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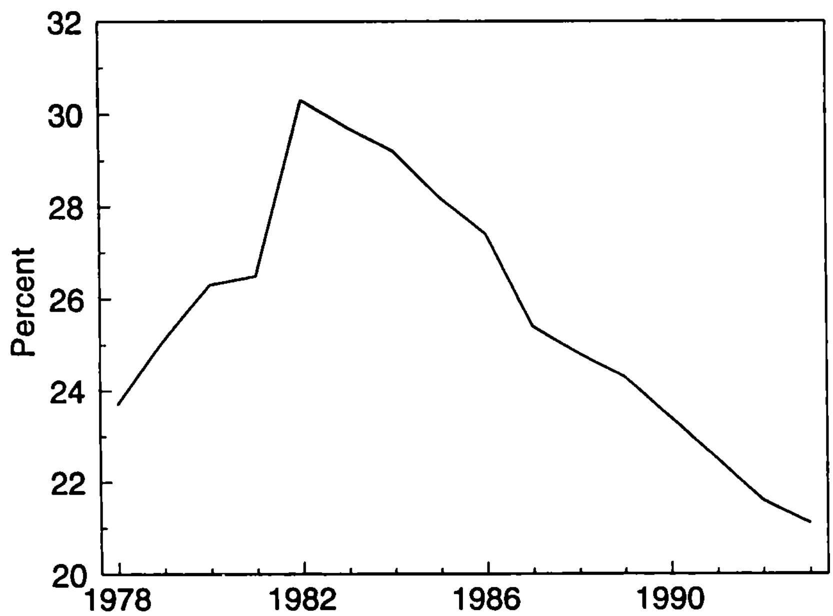
WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

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

October 22, 1993

CHART OF THE WEEK

Bank Loans as a Fraction of Business Borrowing
(Commercial and Industrial)



Over the last decade, U.S. corporations have reduced their reliance on bank lending as a source of funds. Some of this is a consequence of the shift from bank lending to marketed instruments—corporate bonds and commercial paper.

EYES ONLY

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QUOTATION OF THE WEEK

"Well, it looks like we don't have a consensus...yet."

Chairman Henry Gonzalez, at a House Banking Committee hearing on Tuesday where Chairman Greenspan and 15 other senior Federal Reserve officials voiced objection to proposals to change Federal Reserve procedures. (See Article, p. 4.)

EYES ONLY

CURRENT DEVELOPMENT

New Cable Rate Regulations a Limited Success

A Federal Communications Commission (FCC) survey found that cable television rate regulation has lowered the bill for 68 percent of cable customers. Equipment charges generally declined significantly, but the average programming charge likely fell by no more than a few percent. The FCC's regulations, which implement 1992 legislation, took effect September 1.

Analysis. The rules seek to lower programming rates to long-run average cost by reducing each cable system's rate to a "competitive benchmark." Yet many systems are likely continue to charge a rate in excess of cost. The rules have several loopholes.

- The FCC's rules do not reduce rates to the benchmark. Rather, the initial rate reduction is limited to 10 percent, and regulated rates can increase with inflation. Hence, the many cable firms currently charging more than 10 percent above the competitive benchmark can permanently keep rates above cost, unless new competition from telephone companies lowers prices.

- The "competitive benchmark" may be set above long-run average cost. The benchmark is based in part on the rates of systems with less than 30 percent market penetration. Such systems may have low penetration precisely because they are charging high prices.

- The "competitive benchmark" can be evaded because it is defined on a "per channel" basis. Cable systems can lower average per channel rates without cutting the charge for existing programming by adding low-priced programming, or by shifting high-priced programming to unregulated "pay-per-channel" status.

EYES ONLY

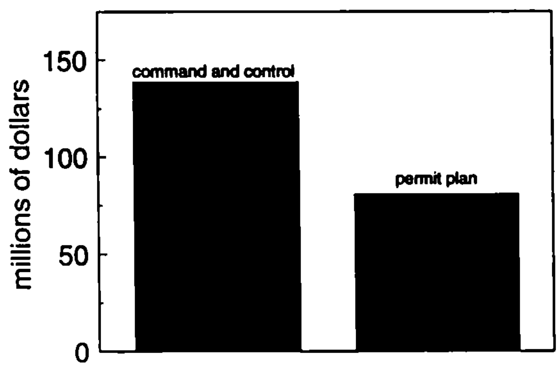
CURRENT DEVELOPMENT

Southern California Approves Smog Market Plan

Last week, Southern California's South Coast Air Quality Management District approved a plan to allow companies to buy and sell permits to pollute. The plan affects 390 of the region's largest polluters including petrochemical plants, glass factories, mining operations, and electric generating stations. These businesses each emit substantial quantities of either nitrogen oxides or sulfur oxides, the main ingredients of Southern California's brown haze.

The new program would require each company to reduce pollutants by a set percentage based on its past emissions. A company that lowers its emissions by more than the required amount will receive credits that it can sell to other companies that cannot meet their targets as cheaply.

Average Annual Costs of Emission Reduction Plans



Analysis. The ability to market pollution permits encourages companies that can reduce pollution cheaply to do so by more than the mandated percentage. Therefore, this plan will produce region-wide emission reductions faster and at lower cost than the current approach of regulating pollution at each source. The Air Quality Management District estimates that marketable permits will reduce the cost of pollution reduction by 42 percent (see chart).

A second trading program in the same District covering pollutants from organic compounds could come next year. EPA has a similar pollution trading program on a national scale to reduce acid rain by promoting reductions in sulfur dioxide emissions from power plants.

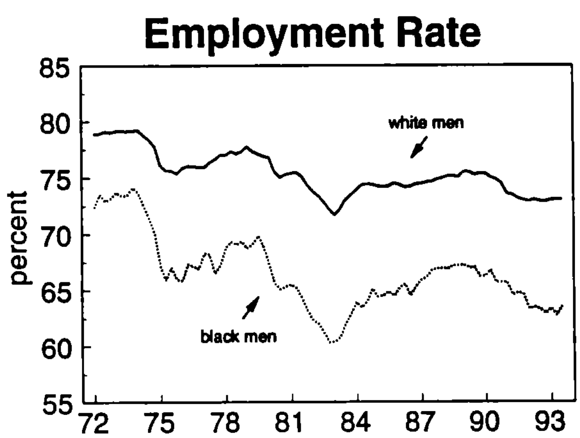
EYES ONLY

CURRENT DEVELOPMENT

Black Employment in Recent Recession Suffered a *Normal* Cyclical Decline

A recent article in the Wall Street Journal stated incorrectly that blacks were the only racial group that suffered declines in employment during the last recession. The Wall Street Journal's figures implied that total employment increased during the recession, which would have come as a surprise to the American people.

The fact is that both blacks and whites suffered employment losses during the last cyclical downturn, with much of the loss by blacks coming before the official beginning of the recession. Blacks did lose jobs at a greater rate than whites, but this pattern is typical of recessions.



Analysis. The employment rate of black men has fallen over 10 percentage points since the early 1970s. The white male employment rate has also fallen, but only half as much. This disturbing trend in black male employment is a much more important story than the normal cyclical fluctuations. Black males work disproportionately in low-wage occupations. Part of the overall decline in labor force participation of black males is a response to declining wages for the lowest-paid workers.

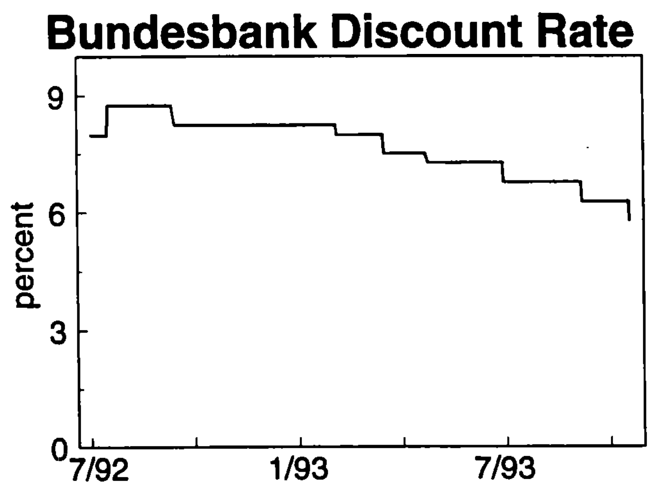
Falling employment of black men has adversely affected the incomes of black families. Moreover, black women have had a high labor force participation rate for decades. Since they were already working, there was little room within the black family for increased income of women to replace the stagnating income of men.

EYES ONLY

CURRENT DEVELOPMENT

Bundesbank Cuts Discount Rate, Other European Countries Follow

The Bundesbank lowered its key interest rates by 50 basis points on Thursday. The discount rate, the effective floor for money market interest rates, was set at 5.75 percent, and the Lombard rate, the effective ceiling, was set at 6.75 percent. These cuts represent the sixth time this year that the Bundesbank has reduced the discount rate.



Interest rate cuts followed in several European countries: Austria, Belgium, Italy, the Netherlands, Switzerland, and Sweden. As of 7 p.m. Thursday, France has conspicuously failed to follow suit.

Analysis. The Bundesbank for the past year has been following a policy of slowly cutting interest rates in small increments. Consumer prices have been rising at a 2.4 percent annual rate over the past 3 months while wholesale prices have been flat. Thus, short-term real interest rates remain high. That fact, plus the weak German economy, suggest that there is additional room for interest rate cuts by the Bundesbank.

EYES ONLY

ARTICLE

Federal Reserve Independence Debated

The House Banking Committee recently held hearings on proposals to make the Fed more accountable in its conduct of monetary policy. The proposals—all opposed by the Fed—include the following:

- Closer alignment of the term of the Federal Reserve Board's Chairman with that of the President. The Chairman's term would begin 1 year into a new administration and would last 4 years.

- Direct Presidential appointment of the Fed's twelve regional bank presidents. Five regional presidents join the seven Fed Governors on the Federal Open Market Committee (FOMC), the body that determines monetary policy. These presidents are currently selected by the regional banks, with approval from the Board of Governors.

- Closer and more formalized communication between the Fed and the executive branch, and greater Congressional oversight of the Fed through broader General Accounting Office (GAO) audits.

- More timely disclosure of Federal Open Market Committee minutes. Presently, FOMC policy decisions are released in summary form 6 weeks after a meeting. One proposal calls for immediate disclosure of the FOMC's decisions. Another calls for release of more detail, even a videotape.

Merits. The various proposals have some merit.

- Although the Fed argues otherwise, the suggestion for faster dissemination of FOMC decisions may remove some of the uncertainty financial markets face in trying to divine Fed policy. FOMC decisions are often leaked. Some recent research shows that these leaks do not affect financial market volatility. Thus, fears of routine release of the decisions are perhaps overstated. The related proposal to provide a fuller record of FOMC meetings would, however, probably reduce debate at FOMC meetings.

- That the Reserve Bank presidents are chosen by their boards of directors, which are composed mainly of business people and bankers, does mean that they have less political legitimacy than they might. An argument for Presidential appointment can indeed be made.

Pitfalls. In a recent letter to Chairman Gonzalez, you said you are presently "disinclined" to support the proposal for Presidential appointment of Reserve Bank presidents, although you understand his concerns. The following considerations provide reasons for not tampering with the current system.

- There is a substantial risk that bond market participants would interpret any change in the rules under which monetary policy is formulated as a sign that the Fed would be subjected to political pressure to overstimulate the economy. Such beliefs would cause interest rates to rise.

- There is some evidence that less independent central banks typically yield higher inflation with few or no offsetting benefits. Countries with tighter political control of their central bank experience high inflation, yet do not enjoy smoother or higher rates of GDP growth, lower interest rates, or more jobs. It could be that countries with independent central banks merely have other sound policies or institutions. Thus, many economists believe that exerting greater political control over the central bank is dangerous.

- Chairman Greenspan and the Fed are adamantly opposed to any change.

None of the proposals under consideration by the House Banking Committee would radically challenge the Fed's independence. Nonetheless, tampering with the present system right now would have few or no benefits and potentially serious and adverse consequences.

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

Survey Shows Human Side of Recession. The University of Chicago's National Opinion Research Center's General Social Survey reveals the consequences for families of the 1990-1991 recession. One fourth of all households reported experiencing pay cuts for the husband, wife, or both sometime during 1990 or 1991. Over 28 percent reported a major worsening of their finances, and over 10 percent were forced to pawn goods. The survey shows that financial problems hit blacks, women, households with many children, and separated and divorced individuals especially hard.

Two Major Banks Cut Their Prime Lending Rates. Morgan Guaranty Trust and Harris Trust reduced their prime rate to 0.5 percent on October 18. As of Thursday, no other major banks have followed.

Telecommunications Companies to Offer Powerful Transmission System. Motorola Inc. and US West Inc. announced plans to sell switches (computers that relay phone calls and data) that will use new asynchronous transfer mode (ATM) technology. ATM allows transmission at speeds up to 622 million bits per second, making the simultaneous transmission of voice, data, and video applications over the same wire feasible. Motorola's product will more than triple the speed of existing telephone lines, and so facilitate the provision of multimedia telecommunications services by telephone companies (see Weekly Economic Briefing, October 1, 1993).

Multimedia Product Launched for Christmas. Yes! Entertainment Corp. has developed a new technology that enables TV signals to control other electronic devices in the home. The technology's first application will be TV Teddy, a Teddy Ruxpin doll that will speak and sing in conjunction with a television program. The information to tell TV Teddy what to say will be embedded in a portion of the signal not displayed on the television. A decoder will translate and transmit the data to the teddy bear. This new technology raises yet another issue of standardization: Will Barbie be able to talk to Barney?

EYES ONLY

RELEASES THIS WEEK

Housing Starts

Housing starts increased 2.8 percent from August to September, to an annual level of 1.35 million units.

Consumer Sentiment ** NOT FOR PUBLIC RELEASE **

In the preliminary report for October, the University of Michigan survey showed that consumer sentiment rebounded sharply.

MAJOR RELEASES NEXT WEEK

Fiscal Year 1993 Deficit (Tuesday)

Durable Goods Shipments and Orders (Wednesday)

GDP (Thursday)

Personal Income (Friday)

EYES ONLY

U.S. ECONOMIC STATISTICS

	1970–1992	1992	1992:4	1993:1	1993:2
Percent growth (annual rate)					
Real GDP	2.5	3.9	5.7	0.8	1.9
GDP deflator	5.8	2.8	3.3	3.6	2.3
Productivity					
Nonfarm business	1.1	3.7	4.1	–1.8	–1.3
Manufacturing (begins 1977)	2.0	5.2	7.0	4.9	5.2
Real compensation per hour	0.6	2.2	1.4	–1.0	–1.5
Shares of Real GDP (percent)					
Business fixed investment	10.9	10.6	10.7	11.1	11.5
Residential investment	4.8	4.0	4.2	4.2	4.0
Exports	7.9	11.6	11.7	11.6	11.6
Imports	9.0	12.3	12.4	12.8	13.1
Shares of Nominal GDP (percent)					
Personal saving	4.9	4.0	4.5	2.8	3.3
Federal surplus	–2.8	–4.6	–4.3	–4.2	–3.5

	1970–1992	1992	July 1993	Aug. 1993	Sept. 1993
Unemployment Rate	6.7	7.4	6.8	6.7	6.7
Payroll employment (thousands)					
increase per month			237	–41	156
increase since Jan. 1993			1103	1062	1218
Inflation (percent per period)					
CPI	6.0	2.9	0.1	0.3	0.0
PPI-Finished goods	5.3	1.6	–0.2	–0.6	0.2

No new data this week.

EYES ONLY

FINANCIAL STATISTICS

	1992	July 1993	Aug. 1993	Sept. 1993	Oct. 21, 1993
Dow-Jones Industrial Average	3284	3529	3597	3592	3636
Interest Rates					
3-month T-bill	3.43	3.04	3.02	2.95	3.05
10-year T-bond	7.01	5.81	5.68	5.36	5.35
Mortgage rate, 30-year fixed	8.40	7.21	7.11	6.91	6.74
Prime rate	6.25	6.00	6.00	6.00	6.00

INTERNATIONAL STATISTICS

Exchange Rates	**Current level Oct. 21, 1993**	**Percent Change from Week ago**	**Percent Change from Year ago**
Deutschemark-Dollar	1.665	+3.3	+10.1
Yen-Dollar	108.3	+0.9	−11.3
Multilateral (1973=100)	94.21	+1.9	+9.1

International Comparisons	**Real GDP growth (last 4 quarters)**	**Unemployment rate**	**CPI inflation (last 12 months)**
United States	+2.9 (Q2)	6.7 (Sep)	2.7 (Sep)
Canada	+2.4 (Q2)	11.3 (Aug)	1.7 (Aug)
Japan	−0.5 (Q2)	2.6 (Jul)	1.9 (Jul)
France	−1.0 (Q2)	11.3 (Jul)	1.7 (Aug)
Germany	−2.4 (Q2)	6.1 (Aug)	4.2 (Aug)
Italy	−0.9 (Q1)	10.6 (Jul)	4.5 (Aug)
United Kingdom	+2.0 (Q2)	10.5 (Aug)	1.7 (Aug)

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WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

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

October 15, 1993

CHART OF THE WEEK

The trade surplus in agricultural products—historically a major export sector for the United States—has stagnated, while the trade surplus in services is now substantial and rising. In 1992, the surplus in services offset more than half of the deficit in merchandise. [See Current Development, page 1.]

EYES ONLY

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CURRENT DEVELOPMENTS

TREND

ARTICLE

DEPARTMENTS

QUOTATION OF THE WEEK

October. This is one of the peculiarly dangerous months to speculate in stocks in. The others are July, January, September, April, November, May, March, June, December, August, and February.

—Mark Twain, Pudd'nhead Wilson.

EYES ONLY

CURRENT DEVELOPMENT

Service Exports Boom

Manufactured and agricultural products have traditionally been the main exports of the United States. Nowadays, however, high productivity makes U.S. firms strong competitors in world markets for services. Service exports have grown an astounding 75 percent in real terms since 1986 and currently account for 29 percent of U.S. exports. Agricultural goods account for only 7 percent while manufacturing accounts for most of the rest.

This rapid growth in exports has led to the large trade surplus in services (see Chart of the Week), which partly offsets the substantial and persistent deficit in manufactured goods. An inflation-adjusted surplus in services of $16 billion in 1986 has mushroomed to a surplus of $61 billion in 1992. The United States currently runs a service sector surplus with virtually all trading partners, including Japan ($13 billion) and Western Europe ($20 billion). The strong growth in the service sector trade surplus contrasts sharply with a fairly stagnant surplus in agricultural trade.

Analysis. Service sector jobs are often thought of as low skilled and low wage. Many of them are, but many export-oriented service jobs are high skilled and high wage. Wages in service jobs overall are 15 percent below the national average, but wages in export-oriented service jobs are 20 percent above the average. Workers in export-oriented service industries are typically not flipping hamburgers or sweeping floors, they are working as airline pilots, engineers, accountants, and professors.

The U.S. exports ...

more equipment installation and repair services than inorganic chemicals,

more than two-thirds as many airline services as commercial aircraft, and

more educational and financial services than corn and wheat.

EYES ONLY

CURRENT DEVELOPMENT

Solution to Michigan School Funding Impasse Debated

Reliance on property taxes to fund public schools has led to substantial inequities in per-pupil expenditures in Michigan, as it has in many states. Following years of failed attempts at school-funding reform, Michigan recently eliminated the local property taxes that funded schools, effective in fall 1994. Absent some action to raise revenue, there will be no money for schools to reopen next year.

The state legislature is now debating Governor Engler's proposal to increase the sales tax from 4 to 6 percent, increase the cigarette tax by 50 cents per pack, increase the single business tax rate, impose a statewide property tax on businesses and second homes, tax home sales, and reduce homeowner tax benefits. The Michigan legislature has until the end of the year to authorize a public referendum on the sales tax increase, which requires a constitutional amendment.

The plan also allows for school choice among public schools.

Analysis. It is estimated that the Governor's proposed tax package will nearly offset the revenue loss from the property tax repeal. The proposal guarantees per- pupil spending of $4,500, but would give larger grants to schools that currently have higher costs. Hence, the proposal perpetuates some differences in per-pupil expenditures, but does guarantee a substantial minimum level of spending for each student in the state.

Michigan Proposal Would Increase Federal Revenues

The Michigan proposal would replace the property tax, which is tax deductible, with a sales tax, which is not. This change would increase Michigan citizens' Federal tax payments by about $400 million per year.

EYES ONLY

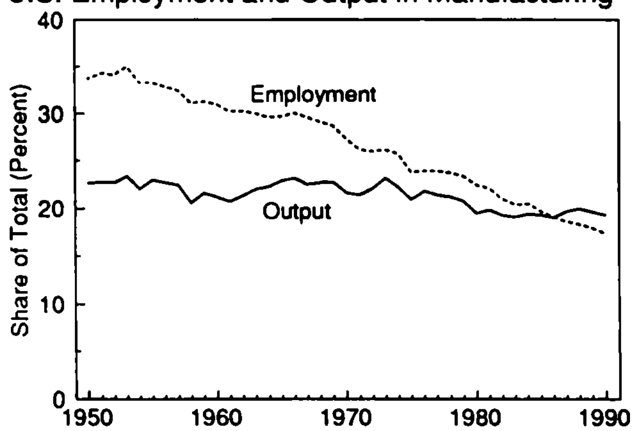
TREND

Manufacturing Output Share Stable While Employment Share Falls

Is U.S. manufacturing industry shrinking? That depends on whether you look at manufacturing's share of output or employment. Manufacturing industries accounted for 23 percent of output in 1950. Today they account for 19 percent. Hence, the long-term trend is small. There is a strong cyclical component, however, so the share should increase slightly as the recovery continues.

In contrast to manufacturing's nearly constant share of output, its share of employment has declined steadily and dramatically since 1950. In 1950, it was 34 percent; now it is 17 percent.

U.S. Employment and Output in Manufacturing



Analysis. Much faster productivity growth in manufacturing than in the rest of the economy has allowed manufacturing's share of output to remain fairly stable while its share of labor input has fallen markedly. Manufacturing productivity growth has been particularly strong from 1980 growing at a 2.8 percent annual rate.

EYES ONLY

ARTICLE

Is the Stock Market Ripe for a Crash?

Some say that October is the cruelest month for the stock market. The two most spectacular crashes of the stock market this century occurred in October. On October 28 and 29, 1929, the stock market lost 13 and 12 percent of its value; on October 19, 1987, it lost 23 percent. These two salient events, combined with the perception that stock prices are currently too high, have led to speculation in the press about another crash this October.

While a large stock market correction, or even a crash, is always possible, there is no particular reason to expect a large move in stock prices this month—or in any specific month, for that matter.

POTUS discuss?

- In general, changes in the stock market cannot be predicted. If a crash were widely anticipated, it would occur almost immediately as investors tried to dump their stock.
- That the two crashes took place in October is an unhappy coincidence. On average, there is nothing special about stock market performance in October.
- Despite recent talk of a stock market bubble, there are no major signs that the current market rally is driven by speculative excess.

Two pieces of "evidence" have been used to argue that the risk of a crash this October is unusually high.

