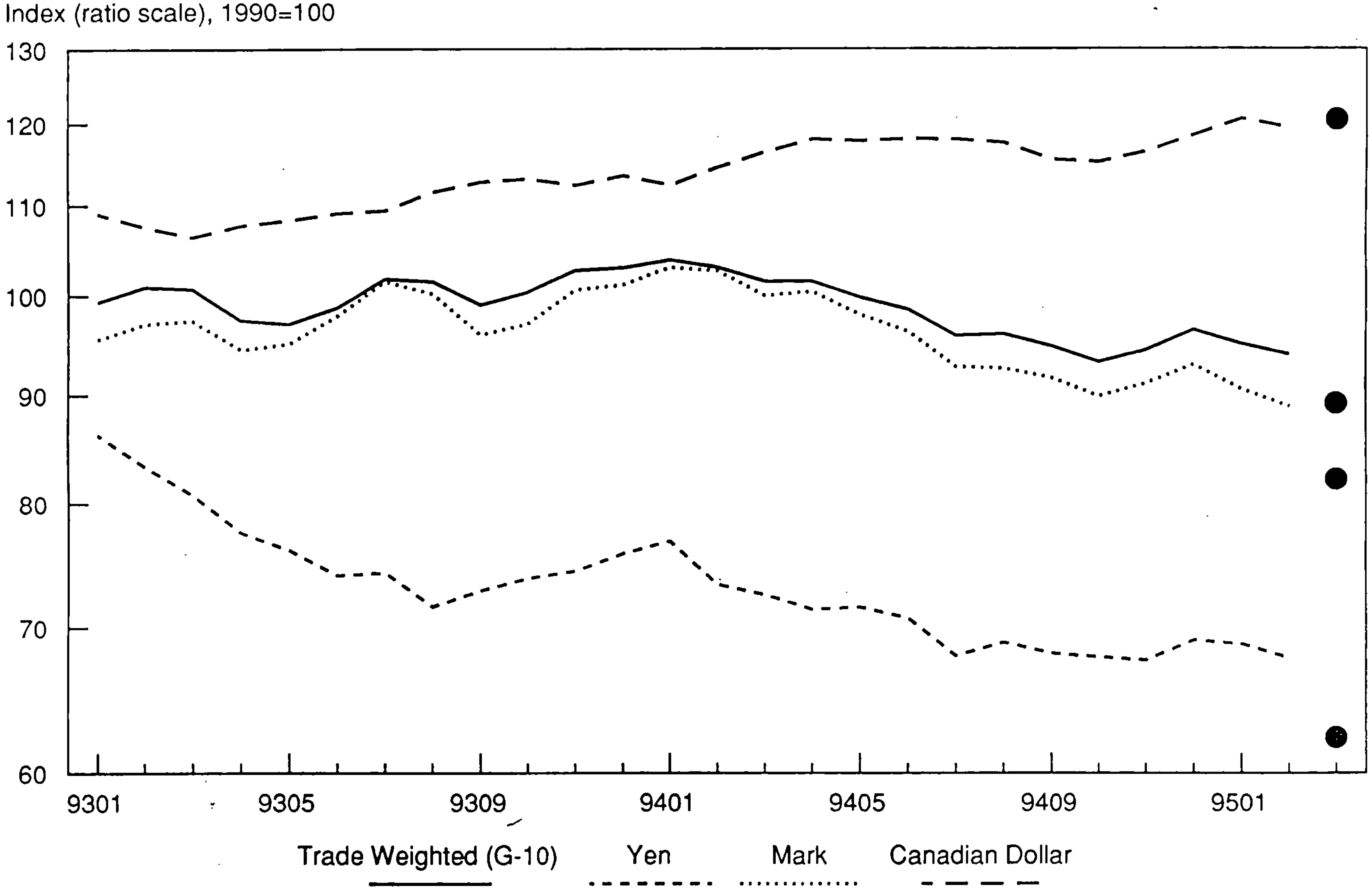
International Comparisons	**Real GDP growth (last 4 quarters)**	**Unemployment rate**	**CPI inflation (last 12 months)**
United States	4.0 (Q4)	5.7 (Jan)	2.8 (Jan)
Canada	5.6 (Q4)	9.6 (Dec)	0.3 (Dec)
Japan	1.1 (Q3)	2.9 (Nov)	0.7 (Dec)
France	3.6 (Q4)	12.4 (Nov)	1.7 (Dec)
Germany	3.6 (Q4)	6.4 (Nov)	2.3 (Jan)
Italy	3.7 (Q3)	12.0 (Oct)	3.8 (Jan)
United Kingdom	3.9 (Q4)	8.8 (Dec)	3.3 (Jan)

FRB G-10 Exchange Value of the Dollar



Note: Marker represents the March 9 observation.

