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THE PRESIDENT HAS SEEN
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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 29, 1999

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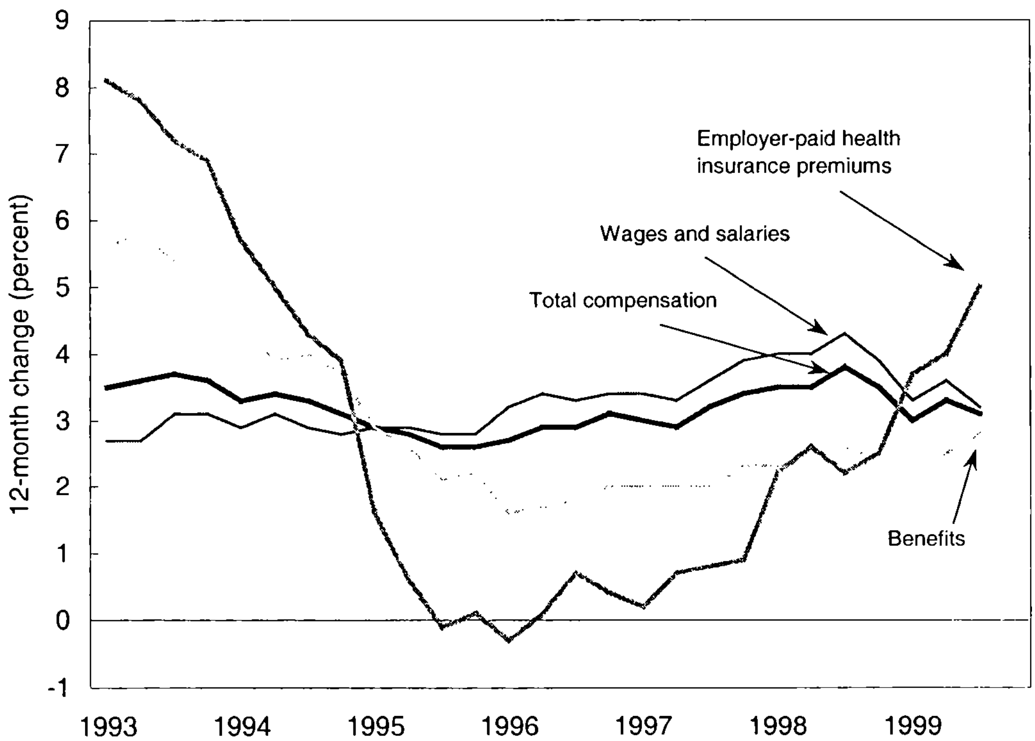
CHART OF THE WEEK

Employment Cost Index for Private Industry



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

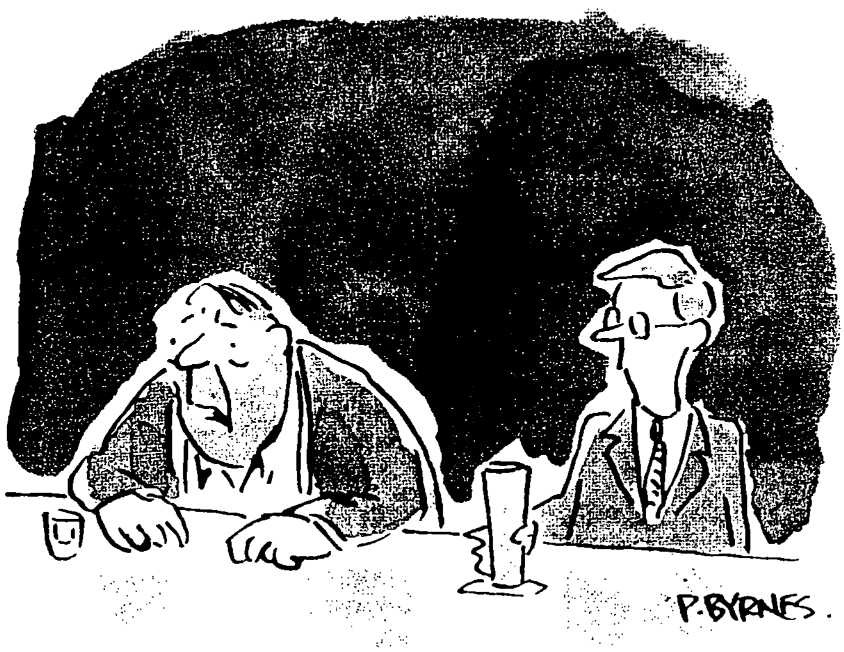
<u>CONTENTS</u>

CURRENT DEVELOPMENT

SPECIAL ANALYSIS

ARTICLE

DEPARTMENTS



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

<u>CURRENT DEVELOPMENT</u>

GDP Scorecard: Third Quarter 1999

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

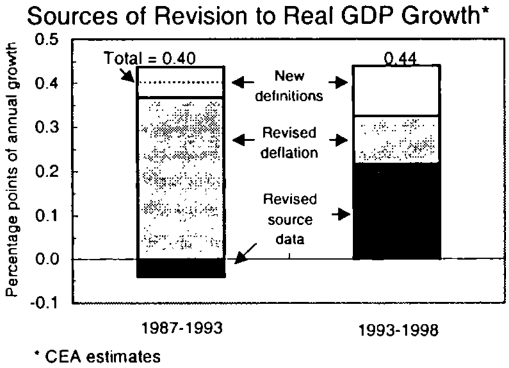
Component	Growth*	Comments
Total consumer expenditures	4.3%	Although down from an annual growth rate of 5.8 percent in the first half, this growth rate is still strong and exceeds the growth of real disposable income.
Equipment and software	21.7%	As usual, computer investment was strong, but industrial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