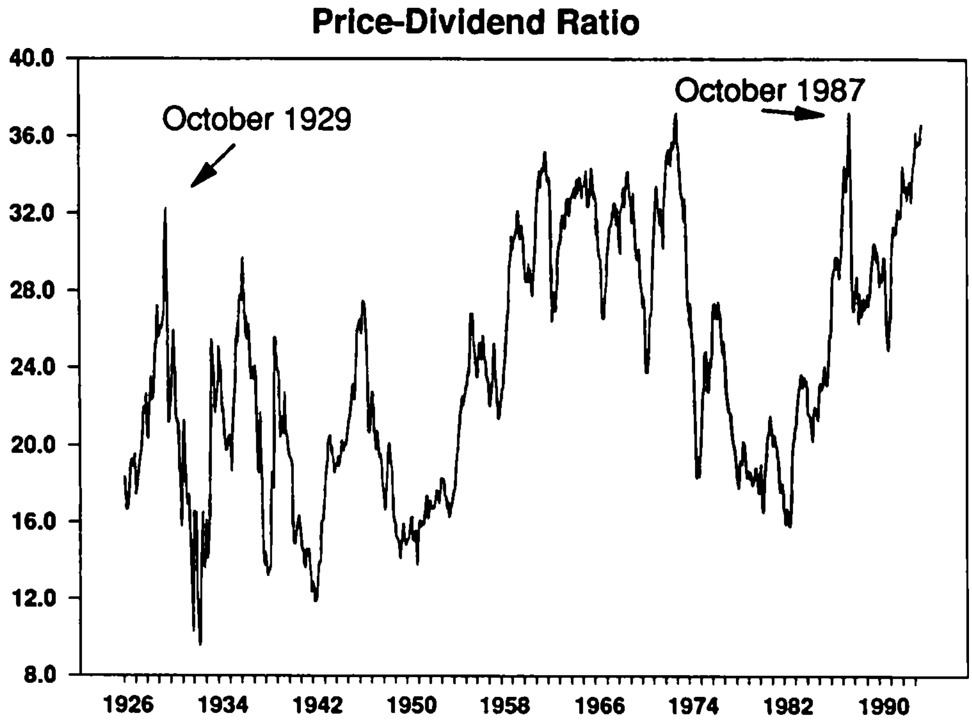
The Price-Dividend Ratio is High. The chart shows the ratio of stock prices to dividends. It does confirm the widespread perception that the stock market is currently high. The two fundamental factors determining the price-dividend ratio are the interest rate and dividend growth.

- Low interest rates are certainly one factor contributing to the current strength of the stock market. Investors seeking higher yields than those offered by bonds and bank deposits are bidding up the price of stocks.
- Dividends have been almost flat since 1990. As the recovery continues to consolidate, they should resume more normal growth.

Hence, the current "high" stock prices are broadly consistent with the fundamentals of low interest rates and sustained economic growth.

The price-dividend ratio is almost as high today as it was prior to the October 1987 crash. But the real interest rate is much lower today than it was then. In

September 1987, the 30-year Treasury bond rate was 9.6 percent and the core inflation rate was about 3.5 percent, implying a 6.1 percent real rate. This September, the long bond rate was 6.0 percent and core inflation was about 3 percent, implying a 3 percent real rate. This decline of about 3 percentage points in the real interest rate makes the current high price-dividend ratio much more consistent with market fundamentals than an equally high ratio in October 1987.



Risk to the Market from Inexperienced Investors? Many investors, accustomed to the high nominal interest rates of the 1980s, are moving funds into the stock market in search of higher yields. Historically, stocks have earned higher returns than bonds, but holding stocks entails greater risk. Some people fear that if stock prices retreat, these less experienced investors might decide to dump their holdings, leading to a crash. Although it is possible that a flight of inexperienced investors from the stock market could increase the size of a stock market movement, this effect is more likely to cause a reversal of recent gains than a crash. Small share holders hold only a small fraction of the market. If they sell irrationally, institutional investors can pick up their stock. Crashes occur when major players in the market lose confidence and try to sell at once.

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

Baby Bell to Acquire Cable TV Giant. Bell Atlantic announced plans to acquire Tele-Communications Inc. (TCI), the Nation's largest operator of cable television systems. The deal is valued at over $20 billion. This proposed merger, which will be reviewed by government regulators, is one of several deals linking phone and cable companies. US West, Southwestern Bell, and Bell South have recently made significant investments in cable operations. As discussed in the Weekly Economic Briefing of October 1, 1993, regulatory and technological developments are undermining the distinction between cable television and local telephone service.

House Banking Committee Holds Hearing on Restructuring the Federal Reserve. The House Banking Committee heard testimony from Fed Chairman Greenspan on several proposals aimed at increasing the accountability of the Federal Reserve. The Committee is considering proposals that would (1) increase oversight of the Fed, (2) change the voting membership of the monetary-policy-setting Federal Open Market Committee, (3) align the term of the Fed chairman more closely with the President's, (4) change how the Federal Reserve district bank presidents are appointed, and (5) provide for earlier release of the FOMC minutes. Chairman Greenspan opposed all of these measures.

On October 19, the Committee will hear testimony from all twelve presidents of the Federal Reserve district banks. An upcoming Weekly Economic Briefing will examine the issue of the Federal Reserve's independence.

Utility Will Convert Vehicles to Natural Gas. Southern California Gas Co. will convert conventional vehicles to burn natural gas. The utility expects to convert 17,000 vans and trucks by 1996 at a cost of $2,500 to $7,500 per vehicle. During the same time period, the company will increase fivefold the number of natural gas refueling stations in Southern California. This expansion of the refueling infrastructure is meant to encourage other fleets to switch to this cleaner-burning fuel.

German Court Clears Way For Maastricht Treaty. The German Federal Constitutional Court ruled that the Maastricht treaty is compatible with the German Constitution, rejecting arguments that the treaty stripped Germany of its basic sovereign rights.

Corn, Soybean Production Down. The October USDA forecast of the U.S. corn crop is 6.96 billion bushels, down 4 percent from the September forecast and about 9 percent below the typical 1980-1992 harvest. Wet weather in the Midwest and drought in the South have led the USDA to revise its soybean production forecast to 1.89 billion bushels, down 1 percent from last month. If the forecast is correct, this year's crop will be about 2 percent below the 1980-1992 average. Because stocks are high, these substandard harvests should have only a small impact on prices.

Drug Industry Consolidation Continues. Two acquisitions in the drug industry were announced this week. Cardinal Distribution purchased Whitmire Distribution for $303 million to create the third largest drug wholesaler in the country. Hoechst Celanese Corporation offered $546 million for a controlling stake of Copley Pharmaceutical, a manufacturer of generic drugs. Drug companies are under increasing pressure from managed-care organizations to cut prices. The acquisitions are part of the industry's ongoing response to these competitive pressures.

U.S. Economic Historians win Nobel Prize. Robert W. Fogel of the University of Chicago and Douglass C. North of Washington University won the 1993 Nobel Memorial Prize in Economic Science. They were honored for "applying economic theory and quantitative methods" to historical issues. Professor Fogel studied the role of railroads in the economic development of the United States. Professor North's research stresses how institutions, especially legal systems, promote economic growth.

EYES ONLY

RELEASES THIS WEEK

Retail Sales

Total retail sales increased 0.1 percent in September; but the increases for both July and August were revised upward to 0.5 percent.

Producer Prices

The producer price index for finished goods rose a modest 0.2 percent in September following declines in the three previous months.

Consumer Prices ** FOR RELEASE 8:30 FRIDAY MORNING **

The consumer price index was unchanged in September.

Industrial Production ** FOR RELEASE 9:15 FRIDAY MORNING **

Industrial production rose 0.2 percent in September. Since September 1992, it has risen 4.6 percent.

Merchandise Trade ** FOR RELEASE 8:30 FRIDAY MORNING **

The merchandise trade deficit was $9.7 billion in August, down from $10.4 million in July.

New Car Sales

Sales of domestically produced cars were 6.8 million units at annual rate during the first 10 days in October, up from an average of 6.6 million units during September.

MAJOR RELEASES NEXT WEEK

Housing Starts (Tuesday)

U.S. ECONOMIC STATISTICS

	1970-1992	1992	1992:4	1993:1	1993:2
Percent growth (annual rate)					
Real GDP	2.5	3.9	5.7	0.8	1.9
GDP deflator	5.8	2.8	3.3	3.6	2.3
Productivity					
Nonfarm business	1.1	3.7	4.1	−1.8	−1.3
Manufacturing (begins 1977)	2.0	5.2	7.0	4.9	5.2
Real compensation per hour	0.6	2.2	1.4	−1.0	−1.5
Shares of Real GDP (percent)					
Business fixed investment	10.9	10.6	10.7	11.1	11.5
Residential investment	4.8	4.0	4.2	4.2	4.0
Exports	7.9	11.6	11.7	11.6	11.6
Imports	9.0	12.3	12.4	12.8	13.1
Shares of Nominal GDP (percent)					
Personal saving	4.9	4.0	4.5	2.8	3.3
Federal surplus	−2.8	−4.6	−4.3	−4.2	−3.5

	1970-1992	1992	July 1993	Aug. 1993	Sept. 1993
Unemployment Rate	6.7	7.4	6.8	6.7	6.7
Payroll employment (thousands)					
increase per month			237	−41	156
increase since Jan. 1993			1103	1062	1218
Inflation (percent per period)					
CPI	6.0	2.9	0.1	0.3	**0.0***
PPI-Finished goods	5.3	1.6	−0.2	−0.6	**0.2**

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* New CPI and PPI releases in boldface. CPI for release 8:30 Friday morning.

EYES ONLY

FINANCIAL STATISTICS

	1992	July 1993	Aug. 1993	Sept. 1993	Oct. 14, 1993
Dow-Jones Industrial Average	3284	3529	3597	3592	3622
Interest Rates					
3-month T-bill	3.43	3.04	3.02	2.95	3.01
10-year T-bond	7.01	5.81	5.68	5.36	5.23
Mortgage rate, 30-year fixed	8.40	7.21	7.11	6.91	6.81
Prime rate	6.25	6.00	6.00	6.00	6.00

INTERNATIONAL STATISTICS

Exchange Rates	**Current level Oct. 14, 1993**	**Percent Change from Week ago**	**Year ago**
Deutschemark-Dollar	1.613	−0.6	+10.4
Yen-Dollar	107.3	+2.2	−11.3
Multilateral (1973=100)	92.49	+0.1	+10.3

International Comparisons	**Real GDP growth (last 4 quarters)**	**Unemployment rate**	**CPI inflation (last 12 months)**
United States	+2.9 (Q2)	6.7 (Sep)	2.7 (Sep)
Canada	+2.4 (Q2)	11.3 (Aug)	1.7 (Aug)
Japan	−0.5 (Q2)	2.6 (Jul)	1.9 (Jul)
France	−1.0 (Q2)	11.3 (Jul)	1.7 (Aug)
Germany	−2.4 (Q2)	6.1 (Aug)	4.2 (Aug)
Italy	−0.9 (Q1)	10.6 (Jul)	4.5 (Aug)
United Kingdom	+2.0 (Q2)	10.5 (Aug)	1.7 (Aug)

f: W.E.B.

EYES ONLY

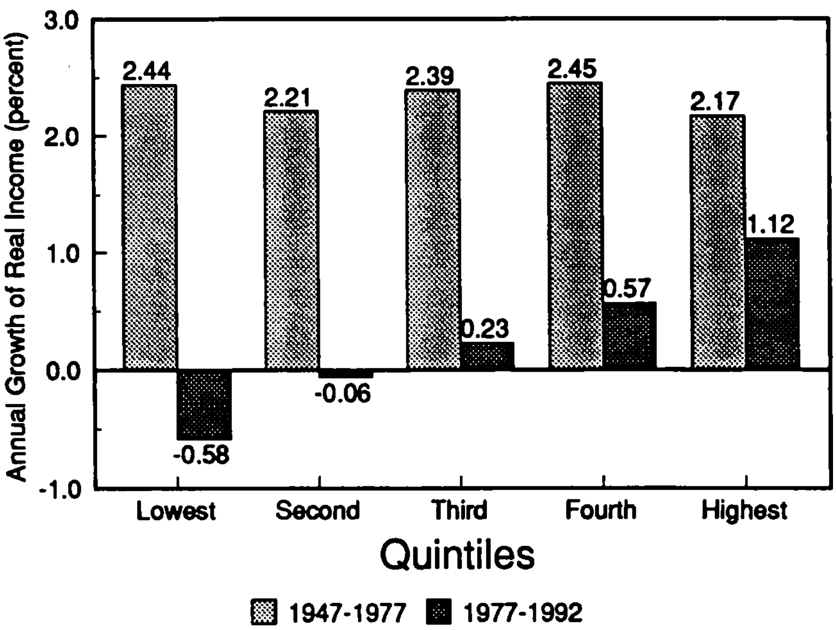
WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

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

October 8, 1993

CHART OF THE WEEK

Widening Income Disparities



For about three decades, real incomes of rich and poor American families grew at roughly equal rates (the light-shaded bars). In the last 15 years, however, this pattern changed dramatically (dark-shaded bars). Real incomes of middle-income families have stagnated while low-income families have experienced real income declines.

EYES ONLY

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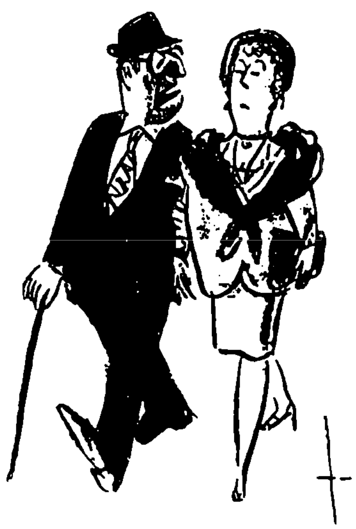


"There is a perfect example of what is wrong with this country today."

"There is a perfect example of what is wrong with this country today."

EYES ONLY

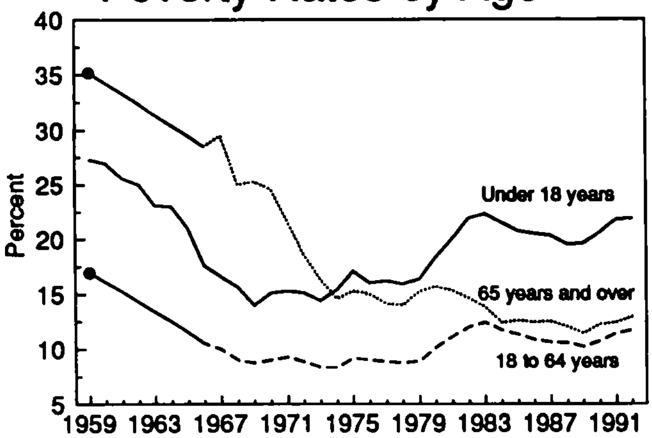
CURRENT DEVELOPMENT

Poverty Rate Increases to 14.5 Percent

During 1992, 14.5 percent of Americans lived in poverty, up from 14.2 percent in 1991. Real median household income fell 0.8 percent. The chart shows how the poverty rate for children has increased substantially since the early 1970s, while the rate for the elderly has fallen since the 1960s. The poverty rate for female-headed families was 34.9 percent in 1992; the rate for black female-headed families was 49.8 percent.

Analysis. The poverty rate both moves with the business cycle and has long-term trends.

Poverty Rates by Age



- During recessions poverty increases. The chart shows small upticks in poverty at or following troughs of the recessions in 1970, 1975, 1982, and 1991. The poverty rate should fall somewhat during the current recovery, but not by enough to reverse the upward shift since the late 1970s.

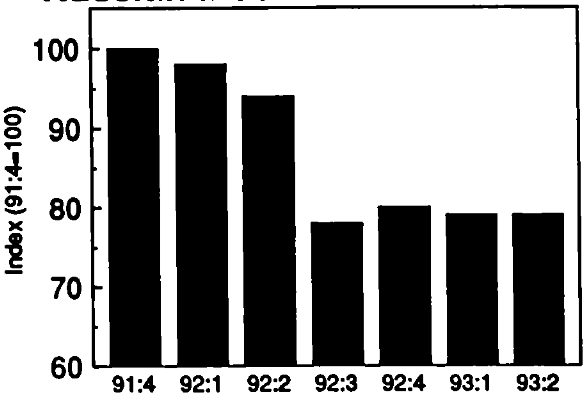
- The decline in wages of the lowest paid workers over the last decade is the largest factor contributing to increased poverty and decreased income of the poor (see "Chart of the Week"). Increased supply and decreased demand for low-skilled workers are the main reasons for the decline of wages of low-income workers.

- The decreased poverty rate for the elderly is accounted for by improving Social Security and Medicare benefits. The increased poverty rate of children arises from both the declining wages of parents and the increase in households headed by single individuals.

CURRENT DEVELOPMENT

Subsidies in Russia Stabilize Output but Cause Inflation

Russian Industrial Production

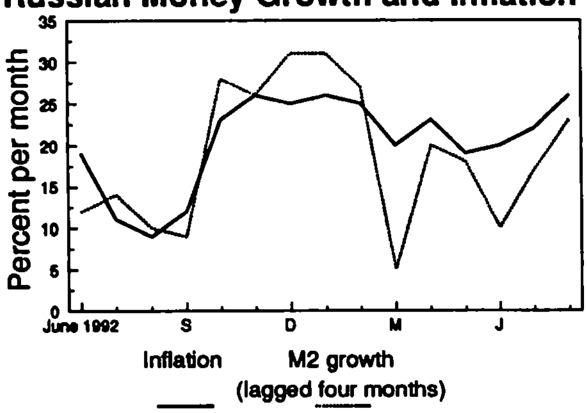


Industrial production in Russia fell 8 percent in 1991 and 19 percent in 1992. Since September 1992, however, output has remained stable. The output decline in Russia has been less dramatic than in many other reforming socialist countries. In Poland, for example, industrial production fell by more than 35 percent in the 2 years following the introduction of reform measures.

At the same time, inflation in Russia is much higher than in most other reforming economies. Since October 1992, prices in Russia have been rising at about 25 percent per month. At a similar point in the reform process, inflation in Poland was well under 5 percent per month.

Analysis. The relatively small decline in production in Russia may reflect the fact that reform has been delayed. Massive subsidies have helped maintain production and employment in the industrial and agricultural sectors, which employ half the Russian workforce. These subsidies, amounting to 26 percent of GDP in 1992, have been financed largely by printing rubles. As the chart shows, using the printing press to finance government spending has led to a high rate of inflation.

Russian Money Growth and Inflation



Restricting the subsidies will be a crucial part of any stabilization process in Russia. Unless Russia undertakes significant reform, it will face a continued tradeoff between maintaining employment and subsidy-driven inflation.

EYES ONLY

TREND

No Trend in Share of Jobs in Small Businesses

Small businesses account for about the same proportion of jobs today as they have over the last 20 years. It is true that small businesses create jobs at a higher rate than large businesses. But small businesses also destroy them at a higher rate. Small firms are more likely to lay off workers or go out of business than large firms.

Share of Employment by Establishment Size

	Workers per Establishment				
	<20	**20-99**	**100-499**	**500-999**	**1000+**
1975	27.1	26.9	22.7	8.1	15.4
1980	26.0	28.3	23.8	7.6	14.3
1985	26.9	29.0	23.9	7.0	13.1
1990	26.1	29.3	24.5	7.0	13.1

Source: Department of Commerce, County Business Patterns.

As the table shows, there have been only small changes in the share of employment in small firms. The smallest and largest firms have had modest employment losses offset by gains within firms of intermediate size.

Analysis. Small firms are a very heterogeneous group. They include mom and pop stores, insurance agencies, and high-tech startups. Today's successful startups will become tomorrow's big firms, but many startups will fail. Policies that address concerns of some small businesses may not be appropriate for others.

Large firms provide, on average, more attractive jobs than small firms. Large firms are much more likely to provide fringe benefits (including health insurance, pensions, and paid vacation) as well as more training. Moreover, the greater volatility of employment in small firms means that these jobs are relatively less secure.

EYES ONLY

ARTICLE

Bush Fiscal Gimmicks Shifted GDP from 1993 to 1992

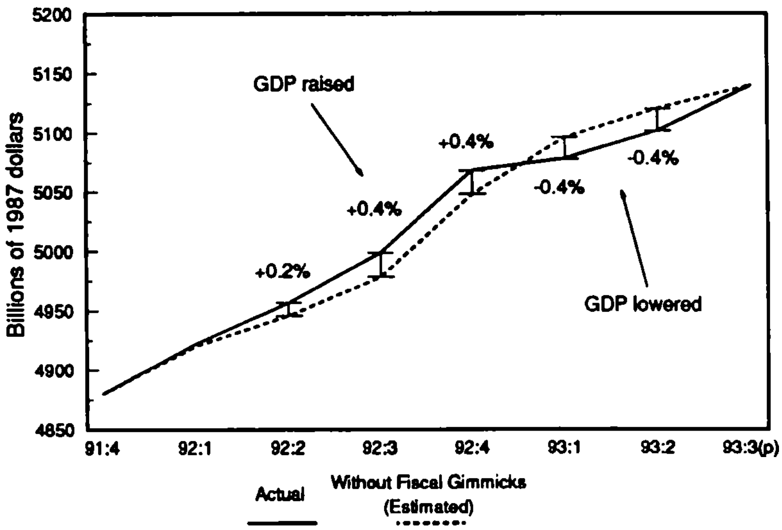
During 1992, President Bush acted to stimulate economic growth. Two fiscal measures gave a short-run boost to the economy in 1992, but led to slower growth in 1993. There were two principal measures:

1) The change in income tax withholding that President Bush announced in his January 1992 State of the Union address.

2) The temporary burst in defense purchases in the second half of 1992.

The CEA estimates that these two measures added 0.2 percent to the level of GDP in the second quarter of 1992 and 0.4 percent in the third and fourth quarters. But as the chart shows, these gains were temporary. The CEA estimates GDP was 0.4 percent lower during the first two quarters of 1993 than it would have been without the fiscal gimmickry.

Real GDP with and without Gimmicks



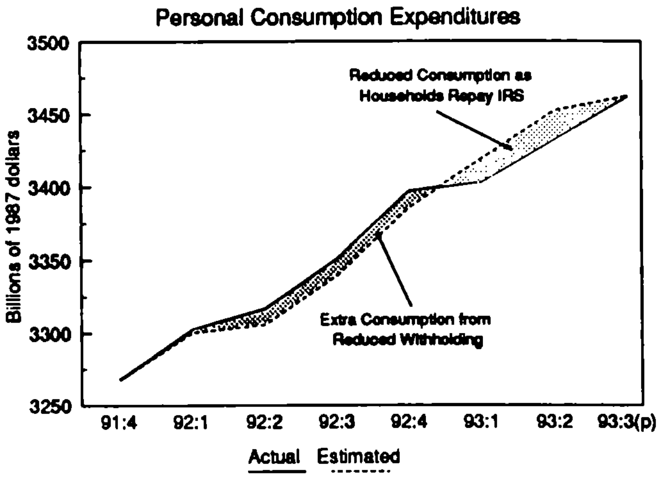
Government has at its disposal powerful tools for affecting the timing of demand and production.

- The Bush Administration intended the two fiscal measures to have only temporary benefits. They borrowed some of 1993's GDP for 1992.

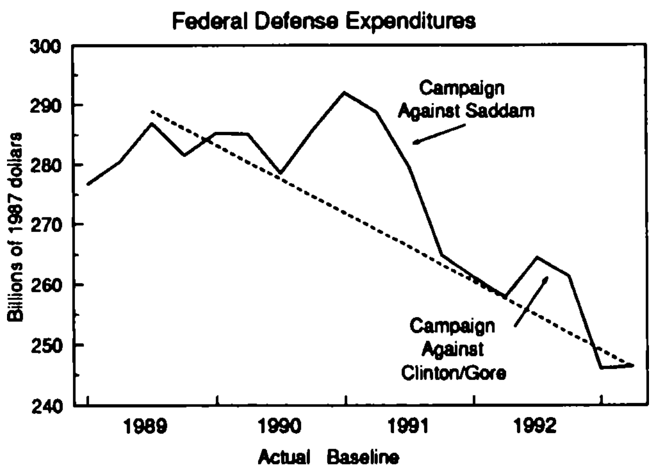
- These measures partly account for the slow growth in the first two quarters of 1993.