Exchange Value of the Dollar



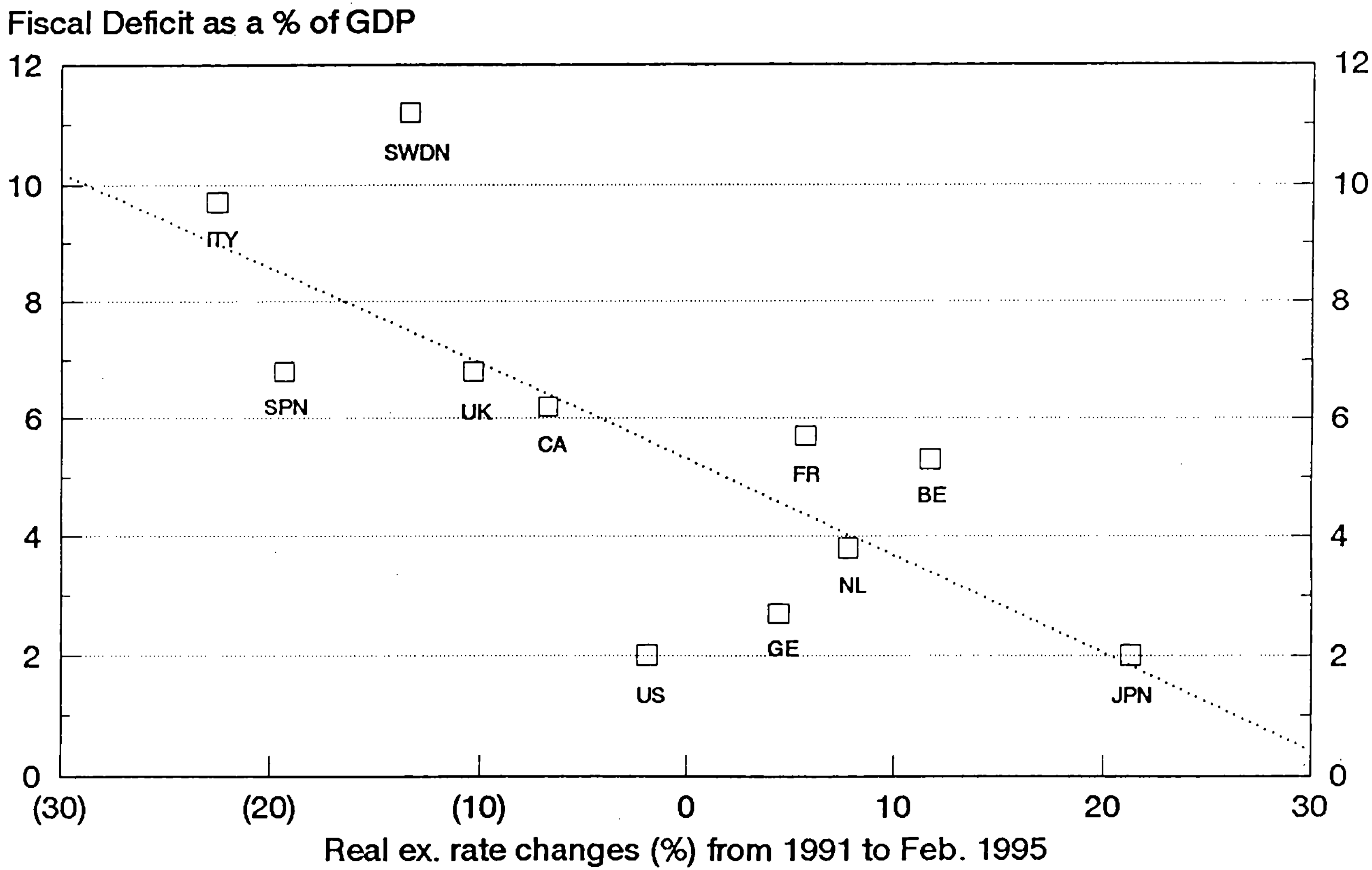
Note: Markers show March 9 observations.

OECD Structural Deficits (as a percent of GDP)

	1992	1993	1994
U.S.	-4.3	-3.4	-2.0
Japan	1.8	-0.2	-2.0
Germany	-2.9	-3.3	-2.7

Source: U.S. Treasury Department

Exchange Rate Changes and Fiscal Deficits



(% change in real trade weighted indices from 1991, average to 2/95 for G-7, 12/94 for others, positive number equals appreciation.)

Source: JP Morgan (Broad index) for exchange rate changes, OECD Economic Outlook for general government financial balances.