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

SPECIAL ANALYSIS

Revisions Show Higher GDP Growth

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



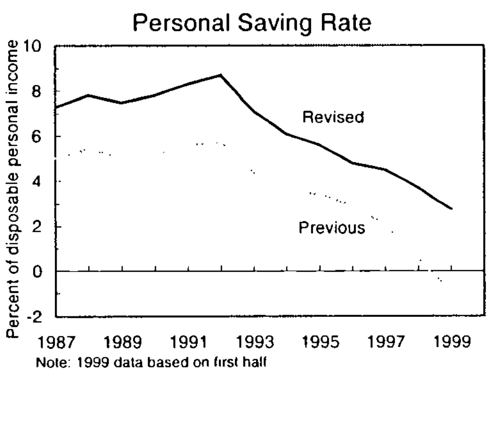
On the product side. Over the 11 year period between 1987 and 1998, revisions to the annual rate of growth of real GDP averaged 0.4 percentage point. Since the first quarter of 1993, real GDP has grown at an average annual rate of 3.8 percent. Over the past 4 years real GDP grew at a 4.1 percent annual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

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

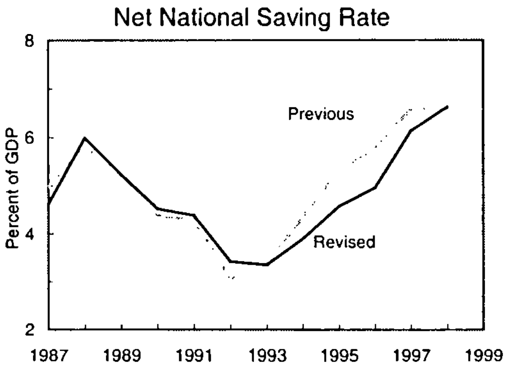
- Source data. Incorporating new data from the economic censuses and other sources added about 0.2 percentage point per year to growth since 1993, but had little impact on prior years.

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

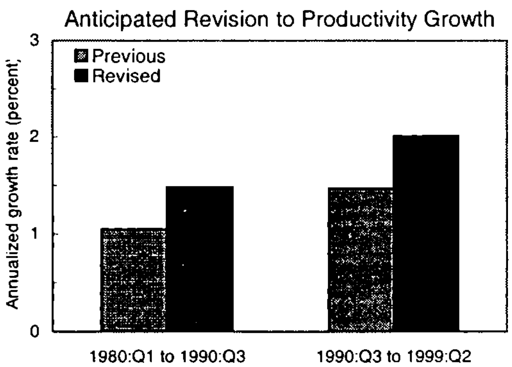
- New definitions. The most significant new definition is the inclusion of the purchase and development of computer software as investment, raising the *level* of GDP by about 1.9 percent by 1998. This change raises the *growth rate* of real GDP by an average of 0.1 percentage point per year.



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



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



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

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

ARTICLE

Evaluating the Evidence on Job Stability

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

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

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

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

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

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

THE PRESIDENT HAS SEEN
11-8-99

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

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

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

Good argument
for Increase

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

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INTERNATIONAL ROUNDUP

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

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

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

RELEASES THIS WEEK

Gross Domestic Product

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

Employment Cost Index

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

Advance Durable Orders

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

Consumer Confidence

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

MAJOR RELEASES NEXT WEEK

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

U.S. ECONOMIC STATISTICS

	1970-1993	1998	1999:1	1999:2	1999:3
Percent growth (annual rate)					
Real GDP (chain-type)	**3.0**	**4.6**	**3.7**	**1.9**	**4.8**
GDP chain-type price index	**5.2**	**1.1**	**2.0**	**1.3**	**1.0**
Nonfarm business (NFB) sector:					
Productivity (chain-type)	1.5	2.6	3.6	0.6	N.A.
Real compensation per hour:					
Using CPI	0.6	2.5	2.9	1.5	N.A.
Using NFB deflator	1.3	3.7	3.0	3.7	N.A.
Shares of Nominal GDP (percent)					
Business fixed investment	N.A.	**12.5**	**12.6**	**12.6**	**12.8**
Residential investment	N.A.	**4.2**	**4.4**	**4.5**	**4.4**
Exports	8.2	**11.0**	**10.7**	**10.7**	**10.9**
Imports	9.2	**12.7**	**12.9**	**13.4**	**13.9**
Personal saving	N.A.	**2.6**	**2.2**	**1.8**	**1.5**
Federal surplus	N.A.	**0.5**	**1.1**	**1.3**	N.A.