Details of the timing of these fiscal measures are given on the next page.

Withholding tax change. The change in the withholding tax gave most wage earners an extra $25 a month in take-home pay beginning in March 1992. In April 1993, these people therefore owed the IRS an extra $250. Many households simply let the extra pay accumulate in their bank accounts and used this accumulation to make the extra $250 payment to the IRS in April. But other households—estimated to be about 40 percent—spent the extra cash. They then had to reduce spending when they settled with the IRS. This led to the shifting of consumption from 1993 to 1992 shown in the chart.



Defense spending. During the second half of 1992, defense spending increased well above the post-Cold-War trend. This burst in spending does not reflect President Bush's much-criticized authorization of exports of future production of F-15s, F-16s, and M-1A2s. Rather, the increases were mainly in the miscellaneous "other services" category, where executive discretion could increase purchases quickly.



Are 1993 Tax Liabilities a Threat to 1994 Growth? High-income households will have large tax liabilities in April 1994 due to the retroactive increase in income tax rates in 1993. There is reason to expect, however, that these extra payments by high-income individuals to the IRS in 1994 will have a smaller effect on GDP than the extra payments to the IRS in 1993 made by taxpayers affected by the 1992 change in withholding. High-income taxpayers are more likely to make the payments out of savings. Moreover, under provisions of OBRA, they can spread the payments over 3 years. And many high-income taxpayers acted to minimize their added tax liability by shifting income from 1993 to December 1992.

EYES ONLY

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

Trade Liberalization Increases World Income. A joint World Bank-OECD study released last week finds that a successful conclusion of the Uruguay Round multilateral trade reforms would yield $190 billion per year in increased income in the world economy by the year 2002 (in 1992 dollars). All regions gain, but the developed countries gain the most. The study finds that trade liberalization would increase real income in the United States by 0.7 percent in 2002. These estimates represent a lower bound, since the model includes only the gains from reductions in manufacturing and agricultural tariffs. It does not incorporate reductions in trade barriers in services, which would greatly benefit the United States.

Alabama To Get Mercedes-Benz Plant. Tuscaloosa won the bidding for the first Mercedes assembly plant in the United States. To attract the project the State and several local governments agreed to a tax break package valued at more than the $300 million cost of the plant. The plant will employ 1,200 workers, but local officials claim it will generate another 10,000-13,000 jobs in the State.

Two Largest Hospital Firms Plan Merger. Columbia Healthcare Corporation announced it will acquire HCA-Hospital Corporation. Columbia has 94 acute-care and specialty hospitals and HCA has 96 hospitals. The merged firm will operate in 26 States and plans to add not-for-profit hospitals, outpatient surgery centers, and home health-care networks within local markets. The two firms project that they will save $130 million annually through combined purchasing and centralized management within markets.

EC Wants Movie Protection. EC Trade Commissioner Leon Brittan argued at a recent meeting of EC foreign ministers that the EC film industry should be protected by a "cultural specificity" clause. The Europeans claim that subsidies are necessary to allow them to compete against big-budget Hollywood productions tailored for the huge U.S. market. The French believe that only a total GATT exemption will ensure sufficient European-produced programs on EC television stations.

Highway Accidents and Homicides Are Leading Causes of Workplace Fatalities. The Labor Department's first national Census of Fatal Occupational Injuries found that vehicle accidents accounted for 18 percent of deaths in 1992; homicides accounted for 17 percent of deaths. Women accounted for only 7 percent of on-the-job deaths, but 40 percent of those deaths were homicides.

Supreme Court Agrees to Review Retroactive Tax Change. The Supreme Court will review the ruling of the U.S. Court of Appeals for the 9th Circuit that the Federal estate tax changes enacted in December 1987, but retroactive to October 1986, are unconstitutional. Since the 1930s, the courts have rejected all constitutional challenges to retroactive tax provisions.

Telephone Competition from Wireless Phone Now Possible. Motorola is backing a small Illinois company that has patented equipment that allows regular phone users to bypass the local phone company through a wireless network. The cost of cellular phone service must still fall sharply before the technology will be widely used, but it is already being installed as a backup system at hospitals and businesses.

EYES ONLY

RELEASES THIS WEEK

Employment **FOR RELEASE FRIDAY, 8:30 a.m.**

The unemployment rate in September was 6.7 percent, unchanged from August.

Automobile Sales

Sales of domestically produced automobiles were 6.6 million units at annual rate during the third quarter, down from 6.9 million in the second quarter.

MAJOR RELEASES NEXT WEEK

Retail Sales (Thursday)

Producer Prices (Thursday)

Consumer Prices (Friday)

Industrial Production (Friday)

Merchandise Trade (Friday)

EYES ONLY

U.S. ECONOMIC STATISTICS

	1970-1992	1992	1992:4	1993:1	1993:2
Percent growth (annual rate)					
Real GDP	2.5	3.9	5.7	0.8	1.9
GDP deflator	5.8	2.8	3.3	3.6	2.3
Productivity					
Nonfarm business	1.1	3.7	4.1	−1.8	−1.3
Manufacturing (begins 1977)	2.0	5.2	7.0	4.9	5.2
Real compensation per hour	0.6	2.2	1.4	−1.0	−1.5
Shares of GDP (percent)					
Personal saving	4.9	4.0	4.5	2.8	3.3
Business fixed investment	10.9	10.6	10.7	11.1	11.5
Residential investment	4.8	4.0	4.2	4.2	4.0
Exports	7.9	11.6	11.7	11.6	11.6
Imports	9.0	12.3	12.4	12.8	13.1
Federal surplus	−2.8	−4.6	−4.3	−4.2	−3.5

	1970-1992	1992	July 1993	Aug. 1993	Sept. 1993
Unemployment Rate	6.7	7.4	6.8	6.7	**6.7***
Payroll employment (thousands)					
increase per month			**237**	**−41**	**156***
increase since Jan. 1993			**1103**	**1062**	**1218**
Inflation (percent per period)					
CPI	6.0	2.9	0.1	0.3	--
PPI-Finished goods	5.3	1.6	−0.2	−0.6	--

***Unemployment and employment for release FRIDAY 8:30 a.m.**

EYES ONLY

FINANCIAL STATISTICS

	1992	July 1993	Aug. 1993	Sept. 1993	Oct. 7, 1993
Dow-Jones Industrial Average	3284	3529	3597	3592	3584
Interest Rates					
3-month T-bill	3.43	3.04	3.02	2.95	2.98
10-year T-bond	7.01	5.81	5.68	5.36	5.33
Mortgage rate, 30-year fixed	8.40	7.21	7.11	6.91	6.87
Prime rate	6.25	6.00	6.00	6.00	6.00

INTERNATIONAL STATISTICS

Exchange Rates	**Current level Oct. 7, 1993**	**Percent Change from Week ago**	**Percent Change from Year ago**
Deutschemark-Dollar	1.622	−0.7	+12.1
Yen-Dollar	105.0	−1.1	−12.7
Multilateral (1973=100)	92.38	−0.6	+10.8

International Comparisons	**Real GDP growth (last 4 quarters)**	**Unemployment rate**	**CPI inflation (last 12 months)**
United States	+2.9 (Q2)	6.7 (Sep)	2.8 (Aug)
Canada	+2.4 (Q2)	11.6 (Jul)	1.7 (Aug)
Japan	−0.5 (Q2)	2.6 (Jul)	1.9 (Jul)
France	−1.0 (Q2)	11.2 (Jun)	1.7 (Aug)
Germany	−2.4 (Q2)	6.0 (Jul)	4.2 (Aug)
Italy	−0.9 (Q1)	10.8 (Apr)	4.5 (Aug)
United Kingdom	+2.0 (Q2)	10.4 (Jun)	1.7 (Aug)

EYES ONLY

P: WEB

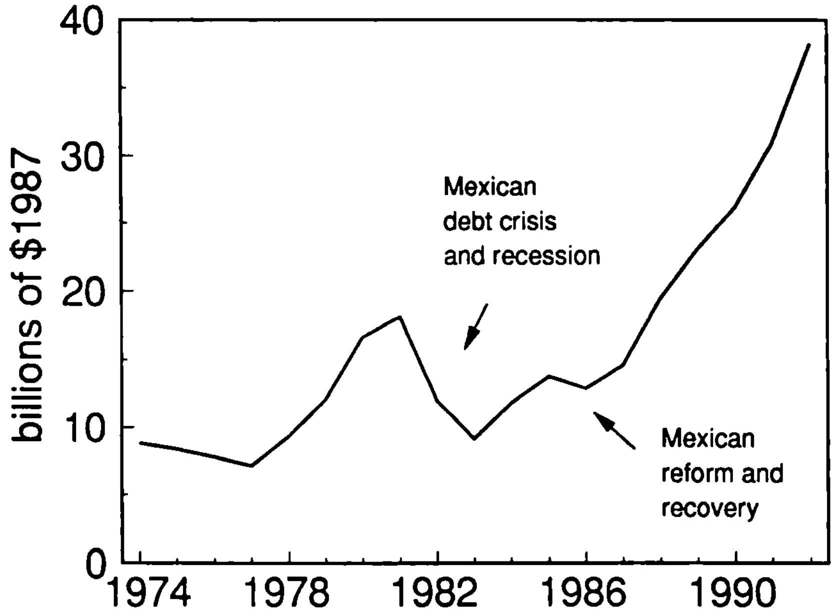
WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

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

October 1, 1993

CHART OF THE WEEK

U.S. Merchandise Exports to Mexico



The decline in U.S. exports to Mexico in the early 1980s was caused by the recession and debt crisis in Mexico. Beginning in 1986, Mexico underwent substantial reforms. It joined the GATT, devalued and stabilized its currency, and unilaterally reduced tariffs and nontariff barriers. The reforms, together with recovery from recession, led to significant increases in Mexico's demand for U.S. goods. Mexico's share of total U.S. exports rose from 4.8 percent in 1974 to 9.0 percent in 1992.

EYES ONLY

CONTENTS

CURRENT DEVELOPMENTS

ARTICLE

DEPARTMENTS

"Won't all these new rules impact adversely on the viability of small businesses with fewer than fifty employees?"

EYES ONLY

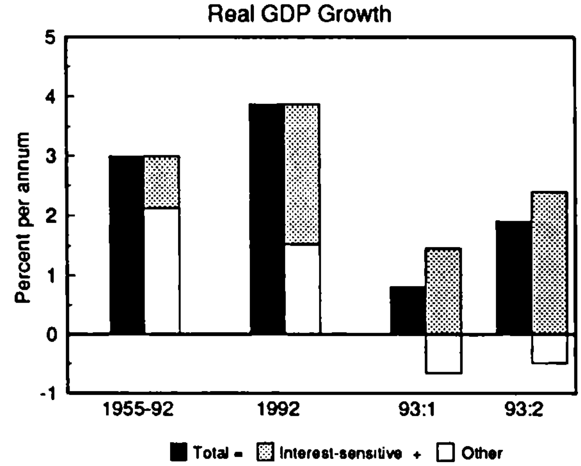
CURRENT DEVELOPMENT

Interest-Sensitive Components Lead GDP Growth

Business fixed investment, housing, and consumer durables—the three most interest-sensitive components of GDP—accounted for more than 100 percent of real growth in the first half of 1993. During the first two quarters of 1993, they grew at an annual rate of 7.8 percent, while the other components of GDP—largely the rest of consumption and government—fell at a rate of 0.7 percent. In 1992, these interest-sensitive components grew 9.9 percent, while the others grew 2.1 percent.

The chart shows growth in GDP and the contributions to growth of the interest-sensitive and other components. The interest-sensitive components account for about 30 percent of GDP growth on average (see bars for 1955-1992). During recoveries, interest-sensitive components typically contribute about one-half of GDP growth. In the current recovery, they have been even more important than usual, contributing almost two-thirds of growth.

Real GDP Growth



Analysis. Low interest rates and the strengthening of the financial system have played a major role in sustaining the recovery. Without the extra boost from interest-sensitive components, growth in the first half of 1993 would have been even more disappointing.

EYES ONLY

CURRENT DEVELOPMENT

IMF Cuts Growth Forecasts, Urges Action

The IMF reduced its forecast of industrial country growth for 1993 and 1994. Managing Director Camdessus characterized growth as "anemic at best" and called for interest rate cuts to spur growth in Europe. He described unemployment levels as "intolerable." This urging of economic stimulus is in sharp contrast to the IMF's usual calls for restraint.

GDP Growth Rates

	1992	1993	1994
Industrial Countries	1.7	1.1	2.2
United States	2.6	2.7	2.6
Japan	1.3	-0.1	2.0
European Community	1.1	-0.2	1.6
Canada	0.7	2.6	3.8
Developing Countries	5.8	6.1	5.5
Asia	7.8	8.7	7.1
Western Hemisphere	2.5	3.4	3.5

Note: Growth rates are calendar year over calendar year. 1992 are actual. 1993 and 1994 are IMF projections.

The depth of the slowdown in the world economy has proven difficult to forecast. Just a year ago, the IMF predicted industrial country growth of 2.8 percent in 1993. Currently, they are forecasting growth of only 1.1 percent in 1993. Diminished prospects in Japan and, to a lesser extent, in Europe largely explain the revisions.

The IMF forecast of U.S. growth was also revised downward, but barely differs from the Administration forecast of 2.4 percent in 1993 and 3.0 percent in 1994. Over the last 12 months, the United States has grown more rapidly than all other major, industrialized economies (see International Statistics on page 10).

Developing countries in Asia and Latin America remain the bright spots in the world economy.

EYES ONLY

CURRENT DEVELOPMENT

New York Schools Reopening After Asbestos Crisis

Most of New York City's public schools reopened after an 11-day delay. Mayor Dinkins, after discovering previous asbestos inspections were faulty, ordered reinspection of all schools before classes could begin.

Prolonged exposure to concentrations of asbestos fibers in the air can be hazardous. But in schools most asbestos is sealed in walls. Recent water leaks and crumbling walls—a legacy of budget cuts in the 1970s—raised concern. Still, the estimated risk from asbestos in schools is only slightly higher than the same risk for outdoor exposure. Furthermore, students left out of school face other risks including staggeringly high homicide rates and the lost value of the education.

Analysis. New York City's sensitivity to the public perception of the hazards of asbestos demonstrates the complexity of policymaking where health and safety are concerned. Governments do not always have the flexibility to weigh relative risks, but where possible they should take them into account when allocating scarce resources.

Selected Lifetime Fatality Risks

Hazard		Deaths per million
Person on ground struck by crashing airplane		4
Asbestos outdoors:	Average exposure	4
	High exposure	40
Asbestos in schools:	Average exposure	6
	High exposure	60
Pedestrian struck by motor vehicle		2,000
Homicide, inner-city males, ages 15-24		10,000

EYES ONLY

ARTICLE

Regulatory, Technological Developments Reshape Telephone and Cable Television Markets

Developments in the regulation of local telephone service and cable television create the prospect of competition in both markets. Wireless communications, the technology of the future, is another source of potential competition.

- o Phone companies will be allowed to carry cable television signals.

    -- In late August, a Federal district court allowed local telephone companies to own cable television programming. If upheld on appeal, this decision will remove the final regulatory impediment limiting the ability of local telephone companies to offer cable television services over phone lines.

    -- Last year, the Federal Communications Commission (FCC) permitted all local phone companies to provide a "video dial tone" allowing them to offer television service.

    -- In 1991, the Federal district court supervising the AT&T breakup permitted the "Baby Bell" companies to own and provide cable television to the extent allowed by other regulators.

- o Conversely, cable companies will be allowed to carry voice communications.

    -- Some state regulators recently authorized cable television firms to provide local telephone service.

- o Wireless technologies might supplant both telephone and cable wiring.

    -- Last week, the FCC announced rules for auctioning a part of the radio spectrum recently reallocated legislatively to providers of personal communications services (PCS). PCS will initially operate much like cellular telephone, but over time may become capable of sending video as well.

Technological and Regulatory Background. Similar technologies, involving lines connected to computerized central office switches, provide cable television and local telephone services. Almost all households have telephones, and most already have cable or could readily be connected.

Traditionally, economists have believed that the local provision of these services is a "natural monopoly"—meaning that only one firm would survive in a competitive market. For this reason, State price regulation rather than competition has long been relied upon to protect consumers from high telephone prices. In keeping with this tradition, local governments will be allowed to regulate some cable rates beginning next week. When cable television was developed, regulators chose to prohibit telephone companies from offering the new service, in part because cable could not be carried over the existing telephone wires.

Although the consequences of competition between local telephone and cable television providers are uncertain, the three most likely possibilities are:

- **Competition**. Fierce competition for the natural monopoly may lead firms to charge very low prices at first. Then the eventual exit of either the phone company or the cable company would reestablish monopoly in a local market. Throughout the country, cable television companies and local telephone companies appear to be positioning themselves for such competition, with phone companies upgrading to fiber optic lines and cable firms considering investment in more sophisticated central office switches.

- **Coexistence**. Regulators may prevent cable and telephone companies from offering new customers prices below those they charge existing customers, out of a concern for fairness to consumers. If so, the firms may be deterred from aggressive efforts to take business from their rivals. They may coexist while charging high prices, competing instead on service.

- **A Wireless Future?** If local telephone and cable services can be provided inexpensively through the radio spectrum rather than wire, the existing natural monopoly would be undermined. Competition that includes wireless providers would keep prices low by allowing many firms to serve each market. Wireless competition for local telephone service has been facilitated by the growth of cellular telephones, the recent allocation of radio spectrum to personal communications services, and digital signal compression. However, wireless competition for cable may be decades away.

EYES ONLY

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

California's Job Losses Concentrated in Southern California. Payroll employment continues to fall throughout California, even as it has been increasing in most of the rest of the country. Most of the job losses in California are concentrated in the greater Los Angeles area. Four greater Los Angeles area Metropolitan Statistical Areas (MSAs)—Los Angeles/Long Beach, Riverside/San Bernadino, Ventura/Oxnard, and Anaheim/Santa Ana—collectively suffered a loss of about 1 percent of all nonfarm jobs from the end of 1992 until July 1993. In contrast, the other 12 MSAs in the state (for which establishment data are available and which together have roughly the same total employment as the greater Los Angeles area) collectively lost only 0.2 percent of nonfarm jobs over the same period. That is, the greater Los Angeles area has been losing jobs at about 5 times the rate of the rest of the state since the end of last year.

Corporate Downsizing to Continue. An American Management Association poll of 870 employers shows that 22 percent plan to reduce employment during the year ending in June 1994. Last year, 25 percent of the respondents expected to reduce employment, with 66 percent anticipating an economic downturn, in contrast to 40 percent this year. According to the new poll, 37 percent of large firms (over 10,000 employees), but only 15 percent of small firms (fewer than 100 employees) expect to reduce employment.

Business Confidence Weakens. The Conference Board's measure of business confidence—based on a survey of U.S. corporate executives—fell 7 points to 50 in the third quarter. The index is thus now showing an even balance between positive and negative responses and is at its lowest level in 2-1/2 years. Manufacturers are generally less optimistic, but firms in finance, insurance, and the trades are more optimistic than last quarter. Nearly 30 percent of the surveyed firms revised their capital budgets downward in the third quarter, in contrast to 22 percent last year.

Surveys by A.T. Kearney Inc. (82 CFOs) and Cahners Economics (400 executives) are consistent with The Conference Board data, but somewhat less pessimistic. The Kearney Survey reported expected fourth quarter operating profit growth of 13 percent from a year earlier, with sales growth of only 4 percent. The Purchasing Managers Survey (about 300 firms), however, reported essentially no change in business conditions for September. These surveys provide useful information for gauging the mood of business, but economists are skeptical of their predictive value.

EYES ONLY

Young Adults More Pessimistic. Only 21 percent of 18- to 29-year olds believe they have a "very good" chance of achieving the "good life" in contrast to 41 percent in 1978, according to a Roper Organization report. The report states that the 20 percentage point drop is "a huge shift in 15 years." Seventeen percent believe their chances for the good life are "not very good" or "not good at all," roughly double the level of any previous survey.

Japan To Import Rice. Japan will import 200,000 tons of rice to meet shortfalls in domestic production caused by severe weather conditions. The imports will come primarily from the United States, Thailand, and Australia. Japanese officials expect this year's rice crop will be only 80 percent of normal production and reserves have been depleted by past weak harvests. The Minister of Agriculture, Eijiro Hata, noted that the combination of excessive rainfall, low temperatures, and lack of sunshine resulted in a once-in-100 years emergency. Nonetheless, Hata said the government was considering easing restrictions on the amount of land used for rice production. The Japanese government has maintained self-sufficiency in rice by creating a rice marketing monopoly that has held prices at 5 to 6 times the world level for comparable quality rice.

Japanese Banks Lower Prime Rate. In response to last week's discount rate cut, a number of Japanese banks, including all three long-term credit banks, have cut their prime lending rates. The cuts are the third in 3 weeks and bring the prime rate to 4.5 percent, a record low.

Washington State Timber Revenue Up, Volume Down. The value of timber sold by the State of Washington for the year ending June 30 was the third largest ever, even though sales by volume were less than 60 percent of the 1979 peak. Timber prices rose rapidly throughout 1992 and early 1993, but have fallen 10 percent since their peak in May.

EYES ONLY

RELEASES THIS WEEK

GDP

Real GDP growth in the second quarter was revised up from an annual rate of 1.8 percent to 1.9 percent.

Personal Income

Personal income rose 1.3 percent in August. The July level was depressed by crop and flood damage. Absent these special factors, the growth in August was 0.7 percent.

Leading Indicators **FOR RELEASE FRIDAY, 8:30 a.m.**

The index of leading indicators rose 1.0 in August. For the first time since December 1986, there were increases in 10 of the 11 components of the index.

MAJOR RELEASES NEXT WEEK

Blue Chip Forecast (Thursday)

Employment (Friday)

EYES ONLY

U.S. ECONOMIC STATISTICS

	1970–1992	1992	1992:4	1993:1	1993:2
Percent growth (annual rate)					
Real GDP	2.5	3.9	5.7	0.8	**1.9***
GDP deflator	5.8	2.8	3.3	3.6	**2.3**
Productivity					
Nonfarm business	1.1	3.7	4.1	−1.8	−1.3
Manufacturing (begins 1977)	2.0	5.2	7.0	4.9	5.2
Real compensation per hour	0.6	2.2	1.4	−1.0	−1.5
Shares of GDP (percent)					
Personal saving	4.9	4.0	4.5	2.8	**3.3**
Business fixed investment	10.9	10.6	10.7	11.1	**11.5**
Residential investment	4.8	4.0	4.2	4.2	**4.0**
Exports	7.9	11.6	11.7	11.6	**11.6**
Imports	9.0	12.3	12.4	12.8	**13.1**
Federal surplus	−2.8	−4.6	−4.3	−4.2	**−3.5**

	1970–1992	1992	June 1993	July 1993	Aug. 1993
Unemployment Rate	6.7	7.4	7.0	6.8	6.7
Payroll employment (thousands)					
increase per month			43	211	−39
increase since Jan. 1993			866	1077	1038
Inflation (percent per period)					
CPI	6.0	2.9	0.0	0.1	0.3
PPI-Finished goods	5.3	1.6	−0.3	−0.2	−0.6

*Data revised this week in **bold**.

EYES ONLY

FINANCIAL STATISTICS

	1992	July 1993	Aug. 1993	Sept. 1993	Sept. 30, 1993
Dow-Jones Industrial Average	3284	3529	3597	3592	3555
Interest Rates					
3-month T-bill	3.43	3.04	3.02	2.95	2.92
10-year T-bond	7.01	5.81	5.68	5.36	5.40
Mortgage rate, 30-year fixed	8.40	7.21	7.11	6.91	6.89
Prime rate	6.25	6.00	6.00	6.00	6.00

INTERNATIONAL STATISTICS

Exchange Rates	**Current level Sept. 30, 1993**	**Percent Change from Week ago**	**Percent Change from Year ago**
Deutschemark-Dollar	1.633	−0.6	+15.2
Yen-Dollar	106.1	+0.1	−11.6
Multilateral (1973=100)	92.91	0.0	+13.9

International Comparisons	**Real GDP growth (last 4 quarters)**	**Unemployment rate**	**CPI inflation (last 12 months)**
United States	+2.9 (Q2)	6.7 (Aug)	2.8 (Aug)
Canada	+2.4 (Q2)	11.6 (Jul)	1.7 (Aug)
Japan	−0.5 (Q2)	2.6 (Jul)	1.9 (Jul)
France	−1.0 (Q2)	11.2 (Jun)	1.7 (Aug)
Germany	−2.4 (Q2)	6.0 (Jul)	4.2 (Aug)
Italy	−0.9 (Q1)	10.8 (Apr)	4.5 (Aug)
United Kingdom	+2.0 (Q2)	10.4 (Jun)	1.7 (Aug)

BR/Bo/GS/SM

EYES ONLY

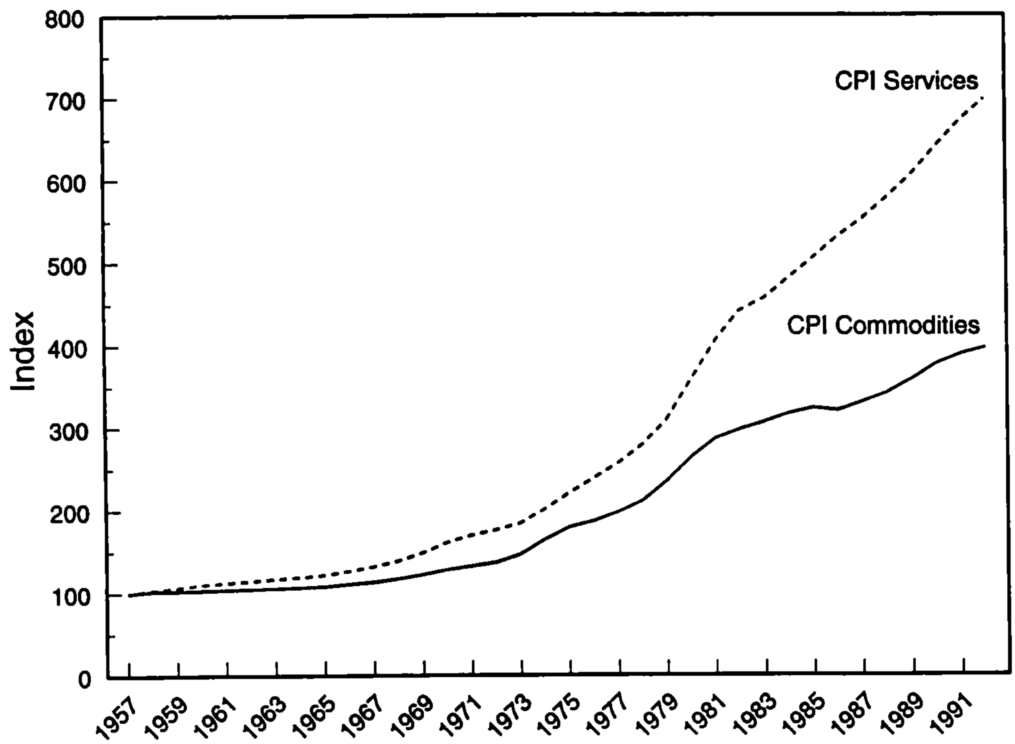
WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

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

November 19, 1993

CHART OF THE WEEK

Service and Commodity Prices



Prices consumers pay for services have risen about 1.7 percentage points faster per year than the prices they pay for commodities. More rapid technological change in production of commodities explains the difference. For many services—education, musical performance, babysitting—output per unit of labor input is essentially fixed; consequently, over time services become more expensive relative to goods, which can be produced with less and less labor each year. Yet, service inflation may be overstated because of unmeasured changes in quality.

EYES ONLY

CONTENTS

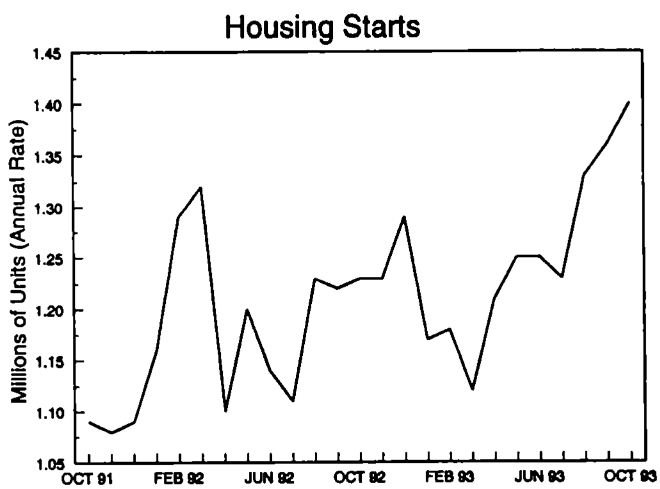
"My father had a saying: 'If you sell a man a fish, you'll make a good living; if you teach a man to fish, you're stupid.' "

EYES ONLY

CURRENT DEVELOPMENT

Recovery of Housing Now Underway

The recovery of residential construction is now well underway. Housing starts were up sharply the last 3 months. Single-family starts are now at their highest level since September 1987. Construction permits are also rising strongly, signaling future strength in starts.



Housing starts stalled between 1.1 and 1.3 million units until the last 3 months, while spending in other interest-sensitive sectors—consumer durables and capital equipment—grew strongly.

Analysis. All investment, but especially housing, responds to interest rates with a lag. It takes time to plan construction, acquire sites, arrange contracts, and so on. The lag in the response of housing has, however, been longer in the current recovery than usual. Based on the movements in interest rates alone, housing starts should have picked up in late 1992 and again in the summer of 1993. But other factors, notably the uncertainty about incomes and employment because of the stop-go pattern of the current recovery, probably worked against the positive impetus to housing given by interest rates.

Other Construction Sectors Remain Weak

Multifamily housing starts are still low and are unlikely to recover to their high levels of the 1980s. Construction of commercial buildings is also weak. The overbuilding of office buildings in the 1980s leaves vacancy rates high, although they are beginning to fall in some markets, such as Denver and Phoenix.

EYES ONLY

CURRENT DEVELOPMENT

Do Mortgage Lending Disparities Prove Discrimination?

Earlier this month, Federal Reserve Governor Lindsey, reported new data on mortgage loan denial rates showing continued disparities among various population groups. For example, 36 percent of black applicants were denied conventional mortgage loans, compared with only 16 percent of white applicants.

Many people cite such disparities in denial rates as evidence of lender discrimination. Although discrimination appears to be part of the problem, the raw data on mortgage denial rates confound discrimination with other factors, such as racial differences in income, credit history, or assets that could account for different denial rates.

Superior methods of measuring discrimination:

- Statistical studies can control for creditworthiness of those who apply for loans. A 1992 Federal Reserve Bank of Boston study, for example, suggests that minorities are much less likely to get loans even after accounting for measures of creditworthiness.
- Studies that compare pairs of applicants, matched in every way but race, can also be used to test for discrimination. Such studies show solid evidence of discrimination in housing and employment. HUD and the Comptroller of the Currency are currently developing similar programs to test for pre-application discrimination in mortgage lending.

Analysis. Despite the difficulty in interpreting mortgage denial rates, some agencies are considering their use as a preliminary measure of discrimination. This approach has a danger: It could discourage lenders from courting the minority community, since doing so might generate higher denial rates than for lenders who discourage such applications. Ironically, those lenders most active in encouraging minority loan applications might be most open to the charge of discrimination in their lending practices. The alternate methods discussed above can provide more reliable evidence of lender discrimination without discouraging lender outreach.

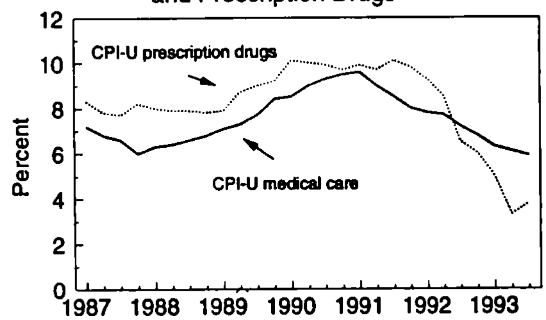
EYES ONLY

TREND

Health Care Inflation Slowing, but Measurement Imperfect

Health care price increases, as measured by the consumer price index (CPI), have slowed over the past several years, especially for prescription drugs. In the third quarter of this year, prescription drug prices were up less than 4 percent from their level a year ago, well below the 8 to 10 percent rate characteristic of much of the past decade. Overall, health care inflation was at about a 6 percent annual rate in the past three quarters, compared to 8 percent over the past decade.

Growth in Consumer Price Indexes: Medical Care and Prescription Drugs



Note: Percent change from same quarter of the previous year.

The CPI for health is not a comprehensive indicator of trends in health care prices. The CPI measures only the prices of out-of-pocket expenditures by consumers. Employer-paid insurance and insurance-paid health costs are not included.

In addition to its limited coverage, the CPI tends to overstate medical price increases for several reasons: it fails to adjust for improvements in the quality of goods and services; it frequently relies on list prices, which ignore the large and growing discounts many purchasers receive; and the weights of the various components do not accurately reflect current expenditure patterns. The index overweights items rapidly growing in price, and underweights items such as hospital care, the prices of which are growing more slowly.

Analysis. The flaws in the CPI for medical care are a consequence of not investing enough in information. New efforts to improve our measurement of new and evolving sectors of the economy, especially relating to health and other services and the environment, are needed.

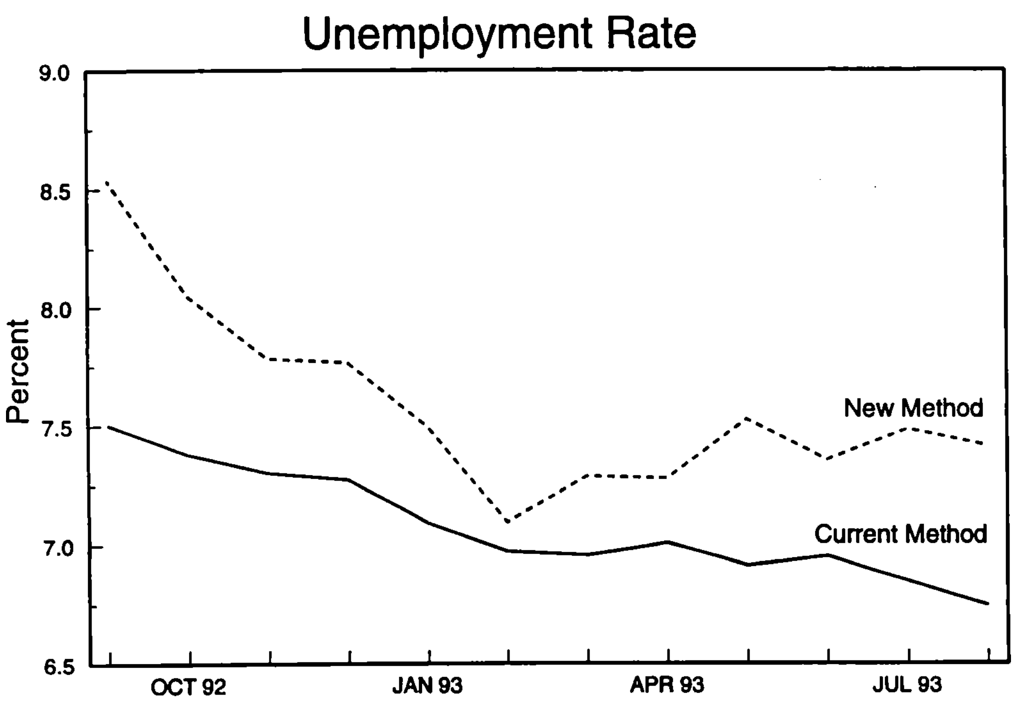
EYES ONLY

ARTICLE

Reported Unemployment Rate Will Be Higher With New Survey

Beginning in January 1994, BLS will base the unemployment and household employment statistics on a redesigned survey and new methods for taking the survey. The unemployment rate is likely to be about 0.5 percentage point higher based on this new survey. The first release of the new unemployment rate will be on February 4.

Since mid-1992, the Census Bureau has been carrying out a survey based on the new methodology. The chart shows the monthly unemployment rates from September 1992 to August 1993 based on the two methods. Throughout 1994, the BLS will provide two estimates of unemployment, one based on the new methodology and one based on the old.



Seasonally adjusted using current seasonal factors.

The average difference between the two measures is 0.5 percentage point, but the new series is much more volatile than the old one. The differences between the two series range from 0.1 percentage point to 1.0 percentage point.

- Beginning in January, the new method will be based on a much larger sample of households, leading to a more precise and less volatile estimate.

- It will take time for the interviewers to get accustomed to the new survey. Its precision should improve over time, but there will still be some statistical "noise" in the new method even after it becomes official in 1994.

- Until there are several years of data, the series based on the new method will have to be adjusted using the seasonal pattern of the old series. If the seasonal patterns are different, this procedure could fail to adjust correctly for seasonal variation in the new series.

Why will measured unemployment increase?

- Removing a sex bias is the biggest factor raising the measured unemployment rate in the new survey.

  -- In the current survey, the interviewer asks—depending on what the interviewer thinks is most appropriate—whether the individual was "working," "keeping house," "going to school," or doing "something else" during the last week. The "keeping house" option, which excludes looking for work, is disproportionately applied to women. Therefore, there is a bias toward classifying women as out of the labor force and therefore not looking for a job. In the new survey, all individuals are asked the same questions regardless of their sex.

- The new survey has a more probing question about "looking for work" that should result in more individuals being categorized as unemployed.

Analysis. Despite the advantages of having data series that are consistent across time, the new methodology will give a more accurate picture of employment and unemployment. It will remove biases based on sex. It will also provide better information on multiple job holding, part-time work, and job changes. The Administration will have an educational job in explaining to people that the higher numbers in the new survey do not mean that unemployment has risen but rather that it is being more accurately measured.

Computer-Assisted Interviewing

The new survey will be implemented using automated data collection (mainly laptop computers). Computer-assisted interviewing virtually eliminates the possibility of questions being skipped or asked in error. It also helps to reduce subtle biases that affect results when interviewers pose questions differently to different respondents.

EYES ONLY

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

Bank Mutual Fund Sales Prompt Concerns Over Adequate Disclosure. Nearly one out of four U.S. banks provides brokerage services, with mutual fund sales accounting for over one-third of this business. Mutual funds sold by banks account for about 12 percent of all mutual fund assets. This activity has raised concern that some consumers may believe mutual funds sold by banks are federally insured. Indeed, an SEC survey of 1,000 households has shown that 28 percent incorrectly believe this. Earlier this year, the Office of the Comptroller of the Currency (OCC) issued guidelines stressing the importance of customer disclosure by banks selling mutual funds. Last week, Comptroller of the Currency Ludwig cited examples of bank noncompliance and noted that the OCC is conducting a survey to gauge the extent of noncompliance.

Federal Reserve to Release FOMC Transcripts. The Federal Reserve decided at its FOMC meeting on Tuesday to accede partially to House Banking Committee Chairman Gonzalez's request for public release of FOMC transcripts. The Fed will release edited transcripts of monetary policy discussions 5 years after the meetings. Chairman Gonzalez had asked for full release of transcripts over 3 years old, edited release of transcripts greater than 60 days but less than 3 years old, and "very short release time for Federal Reserve policy changes."

Boeing to Proceed with Upgrade of Small Airliner to Challenge Airbus. Boeing announced it will begin manufacture of an upgraded version of the 737, after winning a commitment from Southwest Airlines to buy 63 of the new planes. The new model will be ultra-quiet, more fuel efficient, and capable of nonstop cross-country service, flying faster and farther than the current version. Boeing expects the plane to challenge successfully the Airbus A320 and the recently introduced A319, both of which have speed and range advantages over the current 737.

Women Professionals Increasing. In 1990, women held 55 percent of professional and management jobs, up from 48 percent in 1980. Women have made large gains in professions historically dominated by men. In 1990, women made up 26 percent of young (age 25 to 44) doctors, up from 16 percent in 1980; 31 percent of young lawyers, up from 16 percent; and 18 percent of young dentists, up from 7 percent. Nonetheless, 65 percent of women professionals, compared with 74 percent in 1980, were in teaching, nursing, library services, and social work—traditionally female-dominated occupations.

EYES ONLY

RELEASES THIS WEEK

Industrial Production and Capacity Utilization

Industrial production rose a sharp 0.8 percent in October. Capacity utilization rose from 81.9 percent in September to 82.4 percent in October.

Merchandise Trade ** FOR RELEASE FRIDAY 8:30 A.M. **

The merchandise trade deficit widened slightly to $10.9 billion in September.

Housing Starts

Housing starts increased 2.7 percent in October and 13.3 percent over the last 3 months.

Housing Affordability

The National Association of Realtors' housing affordability index rose again in the third quarter. During the third quarter, a family with an income 25 percent below the median could afford to buy the median-priced house.

MAJOR RELEASES NEXT WEEK

Durable Goods (Wednesday)

Note: There will be no Weekly Economic Briefing on Friday, November 26, owing to the Thanksgiving holiday.

EYES ONLY

U.S. ECONOMIC STATISTICS

	1970–1992	1992	1993:1	1993:2	1993:3
Percent growth (annual rate)					
Real GDP	2.5	3.9	0.8	1.9	2.8
GDP deflator	5.8	2.8	3.6	2.3	1.6
Productivity					
Nonfarm business	1.1	3.6	–1.8	–0.4	3.9
Manufacturing (begins 1977)	2.0	4.9	5.0	5.9	2.4
Real compensation per hour	0.6	2.1	–0.9	–1.0	2.3
Shares of Real GDP (percent)					
Business fixed investment	10.9	10.6	11.1	11.5	11.5
Residential investment	4.8	4.0	4.2	4.0	4.1
Exports	7.9	11.6	11.6	11.6	11.5
Imports	9.0	12.3	12.8	13.1	13.1
Shares of Nominal GDP (percent)					
Personal saving	4.9	4.0	2.8	3.3	2.8
Federal surplus	–2.8	–4.6	–4.2	–3.5	

	1970–1992	1992	Aug. 1993	Sept. 1993	Oct. 1993
Unemployment Rate	6.7	7.4	6.7	6.7	6.8
Payroll employment (thousands)					
increase per month			–33	162	177
increase since Jan. 1993			1070	1232	1409
Inflation (percent per period)					
CPI	6.0	2.9	0.3	0.0	0.4
PPI-Finished goods	5.3	1.6	–0.6	0.2	–0.2

No new or revised data this week.

EYES ONLY

FINANCIAL STATISTICS

	1992	Aug. 1993	Sept. 1993	Oct. 1993	Nov. 18, 1993
Dow-Jones Industrial Average	3284	3597	3592	3626	3685
Interest Rates					
3-month T-bill	3.43	3.02	2.95	3.02	3.11
10-year T-bond	7.01	5.68	5.36	5.33	5.72
Mortgage rate, 30-year fixed	8.40	7.11	6.91	6.82	7.08
Prime rate	6.25	6.00	6.00	6.00	6.00

INTERNATIONAL STATISTICS

Exchange Rates	**Current level Nov. 18, 1993**	**Percent Change from Week ago**	**Percent Change from Year ago**
Deutschemark-Dollar	1.713	+1.3	+7.4
Yen-Dollar	107.3	+0.2	−13.3
Multilateral (Mar. 1973=100)	95.79	+0.8	+6.2

International Comparisons	**Real GDP growth (last 4 quarters)**	**Unemployment rate**	**CPI inflation (last 12 months)**
United States	+2.8 (Q3)	6.8 (Oct)	2.8 (Oct)
Canada	+2.4 (Q2)	11.2 (Sep)	1.9 (Sep)
Japan	−0.5 (Q2)	2.6 (Aug)	2.0 (Aug)
France	−1.0 (Q2)	11.3 (Aug)	2.3 (Sep)
Germany	−2.4 (Q2)	6.2 (Sep)	4.0 (Sep)
Italy	−0.6 (Q2)	10.6 (Jul)	4.3 (Sep)
United Kingdom	+2.0 (Q3)	10.5 (Aug)	1.8 (Sep)

EYES ONLY

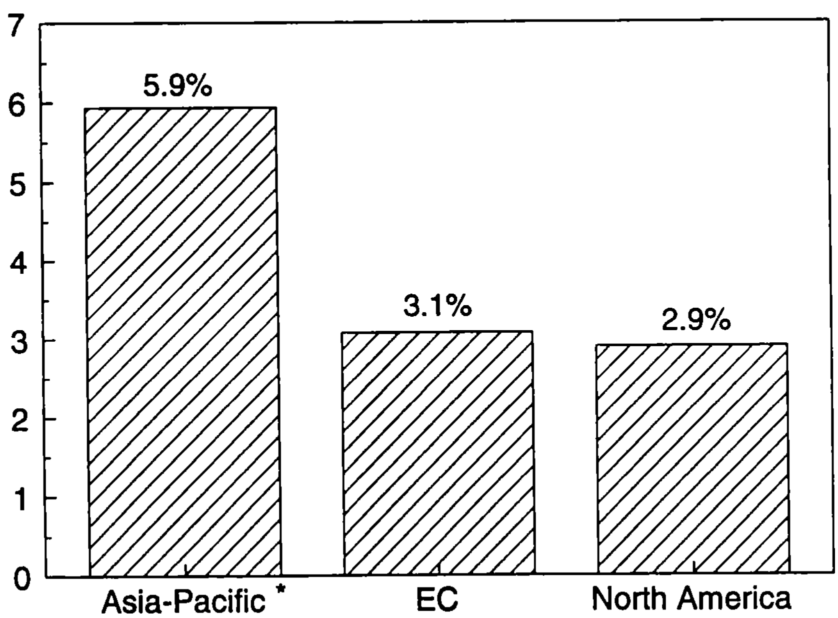
WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

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

November 12, 1993

CHART OF THE WEEK

GDP Growth Rates
(1965 to 1990)



Asia-Pacific countries grew about twice as fast as Europe and North America over the last quarter century. This growth has made them become more important markets and more independent players in world trade.

*The Asia-Pacific countries include Australia, China, Indonesia, Japan, Korea, Malaysia, New Zealand, the Philippines, Singapore, and Thailand. APEC members Hong Kong and Taiwan are excluded because of data problems.

EYES ONLY

CONTENTS

QUOTATION OF THE WEEK

What protection teaches us, is to do to ourselves in time of peace what enemies seek to do to us in time of war.