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

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

New or revised data in **boldface**.

FINANCIAL STATISTICS

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

INTERNATIONAL STATISTICS

Exchange Rates	**Current level October 28, 1999**	**Percent Change from**	
		Week ago	**Year ago**
Euro (in U.S. dollars)	1.052	-2.7	N.A.
Yen (per U.S. dollar)	105.1	-0.8	-10.6
Major currencies index (Mar. 1973=100) (trade-weighted value of the U.S. $)	92.65	0.6	-0.6

International Comparisons [1]	**Real GDP growth** (percent change last 4 quarters)	**Unemployment rate** (percent)	**CPI inflation** (percent change in index last 12 months)
United States	4.1 (Q3)	4.2 (Sep)	2.6 (Sep)
Canada	3.7 (Q2)	7.8 (Aug)	2.1 (Aug)
Japan	1.1 (Q2)	4.7 (Aug)	0.2 (Aug)
France	2.1 (Q2)	11.3 (Aug)	0.5 (Aug)
Germany	0.6 (Q2)	7.1 (Aug)[2]	0.6 (Aug)
Italy	0.8 (Q2)	12.1 (Apr)	1.7 (Aug)
United Kingdom	1.8 (Q3)	6.0 (Jun)	1.1 (Aug)

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

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

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10-21-99

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

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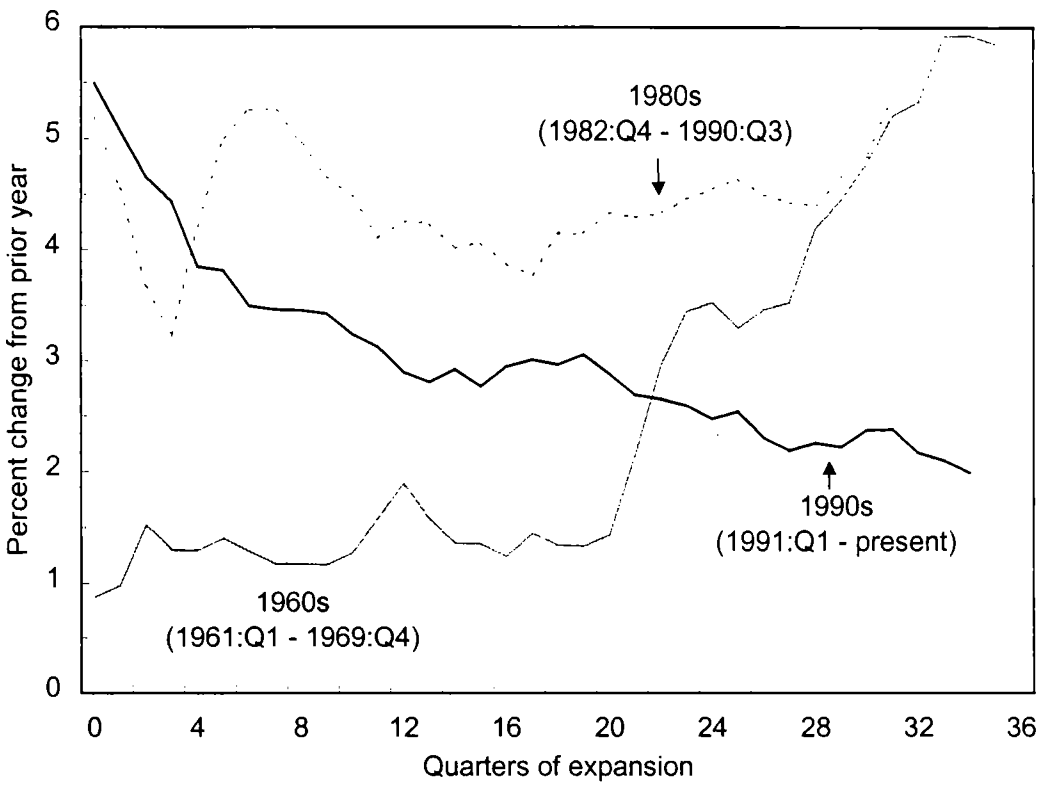
October 22, 1999

CHART OF THE WEEK

Core Inflation in Three Long Expansions



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

CONTENTS

TREND

SPECIAL ANALYSIS

ARTICLE

DEPARTMENTS

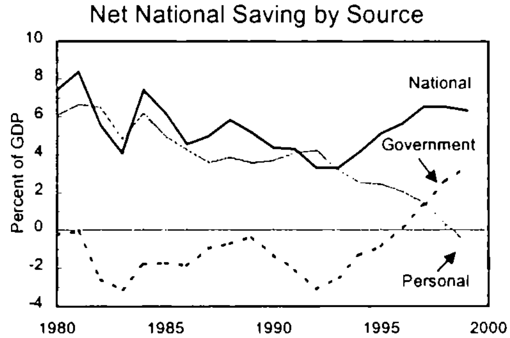
TREND

Have Americans Stopped Saving?