Henry George
Protection or Free Trade, 1886

EYES ONLY

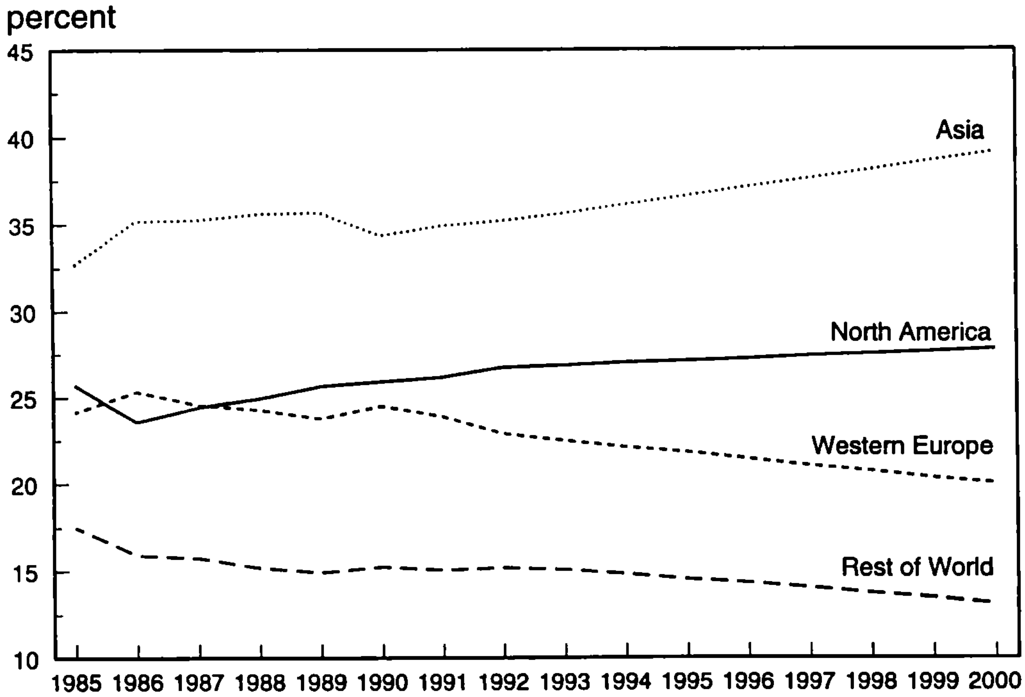
SPECIAL ANALYSIS: APEC

Asia-Pacific Countries Becoming Largest Economic Bloc

The Asia-Pacific countries have achieved the world's most rapid rates of economic growth in the past quarter century. (See the Chart of the Week.) Consequently, these countries, the members of APEC other than the United States and Canada, have increased their share of world output dramatically. Since they are likely to continue to grow more rapidly than other countries, the Asia-Pacific countries will probably continue to increase in importance in world trade. Their share of world output is projected to rise from 24 percent in 1991 to about 30 percent by the year 2000, surpassing both North America and Europe and becoming the world's largest economic zone.

The United States' Asia-Pacific partners currently account for about 35 percent of all U.S. trade, versus 23 percent for the EC. By the end of the century, U.S. trade with Asia is expected to rise to almost 40 percent of all U.S. trade. Asia-Pacific markets will be increasingly important not only for the United States but also for other Asia-Pacific countries. Trade within the region will grow, thereby reducing the weight of the United States in their trade baskets. In short, Asia-Pacific countries will become more important in our trade while we will become less important in theirs.

Shares of U.S. Trade, by Region



Analysis. As our Asian partners' reliance on the U.S. market declines, our ability to use unilateral trade measures or threats of domestic market closure to win greater openness of Asian markets will diminish. This suggests that the United States will have to act in concert with other countries to achieve our economic and political goals in the APEC region. Consequently, there are long-term advantages for the United States from the establishment of an institutional infrastructure for cooperation in the Asia-Pacific region. The APEC forum is the leading candidate for such cooperation.

The outcomes of NAFTA and the Uruguay Round will affect the evolution of the APEC agenda. Enactment of NAFTA will encourage the APEC countries to pursue greater integration with the United States. If the Uruguay Round is successfully completed, APEC will likely focus on issues traditionally not covered in the GATT, such as investment, competition policy, environmental policies, and macroeconomic coordination. If the Uruguay Round fails, however, APEC would likely focus on the reductions of more traditional trade barriers.

APEC includes a diverse range of countries:

Industrialized countries: United States, Japan, Canada, Australia, and New Zealand,

The "Four Tigers:" South Korea, Singapore, Taiwan, and Hong Kong,

Developing countries: Indonesia, Malaysia, Thailand, China, and the Philippines.

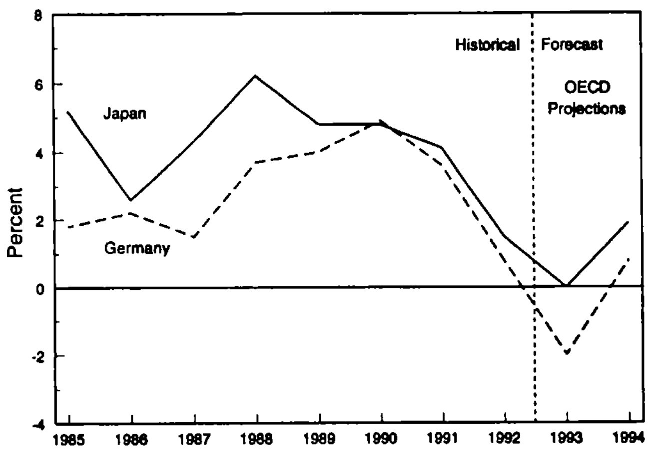
EYES ONLY

CURRENT DEVELOPMENT

Japanese and German Economies Still Weakening

OECD analysts continue to mark down their economic growth forecasts for Japan and Germany. Moreover, the latest data, such as industrial production indexes, are still declining in both countries.

Real GDP Growth



The OECD now forecasts that Japan will post no growth this year and a paltry 1.9 percent growth rate in 1994. The OECD's Japan experts, however, note that the most recent data indicate that further downward revisions to the 1994 forecast may be necessary, possibly to around 1 percent. Investment spending is still contracting, and the strong yen is crimping exports.

The OECD now expects that real GDP in Germany will decline in both the third and fourth quarters of 1993 and will fall by 2 percent for the year. For 1994, the OECD expects GDP growth of just 0.8 percent in Germany. With the world's highest labor costs, (at current exchange rates), German firms may not receive a boost from exports.

Analysis. At the OECD Economic Policy Committee meeting—chaired this week by CEA Chair Tyson—Japan indicated that additional fiscal stimulus was possible and Germany indicated that a further decline in short-term rates could occur this year. Neither country would commit to the timing or size of such expansionary steps.

EYES ONLY

CURRENT DEVELOPMENT

Partial Settlement Accepted in Airline Price-Fixing Case

A Federal district judge approved a settlement between the Justice Department and two of the eight major airlines charged with price-fixing. The government contends that the leading domestic carriers negotiated more than 50 agreements to raise fares since 1988, potentially leading to billions of dollars in consumer overpayments for air travel. USAir and United will no longer engage in practices they allegedly used to negotiate fare agreements. The two airlines agreed not to tell each other the dates that proposed fares would take effect, nor the non-advertised dates that existing fares will end.

The nonsettling defendants include Alaska Air, American, Continental, Delta, Northwest, TWA, and ATP, a joint venture of the major airlines that operates a computer database for collecting and disseminating fare information. The government and the non-settling defendants will go to trial next fall.

Analysis. The magnitude of the consumer injury and the size of the firms involved may make this case the largest price-fixing conspiracy uncovered since General Electric and Westinghouse were found guilty of fixing electrical equipment prices during the 1950s. The lawsuit also shows how computerized data dissemination systems can create new methods for price fixing.

Private Damages Suit Settles First

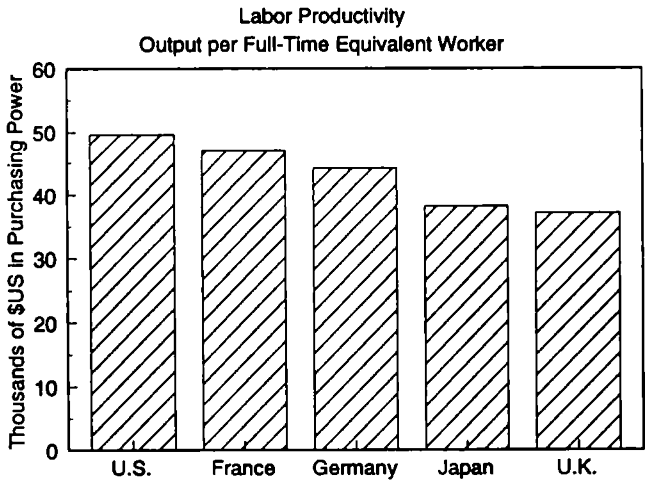
A private class action lawsuit seeking damages from the major carriers was filed in 1990, when the press first reported a Justice Department investigation of airline price-fixing, and was settled last year. Most affected passengers were awarded either minor discounts for future travel or less than $100 cash. The plaintiffs' lawyers earned $14.4 million in fees. Tom O'Donnell, the CEA's Chief of Staff, was a named class representative.

EYES ONLY

ARTICLE

U.S. Leads World in Productivity But Lags in Some Industries

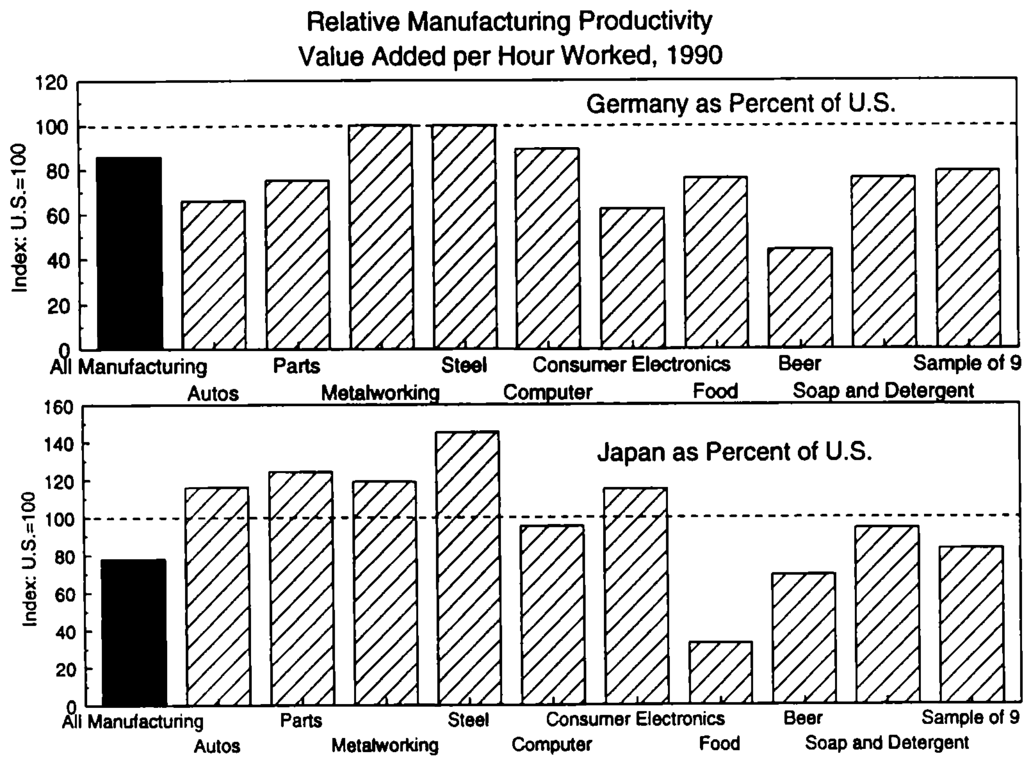
The United States enjoys the highest income per capita in the world. (See Weekly Economic Briefing, October 29). The U.S. economy employs a larger fraction of its population and provides a longer average work week than any high-income country other than Japan. These two factors, however, explain only part of our higher per capita income. The most important source of our success is that U.S. workers produce more output per hour worked than workers of any other Nation. Higher labor productivity in the U.S. leads directly to higher American living standards.



Although productivity is higher in the United States—both overall and within manufacturing—large differences exist across industries. U.S. firms lead in some industries, but lag in others. Case studies by McKinsey & Co. of nine industries in 1990—comprising about 20 percent of the manufacturing sector—found that U.S. productivity exceeded German productivity in seven of the nine and matched German productivity in the remaining two. U.S. productivity fell short of Japanese productivity in five of the nine—including autos, auto parts, steel, and consumer electronics—but exceeded Japanese productivity in the remaining four and on average across all industries.

According to McKinsey, differences in productivity stem primarily from differences in the technology used (processed foods, beer, steel, and metalworking), the design of products for ease of manufacturing (autos, auto parts, consumer electronics, steel, and metalworking), and the organization of functions and tasks (steel, metalworking, autos, auto parts, and consumer electronics).

In some industries, firms have acquired best practices from competitors abroad and productivity differences are small or have narrowed. In other industries, large productivity differences persist. What explains the differences? The case studies suggest that direct competition with leading-edge firms is one important common feature in narrowing productivity differences. Foreign direct investment and "transplants" also figure prominently in the case studies as a means to transfer technology and management practices. For example, the U.S. auto assembly



industry has greatly improved its productivity by learning from Japanese competitors and especially from transplants. U.S. productivity in auto assembly is now comparable to that of Japanese assemblers except for Toyota, which has 40 percent higher productivity than its competitors. In contrast, the German beer industry and the Japanese food industry are sheltered from domestic and foreign competition and lag far behind leading-edge firms.

EYES ONLY

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

Deregulation Boosts U.S. GDP. Econometric studies compiled by Clifford Winston of the Brookings Institution suggest that the deregulation of seven U.S. industries—airlines, railways, trucking, telecommunications, cable television, stockbrokerage services, and natural gas—in the 1980s was beneficial to both consumers and producers. Consumers gained between $33 billion and $43 billion a year in 1990 prices in lower prices and better services. Quantification of quality improvements would add even more. Producers gained an estimated $3 billion a year. The total gain amounts to an improvement of 7-9 percent in output of the deregulated industries.

Gore-Perot Debate Rallies Peso, Mexican Stocks. On Wednesday, the day after the Vice President's debate, the peso more than regained its losses from Tuesday's speculative run. The peso has been under pressure from speculators betting against passage of NAFTA. The Mexican stock market rallied along with the peso, gaining 4.2 percent to close at a record high, with gainers out numbering losers almost ten to one.

Japan's Banks Lose Patience with Real Estate. Rather than follow their usual policy of propping up failing companies with additional loans, several large Japanese banks chose to allow a construction company to fail. It was probably Japan's biggest bankruptcy since World War II. The tougher attitude reflects new tax incentives for banks to write off loans, strong bank profits that make it easier for banks to book bad loans, and the creation of a special cooperative institution set up by Japan's banks to clear bad debts.

Corn and Soybean Production Forecasts Fall. The USDA revised its forecasts of corn and soybean production down sharply this month. The forecast of corn production fell 7 percent and soybean production fell 3 percent from last month. Pressure on supply should not be large, however, because stocks are relatively high and export demand is weaker than last year. Thus, little if any additional inflation from this source is expected.

Higher-Income Families Shop More at Discount Warehouses. Roper Starch Worldwide reports that 30 percent of households earning more than $50,000 a year and 26 percent of those earning between $30,000 and $50,000 shopped at a discount warehouse store in the last month. In contrast, only 14 percent of households earning between $15,000 and $30,000 and only 9 percent of those earning under $15,000 a year reported such shopping.

EYES ONLY

RELEASES THIS WEEK

Blue Chip Forecast

The Blue Chip consensus forecasts for economic growth in both calendar year 1993 and 1994 are now 2.8 percent, both up 0.1 percentage point from last month.

Producer Prices

The producer price index for finished goods fell 0.2 percent in October. This was the third decline in the past 4 months.

Consumer Prices

The consumer price index increased 0.4 percent in October and 2.8 percent over the past 12 months.

Retail Sales

The advance report on retail sales for October showed an increase of 1.5 percent.

MAJOR RELEASES NEXT WEEK

Industrial Production (Monday)

Housing Starts (Wednesday)

Merchandise Trade (Friday)

EYES ONLY

U.S. ECONOMIC STATISTICS

	1970–1992	1992	1993:1	1993:2	1993:3
Percent growth (annual rate)					
Real GDP	2.5	3.9	0.8	1.9	2.8
GDP deflator	5.8	2.8	3.6	2.3	1.6
Productivity					
Nonfarm business	1.1	3.6	–1.8	–0.4	3.9
Manufacturing (begins 1977)	2.0	4.9	5.0	5.9	2.4
Real compensation per hour	0.6	2.1	–0.9	–1.0	2.3
Shares of Real GDP (percent)					
Business fixed investment	10.9	10.6	11.1	11.5	11.5
Residential investment	4.8	4.0	4.2	4.0	4.1
Exports	7.9	11.6	11.6	11.6	11.5
Imports	9.0	12.3	12.8	13.1	13.1
Shares of Nominal GDP (percent)					
Personal saving	4.9	4.0	2.8	3.3	2.8
Federal surplus	–2.8	–4.6	–4.2	–3.5	

	1970–1992	1992	Aug. 1993	Sept. 1993	Oct. 1993
Unemployment Rate	6.7	7.4	6.7	6.7	6.8
Payroll employment (thousands)					
increase per month			–33	162	177
increase since Jan. 1993			1070	1232	1409
Inflation (percent per period)					
CPI	6.0	2.9	0.3	0.0	**0.4***
PPI-Finished goods	5.3	1.6	–0.6	0.2	**–0.2**

*New releases this week in **bold**.

EYES ONLY

FINANCIAL STATISTICS

	1992	Aug. 1993	Sept. 1993	Oct. 1993	Nov. 11, 1993
Dow-Jones Industrial Average	3284	3597	3592	3626	3662
Interest Rates					
3-month T-bill	3.43	3.02	2.95	3.02	3.12
10-year T-bond	7.01	5.68	5.36	5.33	5.72
Mortgage rate, 30-year fixed	8.40	7.11	6.91	6.82	7.12
Prime rate	6.25	6.00	6.00	6.00	6.00

INTERNATIONAL STATISTICS

Exchange Rates	**Current level Nov. 10, 1993**	**Percent Change from**	
		Week ago	**Year ago**
Deutschemark-Dollar	1.692	−0.3	+5.5
Yen-Dollar	107.1	−0.5	−14.0
Multilateral (Mar. 1973=100)	95.02	−0.2	+5.0

International Comparisons	**Real GDP growth (last 4 quarters)**	**Unemployment rate**	**CPI inflation (last 12 months)**
United States	+2.8 (Q3)	6.8 (Oct)	**2.8 (Oct)**
Canada	+2.4 (Q2)	11.2 (Sep)	1.9 (Sep)
Japan	−0.5 (Q2)	2.6 (Aug)	2.0 (Aug)
France	−1.0 (Q2)	11.3 (Aug)	2.3 (Sep)
Germany	−2.4 (Q2)	6.2 (Sep)	4.0 (Sep)
Italy	−0.6 (Q2)	10.6 (Jul)	4.3 (Sep)
United Kingdom	+2.0 (Q3)	10.5 (Aug)	1.8 (Sep)

BR/Bo/GS/SM

EYES ONLY

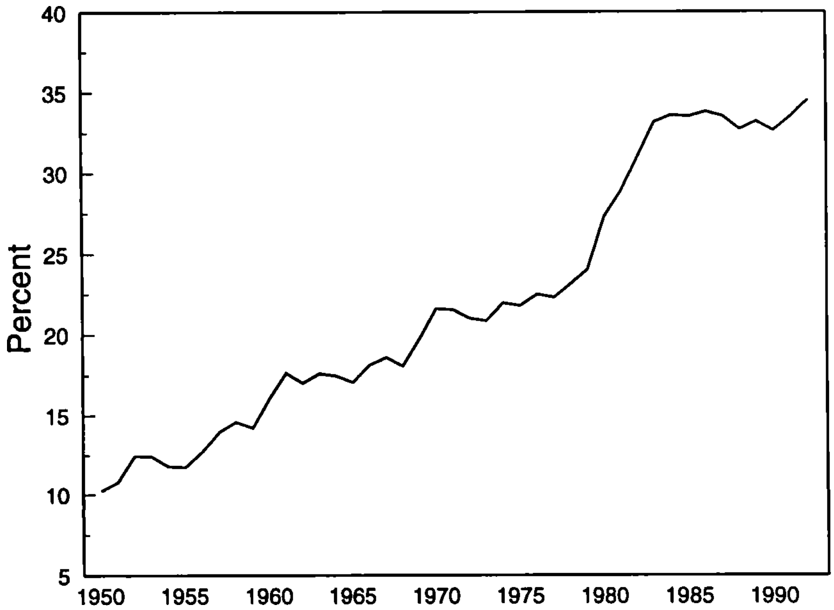
WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

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

November 5, 1993

CHART OF THE WEEK

Information Processing Equipment:
An Increasing Share of Equipment Investment



As a share of investment in all producers' durables, investment in information processing equipment—computers, telephones, and photocopiers—has increased dramatically over the last 40 years. Today, these items account for 35 out of every 100 dollars invested in equipment. The dollar share has stabilized in recent years because declines in computer prices have made purchasing computer power even cheaper. In real terms, information processing equipment purchases have grown at an 8 percent rate since 1980; other producer investment has grown at just a 1 percent rate.

EYES ONLY

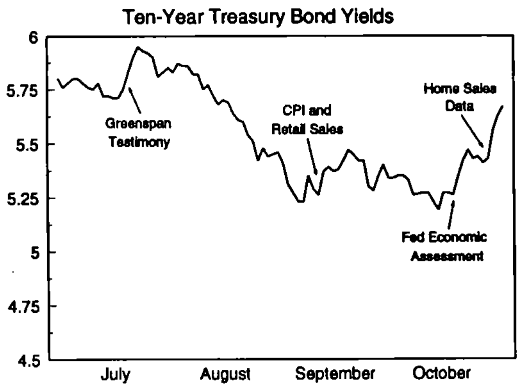
CONTENTS

"Remember, this is a one-shot, not an entitlement."

EYES ONLY

CURRENT DEVELOPMENT

Bond Yields Rise—Yet Again



The decline in long-term yields brought about by the Administration's deficit reduction plan has not been entirely steady. This week's increase in bond yields is a case in point, with two additional episodes occurring since July. On Thursday, yields on 10-year Treasuries closed at 5.67 percent, up from 5.26 percent on October 21.

News that the economy is improving is taken as bad news in the bond market because it raises fears of increased inflation or of monetary restraint. This week's increase in yields was triggered by surprisingly strong home sales in September, the latest in a series of good releases. The increase in yields began 2 weeks ago, allegedly triggered by a positive assessment of business conditions by regional Federal Reserve Banks and Fed Chairman Greenspan.

There have been two other blips in the bond market since July.

- In September, yields increased 21 basis points following the CPI and retail sales announcements. The releases, though hardly dramatic themselves, were interpreted as news of economic strengthening, or maybe less weakness than expected.

- In July, rates increased 24 basis points following Greenspan's statement that interest rates might go up some day.

Analysis. Bond markets are highly speculative. Yields fell back again after the July and September blips up. It remains to be seen whether the current increase is another short-term blip or is longer lasting.

EYES ONLY

CURRENT DEVELOPMENT

Europe Takes Step Toward Monetary Union, Frankfurt Gets New Central Bank

Despite the August collapse of the exchange rate mechanism (ERM), EC leaders selected Frankfurt for the home of the new European Monetary Institute. The Maastricht Treaty calls for the creation of the EMI as the second of three steps leading to European Economic and Monetary Union (EMU) and a common currency. The Institute is the forerunner of the European Central Bank.

During the transition, each country will retain control over its monetary policy. The EMI will help coordinate monetary policies, oversee the European Monetary System, and monitor progress toward union. EMU is scheduled to begin no later than January 1, 1999 and requires participating countries to meet four convergence criteria (see box).