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

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

Net National Saving by Source



Note: 1999 data based on first half

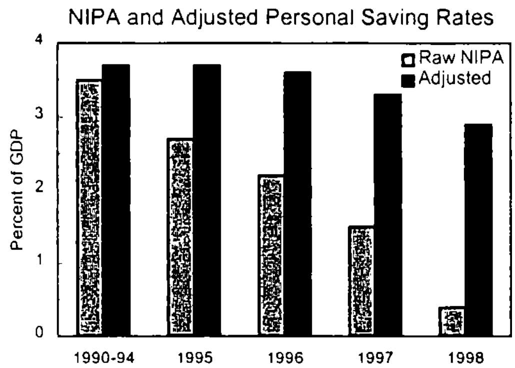
Measuring personal saving. In general, saving may be thought of as the part of current income that is laid aside for future use. The recent study suggests that some adjustments to the NIPA measure of personal saving might bring it more in line with this economic concept of saving. Among the most important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

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

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

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

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



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

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

SPECIAL ANALYSIS

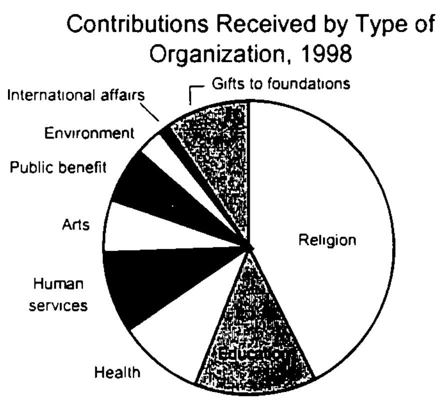
Recent Trends in Philanthropy

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

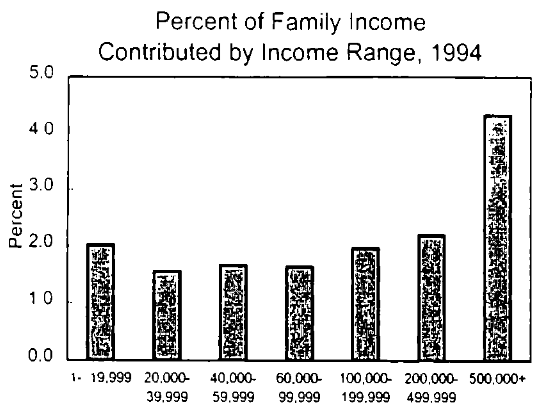
Sources of data. Data on giving come from a variety of sources. The data in the upper chart come from *Giving USA*, which combines data on giving by individuals, foundations, and corporations to make annual estimates of total giving. Individual giving (apart from bequests) is estimated from IRS data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

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

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



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



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

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

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

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

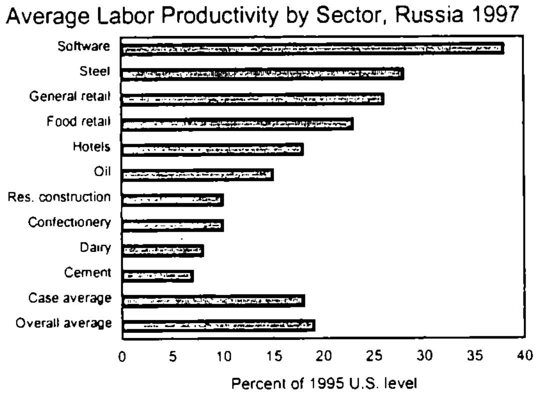
ARTICLE

Reviving Russia: What Is to Be Done?

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

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

Average Labor Productivity by Sector, Russia 1997



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

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

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

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

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

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

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

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

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

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

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

10-27-99

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

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

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

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

10-27-99

INTERNATIONAL ROUNDUP

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

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

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

RELEASES THIS WEEK

U.S. International Trade in Goods and Services

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

Housing Starts

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

Consumer Price Index

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

MAJOR RELEASES NEXT WEEK

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

U.S. ECONOMIC STATISTICS

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

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

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

New or revised data in **boldface**.

FINANCIAL STATISTICS

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

INTERNATIONAL STATISTICS

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

International Comparisons 1/	**Real GDP growth** (percent change last 4 quarters)	**Unemployment rate** (percent)	**CPI inflation** (percent change in index last 12 months)
United States	3.9 (Q2)	4.2 (Sep)	2.6 (Sep)
Canada	3.7 (Q2)	7.8 (Aug)	2.1 (Aug)
Japan	1.1 (Q2)	4.7 (Aug)	0.2 (Aug)
France	2.1 (Q2)	11.3 (Aug)	0.5 (Aug)
Germany	0.6 (Q2)	7.1 (Aug) 2/	0.6 (Aug)
Italy	0.8 (Q2)	12.1 (Apr)	1.7 (Aug)
United Kingdom	1.4 (Q2)	6.0 (Jun)	1.1 (Aug)

1/ For unemployment data, rates approximating U.S. concepts as calculated by the U.S. Department of Labor, Bureau of Labor Statistics.
2/ Rate for former West Germany. Using OECD standardized unemployment data, the unemployment rate for unified Germany for August was 9.2 percent.

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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

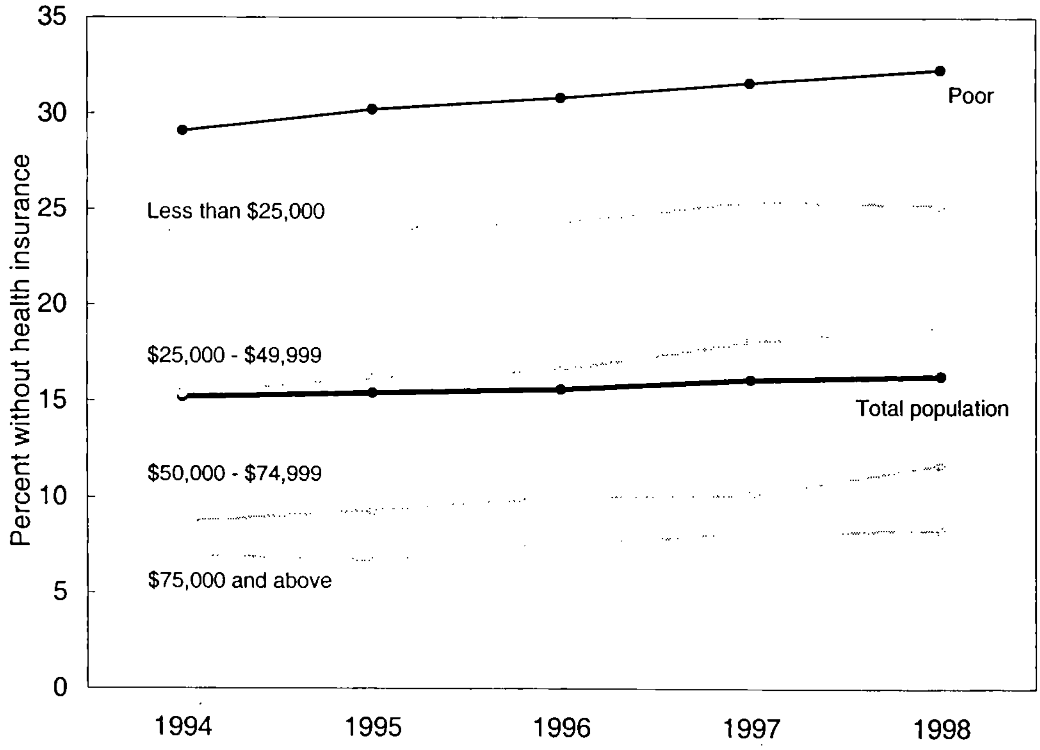
Copied
Jennings
Podesta
Baily

October 8, 1999

CJennings

CHART OF THE WEEK

Lack of Health Insurance Coverage by Income Group



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

How many poor not eligible for Medicaid?

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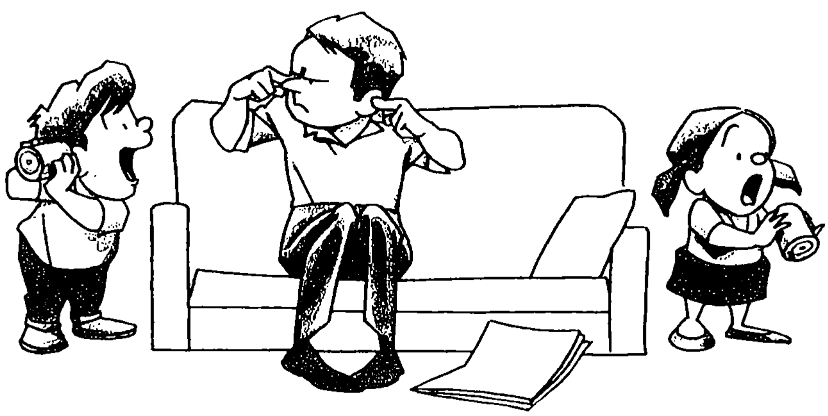
CONTENTS



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

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TREND

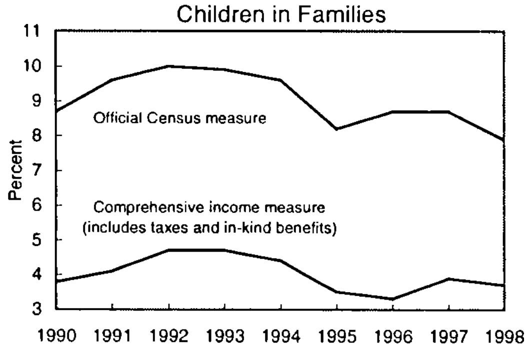
Extreme Child Poverty and the Income of Single Mothers