Analysis. Most observers view the timetable for monetary union as unrealistic. During the first stage, which ends January 1, 1994, all EC countries were to join the ERM and maintain exchange rates within narrow bands. But the ERM collapsed. In addition, no country currently satisfies all four convergence criteria, and only three satisfy three of the four. Since agreement was reached at Maastricht, the EC countries have diverged from the treaty's conditions for Economic and Monetary Union.

Convergence Criteria

Inflation	Within 1.5 percentage points of benchmark*
Long-term Interest Rates	Within 2 percentage points of benchmark
Government Debt	No more than 60 percent of GDP
Budget Deficit	No more than 3 percent of GDP

*Benchmarks are the average of the three lowest inflation countries.

EYES ONLY

ARTICLE

Are Jobs Becoming Less Secure?

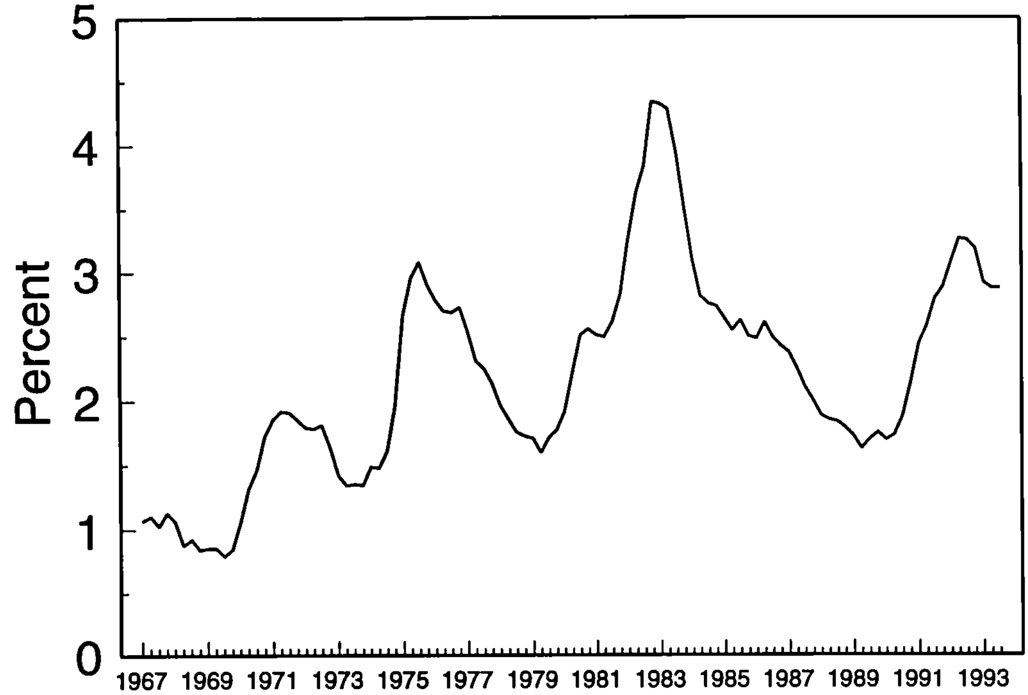
There have been numerous reports of large layoffs by employers who were previously thought to provide almost permanent employment. Has employment suddenly become less secure?

People can be unemployed because they have just entered the labor market, because they have recently re-entered the labor market, or because they have lost a job or been laid off. The chart shows the percentage of people in the last group who have lost jobs permanently. The recent peak of 78 percent in the first quarter of 1993, however, does not represent a radical change from its previous peak of 75 percent in the fourth quarter of 1983.

Similarly, the chart on the next page shows the fraction of the labor force (those working plus those looking for work) who are permanent job losers. This fraction trended upward in the 1970s, but shows large fluctuations with no trend since then. Controlling for business cycle conditions, the last few years are unexceptional. If we add in those on temporary layoff, the combined fraction of all job losers in the labor force is actually lower now than in either of the previous two recessions.

EYES ONLY

Permanent Job Losers as Share of Labor Force



Duration of Jobs. Another approach to the question of job security is to ask how long jobs last. In the U.S. job market, there is a lot of turnover among younger workers as they gain labor-market experience. But once they find the right job, they remain in it for a long period—often a whole career. In 1987, 31 percent of employees had been with their current employer for 8 or more years, up 1 percentage point from 1979. Hence, there has been little change in the fraction of employees in long-term employment relationships.

Conclusion. Unemployment has been high now for an extended period. Measures of distress in the labor market—permanent layoffs and long-term unemployment—are correspondingly high. Therefore, the perception of hard times is understandable. But these problems are not unusual and should abate as the recovery continues.

EYES ONLY

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

Higher Taxes Expected. A Business Week/Harris poll found that 87 percent of 1,252 adult respondents expect higher taxes over the next few years. Although a majority of respondents believe their taxes are too high and that past tax increases were not used efficiently, 73 percent expressed some willingness to accept higher taxes if they were used effectively. Spending for job creation and education were given the highest priority and defense and welfare the lowest.

New Technology Bolsters Renewable Energy. Over the next 5 years, 68 utilities across the country will buy $500 million of solar power panels to generate electricity. Utilities in Maine, Texas, and Vermont have agreed to test new, more efficient wind turbines. And an industry-financed group is refocusing exclusively on finding clean ways to burn biomass—wood and other plant materials.

Emerging Debt Markets Boom. Prices of sovereign debt have risen dramatically as the economies of the heavily indebted countries strengthened. A large and vital market in this debt has developed. Trading volume has increased more than tenfold in the past 3 years and could reach $1.2 trillion this year.

Software Counterfeiter Jailed. A computer software counterfeiter was sentenced to 1 year in Federal prison and a year's probation after pleading guilty. He is believed to be the first person sentenced for software counterfeiting in the United States.

Federal Reserve District Banks Report Slow to Moderate Growth. The Federal Reserve's October regional summary of business activity reported continued slow to moderate growth in most Federal Reserve districts. Consumer spending, particularly for autos and other durables, manufacturing, and residential real estate markets generally showed improvement. The San Francisco Bank reported general improvement across the district, but continued sluggishness in California and relatively weak conditions in western Washington and Hawaii's tourist industry. Separately, the president of the San Francisco Bank said he sees evidence that the worst of this cycle is past for California.

Xerox Introduces "Green" Graphic Film. Xerox introduced a silverless graphic-arts film it claims is cheaper to use and less harmful to the environment than current film. The new selenium-based film forms images when exposed to heat and light, avoiding the chemical processing necessary for traditional silver-halide films. Graphic-arts film is used in printing plates for high-volume printing, including newspapers, magazines, and catalogs.

EYES ONLY

RELEASES THIS WEEK

Employment ** FOR RELEASE 8:30 A.M. FRIDAY **

The unemployment rate was 6.8 percent in October. During October, payroll employment increased by 177,000 workers.

Leading Indicators

The index of leading indicators rose 0.5 percent in September.

Productivity

Productivity in nonfarm business rose at an annual rate of 3.9 percent in the third quarter.

Automobile Sales

Sales of domestically-produced automobiles were 7.1 million units at annual rate in October, up from 6.6 million units in September.

Home Sales

New homes sold at an annual rate of 762,000 in September, a large increase from August. (This series is exceptionally volatile.)

MAJOR RELEASES NEXT WEEK

Producer Prices (Tuesday)

Consumer Prices (Wednesday)

Advance Retail Sales (Friday)

EYES ONLY

U.S. ECONOMIC STATISTICS

	1970–1992	1992	1993:1	1993:2	1993:3
Percent growth (annual rate)					
Real GDP	2.5	3.9	0.8	1.9	2.8
GDP deflator	5.8	2.8	3.6	2.3	1.6
Productivity					
Nonfarm business	1.1	3.6	–1.8	–0.4	**3.9***
Manufacturing (begins 1977)	2.0	4.9	5.0	5.9	**2.4**
Real compensation per hour	0.6	2.1	–0.9	–1.0	**2.3**
Shares of Real GDP (percent)					
Business fixed investment	10.9	10.6	11.1	11.5	11.5
Residential investment	4.8	4.0	4.2	4.0	4.1
Exports	7.9	11.6	11.6	11.6	11.5
Imports	9.0	12.3	12.8	13.1	13.1
Shares of Nominal GDP (percent)					
Personal saving	4.9	4.0	2.8	3.3	2.8
Federal surplus	–2.8	–4.6	–4.2	–3.5	

	1970–1992	1992	Aug. 1993	Sept. 1993	Oct. 1993
Unemployment Rate	6.7	7.4	6.7	6.7	**6.8***
Payroll employment (thousands)					
increase per month			–33	162	**177**
increase since Jan. 1993			1070	1232	**1409**
Inflation (percent per period)					
CPI	6.0	2.9	0.3	0.0	
PPI-Finished goods	5.3	1.6	–0.6	0.2	

*New releases this week in **bold**. **Employment and unemployment for release 8:30 A.M. Friday.**

EYES ONLY

FINANCIAL STATISTICS

	1992	Aug. 1993	Sept. 1993	Oct. 1993	Nov. 4, 1993
Dow-Jones Industrial Average	3284	3597	3592	3626	3625
Interest Rates					
3-month T-bill	3.43	3.02	2.95	3.02	3.08
10-year T-bond	7.01	5.68	5.36	5.33	5.67
Mortgage rate, 30-year fixed	8.40	7.11	6.91	6.82	7.11
Prime rate	6.25	6.00	6.00	6.00	6.00

INTERNATIONAL STATISTICS

Exchange Rates	**Current level Nov. 4, 1993**	**Percent Change from Week ago**	**Percent Change from Year ago**
Deutschemark-Dollar	1.697	+1.5	+7.9
Yen-Dollar	108.3	+0.3	−12.0
Multilateral (Mar. 1973=100)	95.29	+0.8	+7.2

International Comparisons	**Real GDP growth (last 4 quarters)**	**Unemployment rate**	**CPI inflation (last 12 months)**
United States	+2.8 (Q3)	**6.8* (Oct)**	2.7 (Sep)
Canada	+2.4 (Q2)	11.3 (Aug)	1.9 (Sep)
Japan	−0.5 (Q2)	2.6 (Jul)	2.0 (Aug)
France	−1.0 (Q2)	11.3 (Jul)	2.3 (Sep)
Germany	−2.4 (Q2)	6.1 (Aug)	4.0 (Sep)
Italy	−0.6 (Q2)	10.6 (Jul)	4.3 (Sep)
United Kingdom	+2.0 (Q3)	10.5 (Aug)	1.8 (Sep)

***Unemployment for release 8:30 A.M. Friday.**

BR/Bo/GS/SM

EYES ONLY

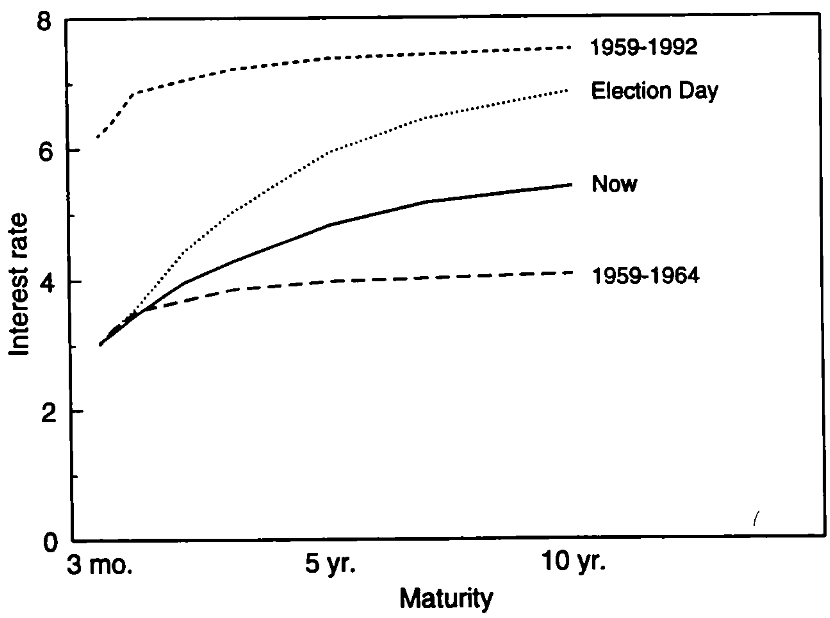
WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

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

October 29, 1993

CHART OF THE WEEK

Interest Rate Yields by Maturity



Yields on long-term bonds have fallen substantially since Election Day, when 10-year Treasuries yielded 6.9 percent. They currently yield 5.4 percent. There has been no corresponding decline in short-term interest rates. Hence, the spread between 3-month bills and 10-year bonds has fallen from 3.9 percentage points to 2.4 percentage points. This spread is still large by historical standards. (From 1959 to 1992, the spread averaged 1.3 percentage points. From 1959 to 1964, the only period since 1959 with short rates as low as they are now, it averaged about 1 percentage point.) The spread tends to forecast future short rates. Short rates will probably rise somewhat as the spread returns to normal. The Administration's forecast has Treasury bill rates increasing to 3.6 percent in 1994 and 3.9 percent in 1995.

EYES ONLY

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QUOTATION OF THE WEEK

In most things we buy, necessity is the mother of invention. In the health care world, invention is the mother of necessity.

Robert Reischauer
New York Times, October 26

EYES ONLY

CURRENT DEVELOPMENT

GDP Scorecard

Real GDP grew at an annual rate of 2.8 percent during the third quarter. The Administration's August forecast predicted growth at about a 3 percent annual rate for the second half of 1993. Our forecast is therefore on track. The following scorecard gives the growth of the major components during the third quarter and indicates factors affecting their recent performance or outlook.

Component	Growth*	Comments
Consumer expenditure on motor vehicles	-3.7	Automobile production was disappointing during the third quarter due to manufacturing problems at GM, constraining sales. Many sales came from inventories. Production should be much stronger in the fourth quarter.
Consumer expenditure excluding motor vehicles	4.6	Spending on other durables, nondurables, and services were all up strongly.
Producer's durable equipment	9.0	Interest-sensitive investment continues to be an important source of strength.
Housing	10.1	The response of housing to interest rates has been slow, but a recent increase in starts suggests that it is now underway.
Nonresidential structures	-0.8	Overhang of commercial structures from the 1980s makes this sector no better than neutral for growth.
Inventories (change, billions of 1987$)	$7.3	Low inventory investment has been a factor depressing growth throughout the year. During the third quarter, farm and automobile inventories were down because of the flood and production problems in autos. Inventory accumulation should be neutral or positive in the fourth quarter.
Federal purchases	-6.1	Defense cuts continue to be a negative factor for growth.
Exports	-1.1	Slow growth abroad and therefore low demand for our goods is a major drag on U.S. production.
Imports	1.9	As the recovery strengthens, demand for imports will grow.

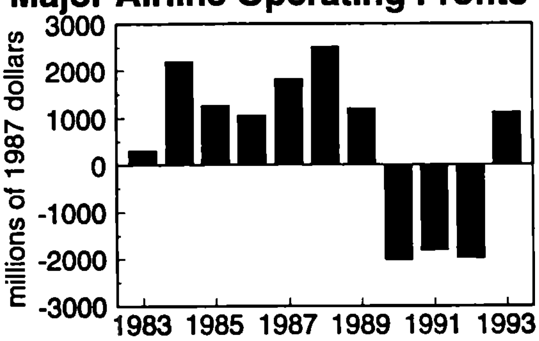
*Percent real growth in third quarter at annual rate (except inventories). These preliminary figures are subject to substantial revision.

EYES ONLY

CURRENT DEVELOPMENT

Airline Profits Rebound

Most of the major U.S. carriers reported operating profits in the third quarter of 1993. American, Delta and United collectively earned $775 million, compared with a loss of $90 million during the same quarter 1 year ago. Northwest, which was considering bankruptcy reorganization last summer, showed an operating profit of $270 million. Most carriers also recorded profits during the second quarter of 1993.



1993 profits are estimates based on information supplied by Kidder, Peabody & Co.

Airline industry profits are sensitive to the business cycle. The major domestic carriers collectively reported $6.8 billion in operating losses between 1990 and 1992, but they earned significant profits in the boom years of the 1980s.

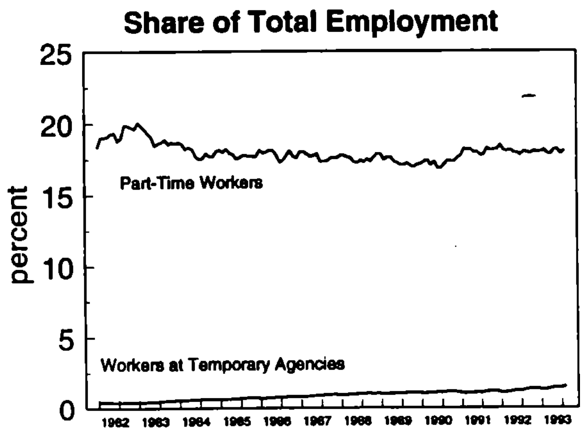
Analysis. Because airline profits are strongly cyclical, a healthy economy may largely solve the financial problems of the airline industry. This was not the conclusion of the National Commission to Ensure a Strong, Competitive Airline Industry, chaired by Governor Baliles. The Commission argued that improved macroeconomic performance would not be sufficient to aid carriers in financial distress and recommended significant tax relief for the airline industry.

The long-term financial health of the aircraft manufacturing industry is closely tied to that of the airlines. A sustained economic rebound in foreign and domestic air travel will be necessary for the airlines to generate substantial orders for new aircraft. Boeing's production rate has declined by more than one-third since the summer of 1992, and the company projects that by mid-1994 it will employ 23,000 fewer workers than at the start of 1993.

EYES ONLY

TREND

Temporary Jobs Grow, But Are Still Small Share of Employment



Although the number of workers in the temporary service industry nearly quadrupled during the last decade, it remains very small. Temporary workers were 0.4 percent of total employment in 1982 and have risen to 1.5 percent today. In addition to workers at temporary help agencies, some firms hire temporary workers on their own. Adding these workers to the agency workers raises the share of temporary workers in total employment to about 3 percent—still a small fraction.

Part-time workers are a much larger fraction of employment. There has been no discernible trend in the share of part-time workers in total employment during the last decade. Although there has been a slight increase in their share recently, it is nearly entirely the result of an increase in voluntary part-time work.

Analysis. Some analysts have raised concerns about decreasing benefit coverage and increasing employment instability resulting from an increase in temporary and part-time work. A subsequent Weekly Economic Briefing will evaluate these concerns.

EYES ONLY

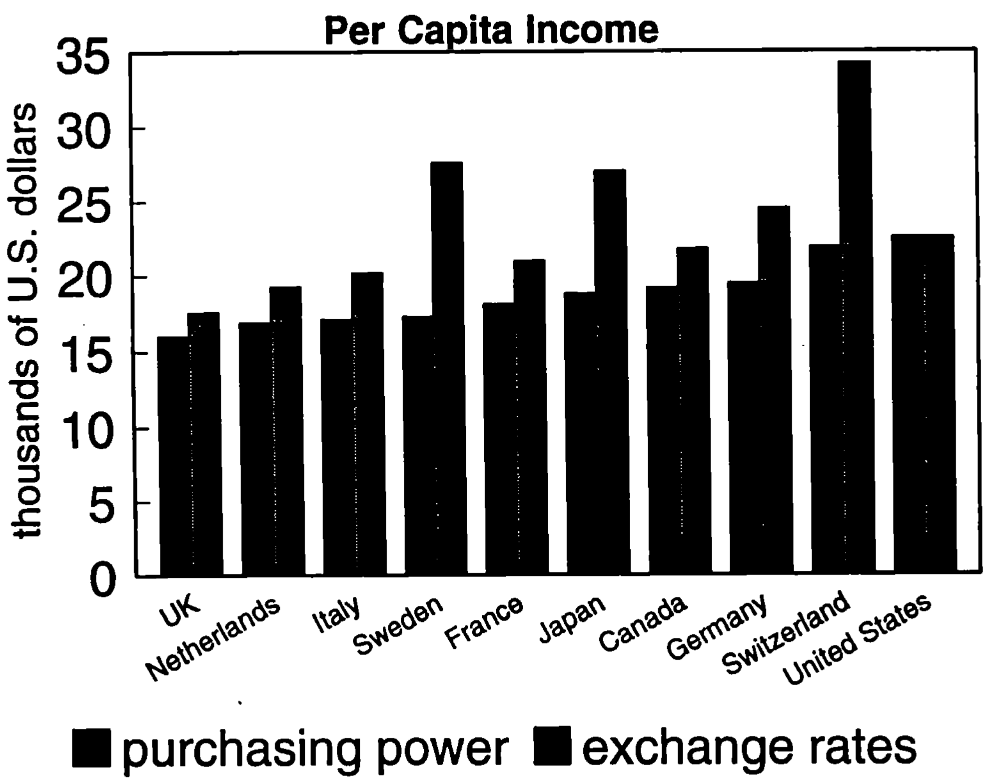
<u>ARTICLE</u>

Exchange Rate Movements Mask Preeminence of U.S. Living Standard

Income per capita in Switzerland was 49,000 Swiss francs in 1991, which corresponded to slightly more than $34,000 at then current exchange rates. Income per capita in the United States was approximately $22,500. Were living standards in Switzerland really 50 percent higher than in the United States?

Living standards depend both on income earned by consumers and on the cost of goods and services available to them. For example, the price of a Big Mac in the United States is $2.28 while the cost of a Big Mac in Switzerland is $3.99. Since Swiss prices are higher, a higher income level in Switzerland does not necessarily mean a higher standard of living.

International differences in prices make it essential to adjust incomes for differences in <u>purchasing power</u> when making international comparisons. The chart shows the levels of income per capita for various countries. The light bars convert the foreign income into dollars using the exchange rate—without making any correction for cost of living. The dark bars correct for differences in purchasing power across countries. The corrections are made using OECD data on prices in different countries.



Adjusted for purchasing power, the United States has the highest per capita income among industrial countries. Switzerland, Sweden, and Japan all have lower income than the United States once the very high prices in those countries are taken into account.

Several industrial countries appear to have enjoyed much more rapid increases in income during the 1985-91 period than the United States. Exchange rate changes account for much of these increases. Looking only at changes in the dollar value of income ignores changes in the dollar value of the cost of living. At the beginning of this period, the dollar was grossly overvalued. Its return to a more normal level since then makes it appear that incomes have been rising more rapidly elsewhere. The table shows how the appreciation of currencies relative to the dollar in the second half of the 1980s overstated income gains in many countries relative to ours.

Real U.S. Dollar Change in Per Capita Income, 1985-91

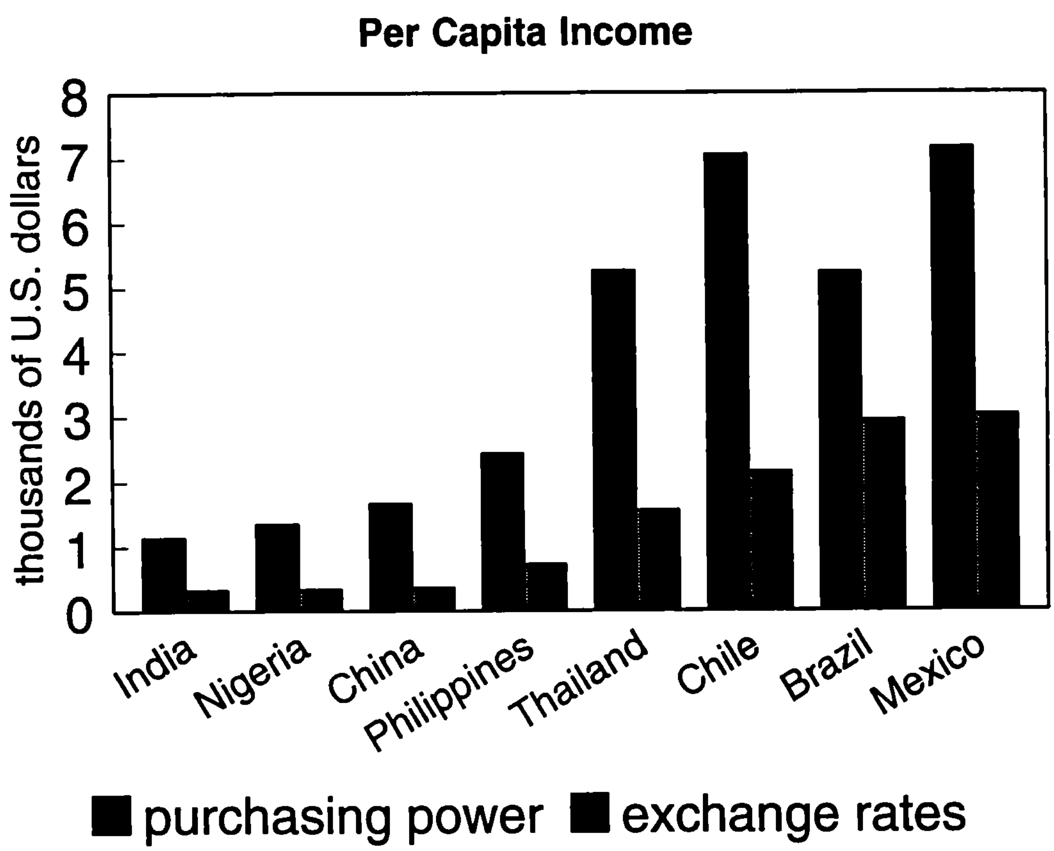
	Exchange rates	Purchasing power
Japan	13,900	5,200
Switzerland	12,500	800
Germany	10,700	2,600
Netherlands	9,200	3,500
France	7,700	1,700
Sweden	6,300	-1,800
Italy	6,000	-400
United Kingdom	4,400	-300
Canada	3,500	400
United States	1,100	1,100

Note: Figures are changes in per capita income in 1985 U.S. dollars, converted using exchange rates or purchasing power.

The movements in the exchange rate substantially overstate changes in real income. Japan and Germany saw huge increases when income is converted to dollars using the exchange rate, but enjoyed much smaller increases once purchasing power is taken into account. Sweden, Italy, and the United Kingdom, which had increases when income is converted to dollars using the exchange rate, actually registered decreases in income measured in purchasing power.

Continued . . .

Mexico's income per capita was 9,150 pesos in 1991, which, converted using the exchange rate, corresponded to only $3,000. In developing countries, low wages lead to low prices for services and other non-traded goods. As a result, low-income countries have price levels that are systematically lower than high-income countries. Consequently, comparing income levels using market exchange rates understates the standard of living of developing countries. Adjusted for purchasing power, Mexico enjoyed a per capita income of about $7,000 in 1991, over twice what is implied by converting the peso income to dollars with the exchange rate.



Income Comparisons Do Not Tell the Whole Story

Purchasing-power corrected income shows differences in the real buying power for marketed goods and services, but is an incomplete measure of the standard of living. Factors such as crime, pollution, congestion, and the quality of health and education affect well-being, but are not captured by income.

EYES ONLY

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

GM and UAW Tentatively Agree to Contract. Under the terms of the new 3-year contract, hourly workers will receive a 3 percent wage increase initially and an additional 3 percent at the beginning of the second year. The agreement gives GM a modest increase in flexibility to restructure its operations. It grants no concessions in health benefits and increases pension benefits. The agreement still must be approved by GM's board and the union's rank and file.

Automakers Report Improved Third Quarter Results. Chrysler and Ford reported positive profits this quarter and GM's loss narrowed sharply. Chrysler earned $423 million versus $202 million the previous year. Ford had a profit of $463 million, up from a $272 million loss last year. GM reduced its loss from $1.1 billion to $113 million. The improved results can largely be attributed to reduced costs and an improving domestic economy.

Cosmetics Sales Boom in China. Cosmetics companies in the United States, Japan, and France are all eyeing the growing market in China. The Chinese government estimates that the market for cosmetics, fragrance, hair and skin care products was 6 billion yuan ($1 billion) in 1992, up from 100 million yuan in 1980. Currently, imports account for only 2 percent of sales, but the number might improve if the growing number of international retail stores in China are successful. Most major U.S. cosmetic and toiletry firms are pursuing opportunities in China.

Fifth TV Network Announced for January 1995. Paramount Communications and Chris-Craft Industries plan to launch a fifth television network. The proposed network will combine stations owned by the two companies and add affiliate stations from the ranks of independent broadcasters. The decision to start the network was prompted in part by Paramount's desire to develop a new distribution system for its programming because the major networks are increasingly producing their own programming. Similarly, Time-Warner in conjunction with Tribune Company is expected to announce plans to form a television network.

SEC Filings Going On Line. The National Science Foundation has funded a 2-year grant to make Securities and Exchange Commission filings available through the Internet computer network. The SEC's Electronic Data Gathering and Retrieval system should be available by January. The NSF grant will fund access to the SEC data for a number of small institutions that could not afford to purchase this information from private sources.

RELEASES THIS WEEK

GDP

Real GDP grew at a 2.8 percent annual rate in the third quarter. The implicit price deflator rose 1.6 percent.

Budget Deficit

The fiscal year 1993 budget deficit was $254.9 billion.

Auto Sales

Sales of domestically produced automobiles were 7.8 million units at annual rate during the second 10 days in October, the highest number for a 10-day period since January.

Durable Goods

New orders for durable goods were up 0.7 percent in September.

Consumer Confidence

The Conference Board reported that its index of consumer confidence fell during October. In contrast, the University of Michigan's consumer sentiment index rose. Both indexes are preliminary.

MAJOR RELEASES NEXT WEEK

Leading Indicators (Tuesday)

Employment (Friday)

EYES ONLY

U.S. ECONOMIC STATISTICS

	1970–1992	1992	1993:1	1993:2	1993:3
Percent growth (annual rate)					
Real GDP	2.5	3.9	0.8	1.9	**2.8***
GDP deflator	5.8	2.8	3.6	2.3	**1.6**
Productivity					
Nonfarm business	1.1	3.7	−1.8	−1.3	
Manufacturing (begins 1977)	2.0	5.2	4.9	5.2	
Real compensation per hour	0.6	2.2	−1.0	−1.5	
Shares of Real GDP (percent)					
Business fixed investment	10.9	10.6	11.1	11.5	**11.5**
Residential investment	4.8	4.0	4.2	4.0	**4.1**
Exports	7.9	11.6	11.6	11.6	**11.5**
Imports	9.0	12.3	12.8	13.1	**13.1**
Shares of Nominal GDP (percent)					
Personal saving	4.9	4.0	2.8	3.3	**2.8**
Federal surplus	−2.8	−4.6	−4.2	−3.5	

	1970–1992	1992	July 1993	Aug. 1993	Sept. 1993
Unemployment Rate	6.7	7.4	6.8	6.7	6.7
Payroll employment (thousands)					
increase per month			237	−41	156
increase since Jan. 1993			1103	1062	1218
Inflation (percent per period)					
CPI	6.0	2.9	0.1	0.3	0.0
PPI-Finished goods	5.3	1.6	−0.2	−0.6	0.2

*New releases this week in **bold**.

EYES ONLY

FINANCIAL STATISTICS

	1992	July 1993	Aug. 1993	Sept. 1993	Oct. 28, 1993
Dow-Jones Industrial Average	3284	3529	3597	3592	*3688 record high*
Interest Rates					
3-month T-bill	3.43	3.04	3.02	2.95	3.04
10-year T-bond	7.01	5.81	5.68	5.36	5.41
Mortgage rate, 30-year fixed	8.40	7.21	7.11	6.91	6.86
Prime rate	6.25	6.00	6.00	6.00	6.00

INTERNATIONAL STATISTICS

Exchange Rates	**Current level Oct. 28, 1993**	**Percent Change from Week ago**	**Year ago**
Deutschemark-Dollar	1.673	+0.4	+8.2
Yen-Dollar	108.0	–0.2	–12.0
Multilateral (Mar. 1973=100)	94.49	+0.3	+7.6

International Comparisons	**Real GDP growth (last 4 quarters)**	**Unemployment rate**	**CPI inflation (last 12 months)**
United States	+2.8 (Q3)	6.7 (Sep)	2.7 (Sep)
Canada	+2.4 (Q2)	11.3 (Aug)	1.9 (Sep)
Japan	–0.5 (Q2)	2.6 (Jul)	2.0 (Aug)
France	–1.0 (Q2)	11.3 (Jul)	2.3 (Sep)
Germany	–2.4 (Q2)	6.1 (Aug)	4.0 (Sep)
Italy	–0.6 (Q2)	10.6 (Jul)	4.3 (Sep)
United Kingdom	+2.0 (Q3)	10.5 (Aug)	1.8 (Sep)

f: Balanced Budget

March 8, 1993

MEMORANDUM FOR HOWARD PASTER

FROM: **Bruce Reed**
Paul Weinstein

SUBJECT: **Line-Item Veto Compromise**

In our negotiations with Congress on the enhanced rescission, we need to make certain that any legislation includes the following changes from the Stenholm bill of last year (the legislation the Speaker endorsed).

Time Allowed for Presidential Consideration

The bill passed in October would give the President only three days after signing an appropriations bill to use his expedited rescission powers. Appropriations bill are simply too complex, are often rushed through passage at the end of the year, and contain too much hidden pork to properly analyze in three days. The President must have expedited rescission powers for the duration of the fiscal year.

Scope of Rescission Authority

In the bill passed last October, a President could only rescind 25% of authorized appropriations (and 100% of unauthorized appropriations). For expedited rescission to have any real effect on pork, the President needs to be able to rescind the full amount of an authorized appropriation.

This has already been fixed.

Duration of Grant of New Powers

The bill passed in October only authorizes expedited rescission procedures for two years. We should propose that these procedures remain in force for Clinton's entire first term -- even better would be permanent authority. Another option would be to have a review rather than a sunset of the authority.

Detailed Schedule

There needs to be a detailed schedule to insure immediate introduction of a measure to approve the President's rescission, prompt report by committee or automatic discharge -- within seven days and without amendment or recommendation -- and a floor vote within ten days with no amendments and limited debate. The President's rescission could be defeated by a simple majority in either body. No funds could be appropriated under the original appropriations bill until Congress has voted on the President's proposed rescissions.

New Name

Since this compromise is not a line-item veto -- rescission allows the President to eliminate actual programs within a line-item, as well as a percentage of an item -- and the term rescission has limited appeal, we need a new name. We suggest calling it the "Presidential Spending Veto."

cc: Carol Rasco
Bob Rubin
Rahm Emanuel

EYES ONLY

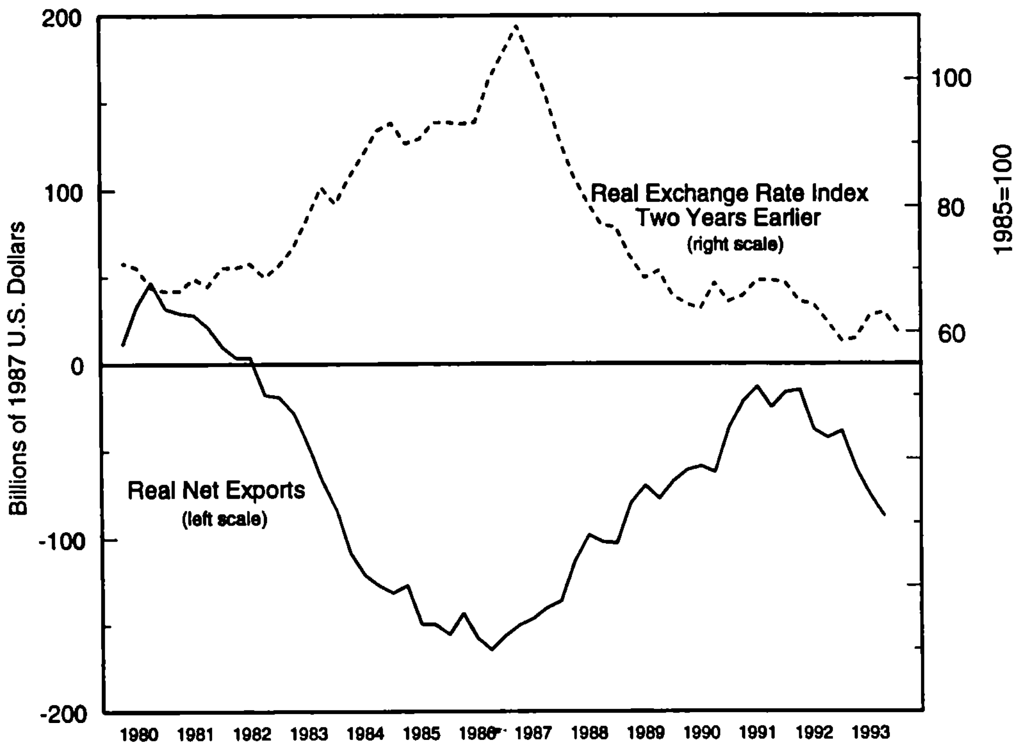
WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

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

December 10, 1993

CHART OF THE WEEK

Real Net Exports versus the Real Exchange Rate



The chart compares real net exports of goods and services (exports minus imports) to the real multilateral exchange rate. Real net exports closely track exchange rates two years earlier. The increase in the trade deficit since 1990 is not, however, associated with any movement of the dollar (see Current Development, page 1).

EYES ONLY

CONTENTS

QUOTATION OF THE WEEK

There's a misinterpretation that it's only the big guys who are interested in the world market. That's baloney. In 20 years, doing business in the world economy for us will be as accepted as doing business in St. Louis and San Francisco, if we can eliminate tariffs.

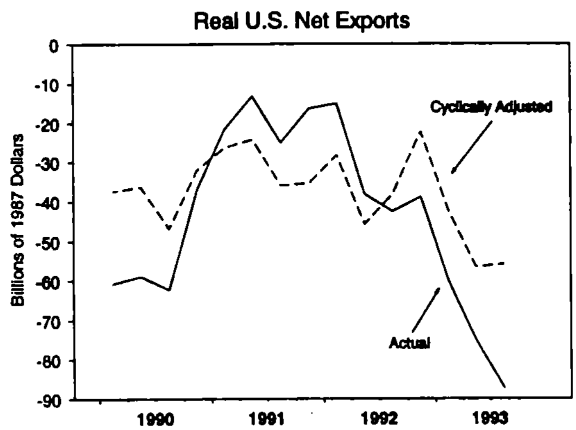
— A furniture manufacturer in Sheboygan Falls, Wisconsin

(Wall Street Journal, December 7)

EYES ONLY

CURRENT DEVELOPMENT

Trade Deficit Widens, Cyclical Factors Largely to Blame



The trade deficit has increased sharply in the last two quarters. The solid line in the chart shows net exports of goods and services (exports minus imports). The trade deficit was only $19 billion in 1991 (1987 prices), compared with $55 billion in 1990 and $100 to $150 billion in the mid-1980s. In the third quarter, the trade deficit rose to almost $90 billion (annual rate).

Analysis. Does the recent widening of the trade deficit mean that we are headed to an era of persistent, high trade deficits as in the 1980s? We think not. Much of the recent swing in net exports is explained by cyclical factors both here and abroad.

- In 1990 and 1991, the United States fell into recession before the rest of the world. As our income declined, our imports fell. Since income was growing abroad, we had stronger export growth than import growth and hence a declining trade deficit.

- In 1992 and especially 1993, we recovered; but Europe and Japan fell into recession. Our imports rose with our income, and our exports sagged because of widespread recession abroad.

- The exchange rate has not moved much in recent years, so it cannot explain the increase in the trade deficit (see Chart of the Week).

The dashed line in the chart shows net exports adjusted for cyclical fluctuations in U.S. and foreign GDP. Cyclical adjustment eliminates much of the sharp drop in net exports. Part of the remaining decline is explained by particularly strong equipment investment, much of which is imported.

EYES ONLY

CURRENT DEVELOPMENT

EITC Claimed by More Eligible Families than Other Programs

The Administration's economic plan substantially expanded the earned income tax credit (EITC). But antipoverty programs serve their purpose only if the targeted population participates. According to recent research, a relatively high fraction of those eligible receive the EITC. The table compares the participation rate for the EITC and other programs.

Analysis. Reasons for the higher participation rate in the EITC than in AFDC and Food Stamps include the following:

- EITC benefits are paid in cash, not in kind.
- There is no EITC bureaucracy that must be met on a face-to-face basis. Participants simply attach a form to their tax returns.
- There is little or no stigma attached to receipt of the EITC.

Participation rates for Head Start and public housing are much lower because these programs cannot accommodate all eligible individuals and therefore must ration availability.

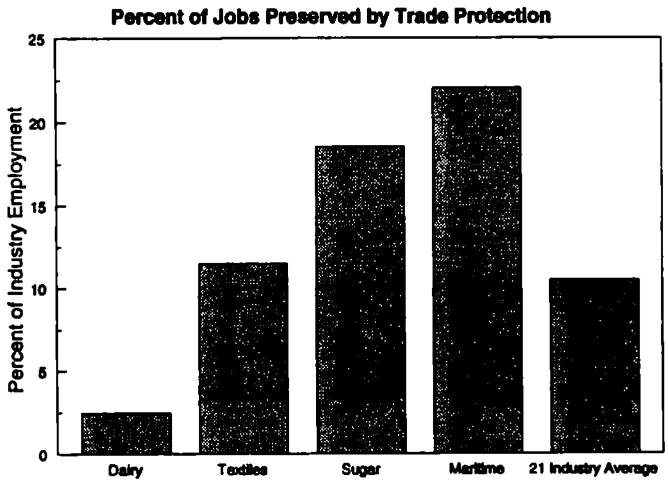
Participation in Selected Antipoverty Programs

Program	Participation Rate of Eligible Population
Earned Income Tax Credit (EITC)	75-90 percent
Aid to Families with Dependent Children (AFDC)	65-70 percent
Food Stamps	56 percent
Head Start	28 percent
Public or Subsidized Housing	20 percent

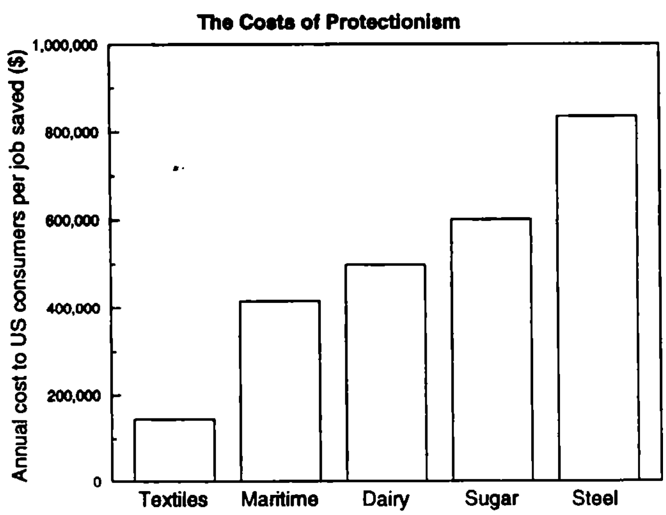
ARTICLE

Losses from Trade Protection

Trade protection is often used to "save" American jobs. Is it effective? Trade barriers do preserve jobs in the protected industry, but frequently only a few jobs are saved. For example, trade barriers are estimated to preserve approximately 2,200 sugar jobs, 2,400 dairy jobs, and 4,400 maritime jobs. While protection saves as many as 165,000 jobs in textiles and apparel, this represents only 11.5 percent of production jobs in the industry. In addition, when industrial goods are protected, costs are raised and jobs are lost in downstream industries.



Keeping "cheap foreign goods" out of our markets means that American consumers must pay more for some of the things they buy. While no one has a complete accounting of the number of jobs preserved or the cost to domestic consumers, estimates indicate that trade barriers are an extravagantly expensive jobs program. The annual cost to U.S. consumers of preserving a (low-wage) job in the textile and apparel industry is $145,000. Even this seems like a bargain compared to annual costs of more than $400,000 per job in the maritime industry and $600,000 per job in the sugar industry. Protection for the steel industry from anti-dumping and countervailing duty cases decided this year is expected to cost American consumers more than $835,000 per year for each job saved.



Why are the costs to consumers per job saved so high? In part, the high costs arise because relatively few jobs are saved. When granted, protection is frequently aimed at declining industries and often fails to halt the decline.

If only a small part of the added cost to consumers is received by workers in protected industries, where does the remaining money go? The largest beneficiaries are generally the protected firms. Their additional profits may be used to finance investment or may be distributed to shareholders. While protection is sometimes rationalized as a way to give firms breathing room to become competitive, there seem to be few instances in which protection has actually improved the competitive position of an industry.

In 1990, protection in 21 industries is estimated to have cost U.S. consumers more than $32 billion, with the textile and apparel industry accounting for about three-fourths of the total. As the table shows, domestic consumers paid more than $24 billion in 1990 to boost profits of textile and apparel producers by less than $12 billion. This case is typical: trade protection normally imposes heavy costs on consumers to secure smaller benefits for industry.

Tariff revenue accounts for part of the difference between the cost to consumers and the benefit to shareholders. The rest is either transferred abroad or is wasted due to inefficiency.

Estimated Economic Impact of U.S. Trade Protection in 1990 (Billions of Dollars)

Protected Industry	U.S. Consumer Cost	U.S. Profit Gain	Tariff Revenue	National Loss
Textiles & Apparel	-24.4	+11.6	+4.2	-8.6
Maritime (Jones Act)	-1.8	+1.3	-	-0.5
Sugar	-1.4	+0.8	-	-0.6
Dairy	-1.2	+1.1	-	-0.1
Total of 21 Industries	-32.3	+15.8	+5.9	-10.4

EYES ONLY

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

Poll Shows Economic Issues Still Important, but other Issues Gain. A Times Mirror poll conducted last weekend asked respondents to identify the issues the President should give the top priority: 28 percent said improving the job situation and 22 percent indicated reducing the deficit. The poll also showed that only 33 percent of Americans now believe economic issues are the nation's most important problems in contrast to 53 percent in June and 76 percent in January 1992. (Crime has risen to 25 percent today from 3 percent 2 years ago.)

Federal Reserve Districts Report Continued Moderate Growth. The Federal Reserve's report of economic conditions by district shows improvements throughout most of the country and in most sectors. Southern California and western Washington, however, continue to show few signs of recovery. Retail sales began to pick up in October in most areas and Thanksgiving holiday sales exceeded expectations in several midwestern districts despite severe weather. Manufacturing improved throughout the country although aerospace and defense-related industries remain weak. Housing markets continued to strengthen and several districts reported constraints developing because of tightening labor and materials markets.

Job Outlook for College Graduates Improves Slightly. A survey of employer hiring intentions for new college graduates projects an increase of 1 percent for 1993-94. The small increase follows declines of 2 percent last year and 10 to 13 percent in each of the 3 previous years. Expected employment opportunities are strongest in the central and southeastern states and weakest in the northeastern and western states.

Mortgage Delinquencies Sink to 19-Year Low. The proportion of homeowners more than 30 days late in making their mortgage payments has fallen to its lowest level since 1974. Delinquencies increased from levels a year earlier in only two states, California and Pennsylvania. The general improvement reflects lower interest payments on new and refinanced mortgages and reduced unemployment.

Optimism of Small Business Improves. Our friends at the NFIB delivered some good news: Their index of small business optimism—based on a survey of NFIB members—rose sharply in November. It now exceeds its level of October 1992.