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

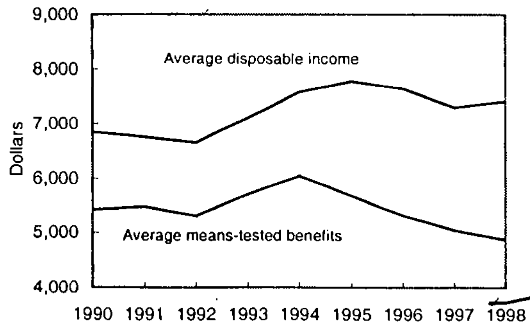
Background. The CDF report focused on extreme poverty (household income less than half the poverty threshold). While official Census data showed no change from 1996 to 1997 in the proportion of children living in extreme poverty, CDF used a comprehensive definition of income that includes the effects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

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

Extreme Poverty Rates for Children in Families



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



Female-headed households. The trend toward lower disposable income for the poorest fifth of female-headed households with children reported by the CBPP was also halted in 1998. The HHS analysis shows that the average

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10-12-99

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means-tested benefits received by this group continued to decline in 1998 (see lower chart on previous page). However, earnings and other income increased by more than enough to offset the decline in benefits, leading to an increase in average disposable income (the comprehensive definition of income). As a result, the comprehensive measure of the poverty rate for female-headed families declined slightly between 1997 and 1998.

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

Why? Reg. in eligibility? admin. policy? Gene

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SPECIAL ANALYSIS

An Alternative to Stricter Medicaid Asset Limits

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

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

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

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

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

Early indicators are encouraging. Preliminary evaluations suggest that partnership programs have successfully attracted middle-income-and-asset households—exactly those who might otherwise transfer their assets in order to qualify for Medicaid. In New York, partnership insurance accounts for 20 percent of all long-term care policies active in the state. In addition, partnership policies

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10-12-99

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may represent a more affordable long-term care option for some people. In Connecticut, for example, it is only necessary to purchase an amount of insurance equal to the amount of assets an individual wishes to protect. These early indicators suggest that partnership policies may present a viable way to address the transfer problem.

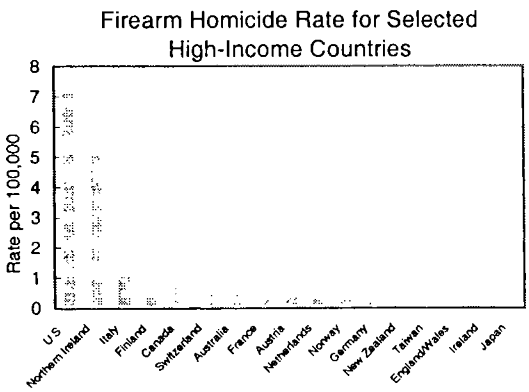
Policy implications. Partnership programs are consistent with Administration goals of increasing long-term care insurance coverage, expanding Medicaid eligibility, and encouraging partnerships between Medicaid and qualified elderly housing. However, even in states that have partnership programs, few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

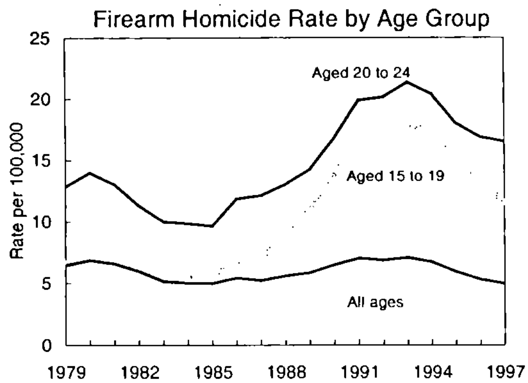
Conclusion. The Administration has proposed a major initiative to address the Nation's long-term care needs. Some version of partnership programs may offer additional encouragement for using private long-term care insurance rather than simply transferring assets to qualify for Medicaid.

ARTICLE

The Costs of Gun Violence

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





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

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

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

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

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

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

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10-12-99

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BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

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

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

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

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INTERNATIONAL ROUNDUP

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

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

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

EYES ONLY

RELEASES THIS WEEK

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

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

Leading Indicators

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

MAJOR RELEASES NEXT WEEK

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

EYES ONLY

U.S. ECONOMIC STATISTICS

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

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

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

New or revised data in **boldface**.
Employment and unemployment data **embargoed until 8:30 a.m., Friday, October 8, 1999**.

EYES ONLY

FINANCIAL STATISTICS

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

INTERNATIONAL STATISTICS

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

International Comparisons [1]	**Real GDP growth** (percent change last 4 quarters)	**Unemployment rate** (percent)	**CPI inflation** (percent change in index last 12 months)
United States	3.9 (Q2)	**4.2** (Sep)	2.3 (Aug)
Canada	3.7 (Q2)	7.7 (Jul)	2.1 (Aug)
Japan	1.1 (Q2)	4.9 (Jul)	0.2 (Aug)
France	2.1 (Q2)	11.3 (Jun)	0.5 (Aug)
Germany	0.6 (Q2)	7.1 (Jul)[2]	0.6 (Aug)
Italy	0.8 (Q2)	12.1 (Apr)	1.7 (Aug)
United Kingdom	1.4 (Q2)	6.1 (May)	1.1 (Aug)