EYES ONLY

RELEASES THIS WEEK

Consumer Prices **** FOR RELEASE Friday 8:30 A.M. ****

The consumer price index increased 0.2 percent in November. Over the last 12 months, it has increased 2.7 percent.

Producer Prices

The producer price index for finished goods was unchanged in November. Over the last 12 months, it has increased only 0.3 percent.

Productivity

Output per hour grew at a 4.3 percent annual rate in nonfarm business during the third quarter, a significant upward revision from the preliminary estimate.

Auto Sales

Domestic automobiles sold at a 7.1 million annual rate during November compared to 6.3 million in November 1992.

MAJOR RELEASES NEXT WEEK

Retail Sales (Tuesday)

Industrial Production (Wednesday)

Merchandise Trade (Thursday)

Housing Starts (Friday)

EYES ONLY

U.S. ECONOMIC STATISTICS

	1970–1992	1992	1993:1	1993:2	1993:3
Percent growth (annual rate)					
Real GDP	2.5	3.9	0.8	1.9	2.7
GDP deflator	5.8	2.8	3.6	2.3	1.6
Productivity					
Nonfarm business	1.1	3.6	–1.8	–0.4	**4.3***
Manufacturing (begins 1977)	2.0	4.9	**5.1**	5.9	**3.1**
Real compensation per hour	0.6	2.1	–0.9	–1.0	**2.5**
Shares of Real GDP (percent)					
Business fixed investment	10.9	10.6	11.1	11.5	11.6
Residential investment	4.8	4.0	4.2	4.0	4.1
Exports	7.9	11.6	11.6	11.6	11.5
Imports	9.0	12.3	12.8	13.1	13.2
Shares of Nominal GDP (percent)					
Personal saving	4.9	4.0	2.8	3.3	2.8
Federal surplus	–2.8	–4.6	–4.2	–3.5	–3.3

	1970–1992	1992	Sept. 1993	Oct. 1993	Nov. 1993
Unemployment Rate	6.7	7.4	6.7	6.8	6.4
Payroll employment (thousands)					
increase per month			197	147	208
increase since Jan. 1993			1267	1414	1622
Inflation (percent per period)					
CPI	6.0	2.9	0.0	0.4	**0.2***
PPI-Finished goods	5.3	1.6	0.2	–0.2	**0.0**

*New or revised data in **boldface**. Consumer price index data for release **Friday 8:30 A.M.**

EYES ONLY

FINANCIAL STATISTICS

	1992	Sept. 1993	Oct. 1993	Nov. 1993	Dec. 9, 1993
Dow-Jones Industrial Average	3284	3592	3626	3675	3730
Interest Rates					
3-month T-bill	3.43	2.95	3.02	3.10	3.06
10-year T-bond	7.01	5.36	5.33	5.72	5.68
Mortgage rate, 30-year fixed	8.40	6.91	6.82	7.16	7.14
Prime rate	6.25	6.00	6.00	6.00	6.00

INTERNATIONAL STATISTICS

Exchange Rates	**Current level Dec. 9, 1993**	**Percent Change from Week ago**	**Percent Change from Year ago**
Deutschemark-Dollar	1.705	−1.1	+8.7
Yen-Dollar	108.7	−0.0	−12.4
Multilateral (Mar. 1973=100)	95.35	−1.2	+6.2

International Comparisons	**Real GDP growth (last 4 quarters)**	**Unemployment rate**	**CPI inflation (last 12 months)**
United States	+2.8 (Q3)	6.4 (Nov)	**2.7*** (Nov)
Canada	+2.4 (Q2)	11.1 (Oct)	1.9 (Oct)
Japan	−0.5 (Q2)	2.6 (Sep)	1.5 (Sep)
France	−0.8 (Q2)	11.4 (Sep)	2.2 (Oct)
Germany	−2.4 (Q2)	6.4 (Oct)	3.9 (Oct)
Italy	−0.6 (Q2)	10.6 (Jul)	4.3 (Oct)
United Kingdom	+1.9 (Q3)	10.1 (Oct)	1.3 (Oct)

***Consumer price index for release Friday 8:30 A.M.**

11:00

BR/BO/GS/SM

EYES ONLY

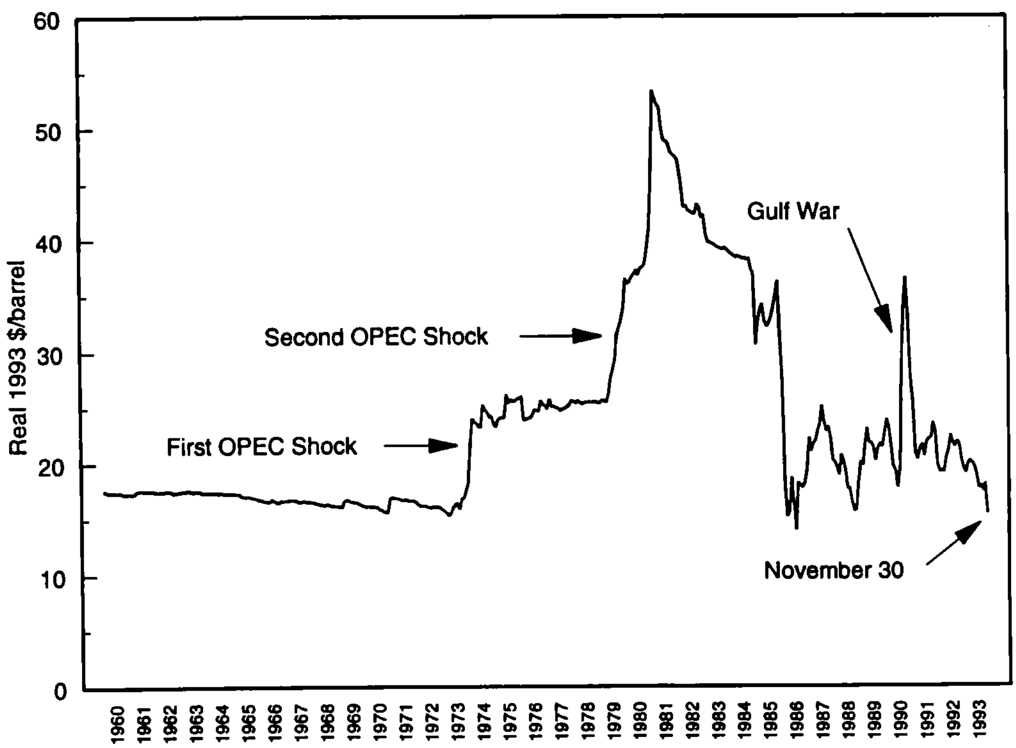
WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

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

December 3, 1993

CHART OF THE WEEK

Real Oil Prices



Oil prices, corrected for inflation, are lower today than they were in 1960.

EYES ONLY

CONTENTS

QUOTATIONS OF THE WEEK

In reaction to the decline in oil prices:

"This is unmitigated good news for the consumer."

—University of North Carolina professor James Smith

"An extremely dangerous situation."

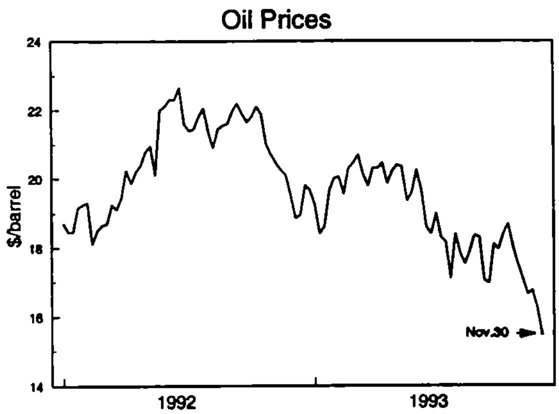
—Houston oilman George Alcorn

(Wall Street Journal, December 1)

EYES ONLY

CURRENT DEVELOPMENT

Oil Price Declines Good News for Inflation and Growth



Oil prices fell by over a dollar a barrel following the failure of OPEC to take action to prop up prices at its meeting that ended November 24. Over the last 6 weeks, prices have fallen by about 15 percent.

Several factors are contributing to lower oil prices. Demand is weak because of recessions in Japan and Europe. Supplies from the North Sea and the former Soviet Union have been unexpectedly high, and Iraq is expected to reenter the world market soon.

Analysis. The decline in oil prices is good news for both inflation and growth. A 15 percent decline, if it turns out to be long-lasting, would reduce CPI inflation by about 0.5 percentage point for a year. Employment would be about 250,000 jobs higher after a year. Even though a decline in oil prices is good news for the economy overall, it hurts oil-patch states.

As the Chart of the Week shows, since 1985 there have been several swings in oil prices about as large as the first OPEC price shock, but they have been relatively short-lived. Because the recent fluctuations in oil prices have been temporary, they have had a much smaller economic impact than did the OPEC shocks. The economic effects of the most recent decline in price will depend on whether it proves to be temporary or is sustained over time.

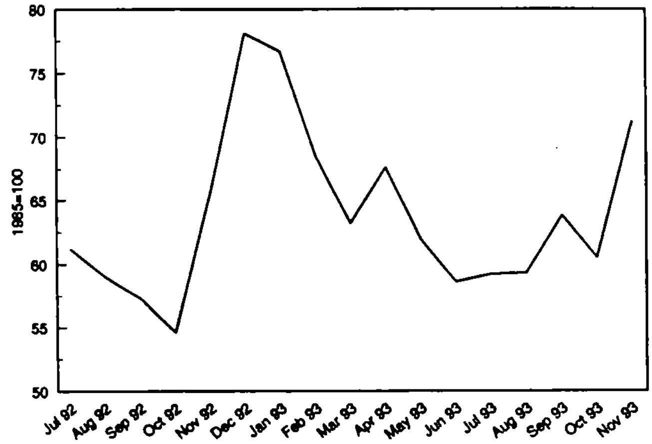
EYES ONLY

CURRENT DEVELOPMENT

Consumer Confidence Rebounds

Consumer confidence, after falling in the spring, has rebounded. The Conference Board's index of consumer confidence rose sharply in November. The University of Michigan's index of consumer sentiment was up strongly in October. Despite these increases, both indexes are still below their December 1992 levels.

Consumer Confidence



Analysis. After the 1992 election, there was an increase in confidence and a burst of consumer spending that fizzled in early 1993. Will the same happen in early 1994? Although psychological factors such as confidence are hard to predict, it is likely that the good performance of the economy late this year will be sustained into 1994. Unlike in 1992, in 1993 the increase in consumption has been supported by growth in jobs. Despite this, the public had remained pessimistic. But with the recent increase in confidence, it appears that consumer pessimism will be a smaller drag on the economy than it was in the first half of 1993.

EYES ONLY

CURRENT DEVELOPMENT

Auto Slump in Japan Cuts Sales, Production, and Profits

Motor vehicle production in Japan is likely to be 10 percent lower in 1993 than in 1991. The main cause of this decline is weak demand in the Japanese domestic market. In addition, the strong yen, slow growth in the industrialized countries, and protectionism in Europe have reduced export sales. Finally, the competitiveness of U.S. auto makers has improved significantly and they have gained market share at the expense of the Japanese in the American market.

Cuts in Japanese Auto Production

- Subaru has sold production facilities to Nissan.
- Nissan closed its Zama plant in suburban Tokyo.
- Isuzu will cease passenger car production entirely.
- Mazda shut down the entire company for 2 days in November.

As a result of slumping demand, the profits of Japanese auto producers have fallen. Profits at Honda during the first 3 months of the current fiscal year were half what they were in the first 3 months of the previous year. Both Nissan and Mazda are showing losses so far this fiscal year.

In addition, cost cutting has put severe pressure on auto parts suppliers in Japan. MITI estimates that as many as one-fourth of the auto parts manufact-urers operating in 1985 are no longer in business.

Analysis. Because of the decline of its domestic market, the Japanese auto industry will find it quite difficult to achieve the goals for purchases of U.S. auto parts negotiated with the Bush Administration. These goals were based on assumptions about sales that have turned out to be far too optimistic. Moreover, reduced demand in Japan will make it more difficult to negotiate increased sales of foreign autos and auto parts, as sought by the United States in the Framework talks.

EYES ONLY

CURRENT DEVELOPMENT

Interest Rate Declines Worsen Pension Underfunding

On November 22, the Pension Benefit Guaranty Corporation (PBGC) released its annual list of the most underfunded pension plans in America. For the second consecutive year, General Motors led the list, with estimated liabilities exceeding assets by over $20 billion. Many other firms also had significantly underfunded pension plans, and the 50 firms topping the list were underfunded in 1992 by over $38 billion—an increase of $9 billion over the previous year.

Analysis. The overall decline in interest rates is one key reason for the increased amount of underfunding. To fund expected future payments to retirees, firms must make contributions to pension plans, which are invested in financial assets such as stocks and bonds. When real interest rates fall, pension plans earn less on their bonds. Consequently, they need more assets in order to finance expected future pensions. Declining interest rates have raised the value of some assets, but these capital gains have not been sufficient to offset the declines in real returns.

GM Proposes Pension Funding Plan

In mid-November, General Motors proposed reducing its pension plan underfunding by contributing a special class of stock with dividends tied to the fortunes of the EDS unit it bought from Ross Perot. Based on the then-current market price of $31 per share, General Motors valued these shares at $5.7 billion. Even with this transfer, GM's pension plan will have over $14 billion in unfunded liabilities. The PBGC is ultimately responsible for underfunded pensions, and these liabilities could be borne by the PBGC were GM to encounter financial distress. The proposed contribution would also leave the General Motors pension fund with a greater concentration of its own shares than current law allows. Such a large holding of GM stock would reduce the diversification of the pension plan's portfolio—leaving the pension plan's soundness excessively vulnerable to declines in GM's performance.

EYES ONLY

ARTICLE

Trade Liberalization, Jobs, and Living Standards

Does trade liberalization—such as NAFTA, the Uruguay Round, and the Japan Framework—really create jobs? The answer is "yes and no," but on balance, job creation is not the only and usually not the main reason to liberalize trade. The primary benefit of trade liberalization is enhanced productivity and living standards over the long run.

Trade Liberalization and Employment

In the short run, the number of jobs in the economy depends on the level of output (real GDP). Roughly speaking, each $1 billion of additional GDP "creates" 20,000 jobs in the U.S. economy. Output, in turn, depends on aggregate demand, one component of which is net exports (the difference between exports and imports). Thus as long as there is slack in the economy—as there is today—an increase in net exports will stimulate production and create jobs. For example, most scholars estimate that NAFTA will boost net exports and create additional jobs over the next several years. On the other hand, when there is little slack in the economy, such as in 1989 when the unemployment rate averaged 5.2 percent, increases in net exports are more likely to create upward pressure on prices than an increase in the number of jobs.

Trade Liberalization and Trade Deficits

Whether trade liberalization creates jobs in the short run depends on whether trade liberalization actually increases net exports. It may, but the effect is likely to be small for two reasons. First, one country's exports are another country's imports, so that liberalization cannot simultaneously raise net exports for all countries. Attempts to create jobs by raising net exports in one country must necessarily reduce net exports in other countries.

Second, and more fundamentally, the macroeconomic factors that determine overall trade deficits are rarely affected by trade liberalization. When a nation runs a trade deficit, it spends more abroad than it earns abroad. Therefore, a trade deficit occurs when a nation's spending exceeds its production. Trade restrictions are not a major cause of our current trade deficit. Instead, the trade deficit reflects our relatively low private saving rate and our large government budget deficits. Unless lowering trade barriers reduces the imbalance between spending and production, it cannot affect our overall trade balance. So trade liberalization should not be expected to have much effect on the U.S. trade balance.

This does not mean that our sectoral talks with Japan cannot raise U.S. exports to Japan. They can. If they succeed, however, and the imbalance between U.S. spending and U.S. production remains, increased Japanese demand for U.S. goods will lead to an appreciation of the dollar. While U.S. exports to Japan will rise as a result of Japanese liberalization, a stronger dollar will lead to increased imports or reduced exports elsewhere. Our bilateral deficit with Japan may decrease, but our overall trade deficit will not change very much.

Although opening Japanese markets is unlikely to have a big impact on the overall U.S. trade deficit, it will still benefit the United States in several ways. First, impediments in the Japanese market cost some American industries sales, profits, and employment opportunities, many of which pay higher wages than those paid in other sectors of the economy. Second, barriers to a major market like Japan preclude the realization of substantial productivity and efficiency gains that could be realized with freer trade. Third, a stronger dollar resulting from an improvement in the U.S.-Japan bilateral trade imbalance would raise the purchasing power of American residents and therefore raise real incomes. Finally, if liberalization of Japan's market is accompanied by a reduction in Japan's multilateral trade surplus, as the Framework calls for, growth in the rest of the world would be positively affected.

Trade Liberalization, Productivity, and Living Standards

If removing trade barriers will not necessarily create jobs or reduce our trade deficit, why is it so important? In the long run the main benefit from reducing trade barriers is found in higher productivity and therefore in higher incomes and improved living standards. Increased trade allows nations to specialize in areas where their productivity advantages over other nations are greatest. By increasing worldwide efficiency, trade liberalization raises productivity and living standards <u>in all nations</u> that are party to a trade agreement. <u>Higher wages and living standards, not higher employment or reduced trade deficits, are the main long-run benefits from freer trade</u>.

Trade Liberalization and Labor Adjustment

Although trade liberalization has immediate and lasting benefits for the nation as a whole, it will usually adversely affect some groups. Some workers in import-competing industries might lose their jobs. Many of these workers may quickly find other employment if the economy is growing strongly. But even in a robust economy, adjustment for others might be long and hard, especially if their skills cannot be readily transferred to another industry.

Trade liberalization creates enough benefits to more than compensate for the harm suffered by displaced workers. But there is no guarantee that the marketplace will fully compensate them. Training programs can help workers who must adjust their skills to meet changes in the workplace that arise from international competition, new technology, or changes in demand for products.

EYES ONLY

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

Retailers Cautious Despite Early Gains. Several large retailers reported double-digit percentage gains in sales during the Thanksgiving holiday, compared with the same period a year ago. The only early reports of slow sales came from the Midwest and Texas, which were hit hard by winter storms. A California regional department store chain reported sales increases of at least 10 percent, and a discount women's apparel chain reported increases of 5 percent. Interviews suggest shoppers remain cautious and unusually value conscious.

Japanese Stock Market Plummets. On Thursday Japan's Nikkei-225 stock average closed at 17,459, about 15 percent below its level in late October. The index had fallen to 16,079 on Monday, but began to recover Tuesday after the Japanese government promised to take actions to stimulate the economy.

Business Survey Finds NAFTA Will Boost Net Exports. A survey of 400 senior and midlevel decisionmakers in four cyclically-sensitive industries found that 56 percent expect their companies to increase exports to Mexico with the enactment of NAFTA. Fewer than 10 percent expect their businesses to invest in production facilities in Mexico or to increase imports of Mexican parts and supplies. These views generally hold true across industry sectors and regions, although 12 percent of Western respondents expect imports from Mexico to increase.

Volkswagen Introduces Four-Day Workweek. In an effort to avoid massive layoffs, Europe's largest car maker and labor representatives agreed to a temporary four-day workweek with reduced wages. Bonus redistributions and a small pay raise in January will keep monthly paychecks near 1993 levels. VW also agreed to move up the timetable for its earlier agreement to shorten the standard workweek to 35 hours from 37 hours.

Banks Continue to Ease Terms and Standards of Lending. The Federal Reserve Senior Loan Officer Opinion Survey for November showed continued easing of terms and standards on loans to businesses and households over the past 3 months. For the third consecutive quarter, respondents reported easing loan terms for both large and small firms. The loan officers also reported continued easing for consumer installment and home equity loans and mortgage loans.

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RELEASES THIS WEEK

Employment ** FOR RELEASE FRIDAY 8:30 A.M. **

The unemployment rate in November fell to 6.4 percent. Nonfarm payroll employment increased by 208,000 jobs.

Leading Indicators ** FOR RELEASE FRIDAY 8:30 A.M. **

The composite index of leading indicators rose 0.5 percent in November.

GDP

Real GDP in the third quarter grew at a 2.7 percent annual rate, a downward revision of 0.1 percentage point from the advance estimate.

Personal Income and Consumption

Personal income rose 0.6 percent in October. Corrected for inflation, consumer spending rose 0.4 percent.

Purchasing Managers' Index

The National Association of Purchasing Managers' index rose sharply in November for the second consecutive month.

MAJOR RELEASES NEXT WEEK

Productivity (Wednesday)

PPI (Thursday)

CPI (Friday)

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U.S. ECONOMIC STATISTICS

	1970–1992	1992	1993:1	1993:2	1993:3
Percent growth (annual rate)					
Real GDP	2.5	3.9	0.8	1.9	**2.7**
GDP deflator	5.8	2.8	3.6	2.3	**1.6**
Productivity					
Nonfarm business	1.1	3.6	–1.8	–0.4	3.9
Manufacturing (begins 1977)	2.0	4.9	5.0	5.9	2.4
Real compensation per hour	0.6	2.1	–0.9	–1.0	2.3
Shares of Real GDP (percent)					
Business fixed investment	10.9	10.6	11.1	11.5	**11.6**
Residential investment	4.8	4.0	4.2	4.0	**4.1**
Exports	7.9	11.6	11.6	11.6	**11.5**
Imports	9.0	12.3	12.8	13.1	**13.2**
Shares of Nominal GDP (percent)					
Personal saving	4.9	4.0	2.8	3.3	**2.8**
Federal surplus	–2.8	–4.6	–4.2	–3.5	**–3.3**

	1970–1992	1992	Sept. 1993	Oct. 1993	Nov. 1993
Unemployment Rate	6.7	7.4	6.7	6.8	**6.4***
Payroll employment (thousands)					
increase per month			**197**	**147**	**208***
increase since Jan. 1993			**1267**	**1414**	**1622**
Inflation (percent per period)					
CPI	6.0	2.9	0.0	0.4	NA
PPI-Finished goods	5.3	1.6	0.2	–0.2	NA

*New or revised data in **boldface**. Unemployment rate and employment data for release **Friday 8:30 A.M.**

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FINANCIAL STATISTICS

	1992	Sept. 1993	Oct. 1993	Nov. 1993	Dec. 2, 1993
Dow-Jones Industrial Average	3284	3592	3626	3675	3702
Interest Rates					
3-month T-bill	3.43	2.95	3.02	3.10	3.11
10-year T-bond	7.01	5.36	5.33	5.72	5.81
Mortgage rate, 30-year fixed	8.40	6.91	6.82	7.16	7.25
Prime rate	6.25	6.00	6.00	6.00	6.00

INTERNATIONAL STATISTICS

Exchange Rates	**Current level Dec. 2, 1993**	**Percent Change from Week ago**	**Percent Change from Year ago**
Deutschemark-Dollar	1.724	+1.1	+9.6
Yen-Dollar	108.7	+0.5	−12.6
Multilateral (Mar. 1973=100)	96.50	+0.8	+7.1

International Comparisons	**Real GDP growth (last 4 quarters)**	**Unemployment rate**	**CPI inflation (last 12 months)**
United States	+2.8 (Q3)	**6.4*** (Nov)	2.8 (Oct)
Canada	+2.4 (Q2)	11.2 (Sep)	1.9 (Oct)
Japan	−0.5 (Q2)	2.6 (Aug)	1.5 (Sep)
France	−0.8 (Q2)	11.3 (Aug)	2.2 (Oct)
Germany	−2.4 (Q2)	6.2 (Sep)	3.9 (Oct)
Italy	−0.6 (Q2)	10.6 (Jul)	4.3 (Oct)
United Kingdom	+1.9 (Q3)	10.5 (Aug)	1.3 (Oct)

***Unemployment rate for release Friday 8:30 A.M.**