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

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

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

CC; MNB
RB
AC
CS

10-5-99

EYES ONLY

WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

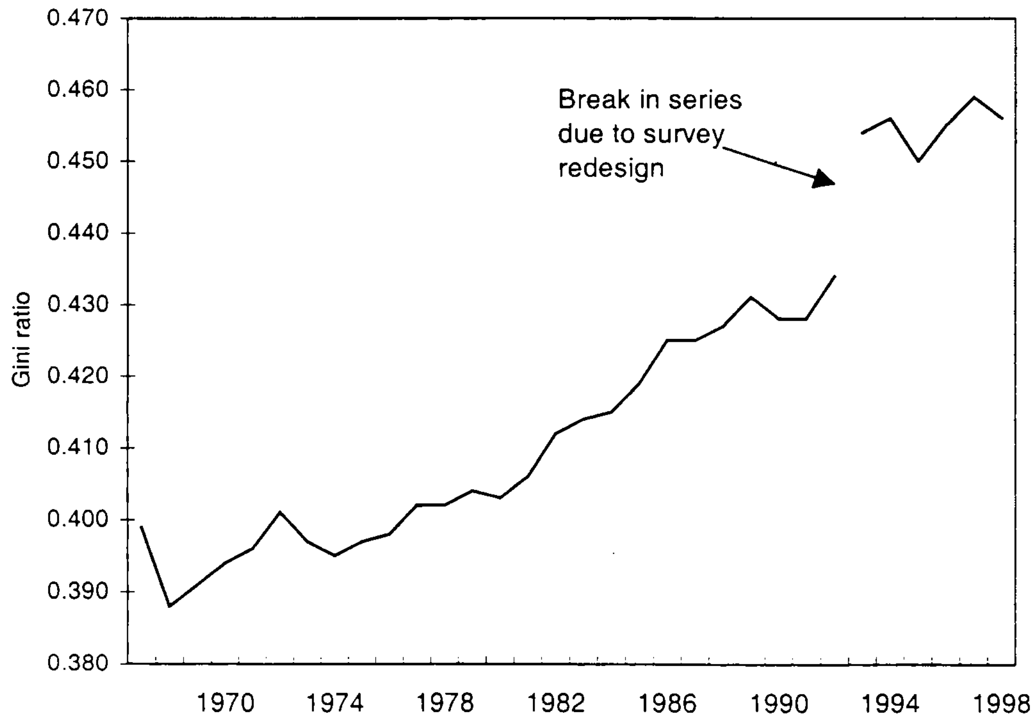
Prepared by the Council of Economic Advisers
with the assistance of the Office of the Vice President

copied
Baily
Podesta
Pg 6:
Reed
Podesta
Pg 7:
Sperling
Podesta

October 1, 1999

CHART OF THE WEEK

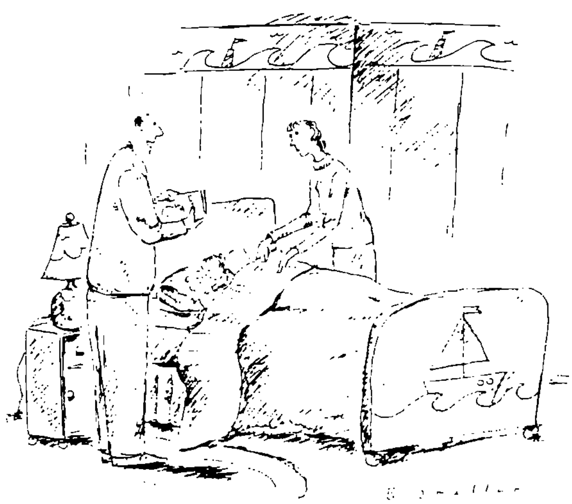
Income Inequality Has Stopped Increasing



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

EYES ONLY

CONTENTS



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

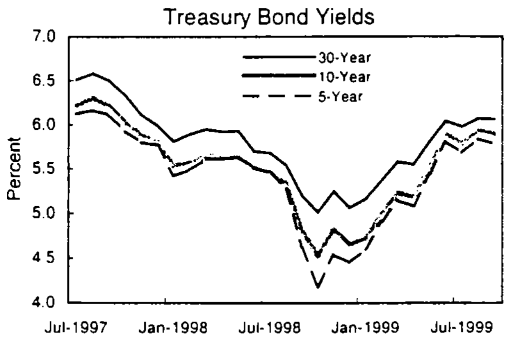
10-5-99

EYES ONLY

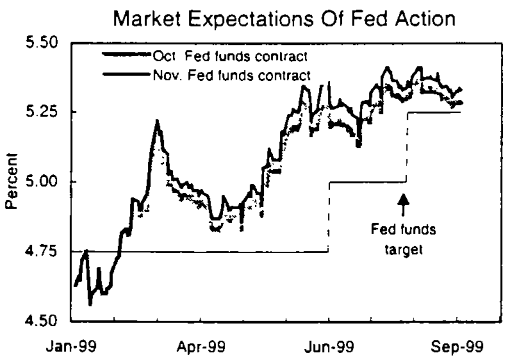
FINANCIAL MARKET UPDATE

Third Quarter, 1999

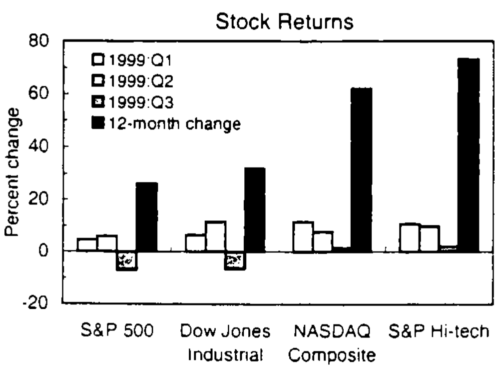
In August the Fed again raised its Federal funds target by ¼ point. Interest rates this quarter have remained near levels reached in June, and growth in stock prices has stalled.



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



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



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

EYES ONLY

CURRENT DEVELOPMENT

Y2K Inventory Building Could Make GDP More Volatile

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

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

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

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

EYES ONLY

SPECIAL ANALYSIS

E-Commerce (Re)discovers the Distribution System

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

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

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

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

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

EYES ONLY

10-5-99

ARTICLE

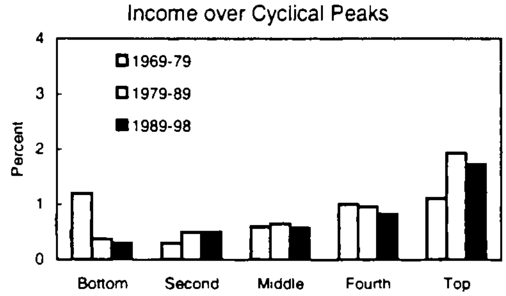
Measuring Income and Poverty

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

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

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

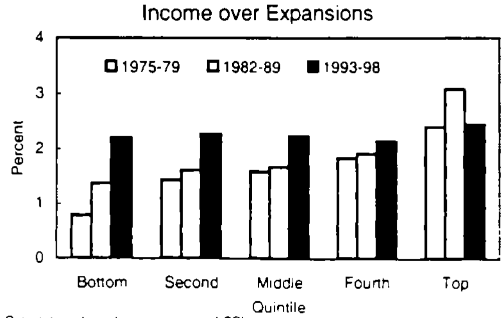
Average Annual Growth in Household Income over Cyclical Peaks



Calculations based on experimental CPI

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

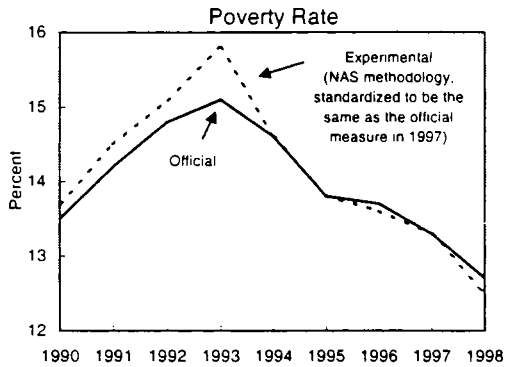
Average Annual Growth in Household Income over Expansions



Calculations based on experimental CPI

expansions shown in the chart (except for the growth in the richest fifth in the 1982-89 expansion).

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



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

EYES ONLY

10-5-99

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

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

cc Bruce
We need a plan to deal w/ this
BC

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

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Podesta

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

EYES ONLY

10-8-99

INTERNATIONAL ROUNDUP

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

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Gene ?

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Sperling
Podesta

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

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

EYES ONLY

RELEASES THIS WEEK

NAPM Report on Business

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

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

Gross Domestic Product

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

Advance Durable Orders

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

Consumer Confidence

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

MAJOR RELEASES NEXT WEEK

Leading Indicators (Tuesday)
Employment (Friday)

EYES ONLY

U.S. ECONOMIC STATISTICS

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

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

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

New or revised data in **boldface**.

EYES ONLY

FINANCIAL STATISTICS

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

INTERNATIONAL STATISTICS

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

International Comparisons [1]	**Real GDP growth** (percent change last 4 quarters)	**Unemployment rate** (percent)	**CPI inflation** (percent change in index last 12 months)
United States	3.9 (Q2)	4.2 (Aug)	2.3 (Aug)
Canada	3.7 (Q2)	7.7 (Jul)	2.1 (Aug)
Japan	1.1 (Q2)	4.9 (Jul)	-0.1 (Jul)
France	2.1 (Q2)	11.3 (Jun)	0.5 (Aug)
Germany	0.6 (Q2)	7.1 (Jul)[2]	0.6 (Aug)
Italy	0.8 (Q2)	12.1 (Apr)	1.7 (Aug)
United Kingdom	1.4 (Q2)	6.1 (May)	1.1 (Aug)

1/ For unemployment data, rates approximating U.S. concepts as calculated by the U.S. Department of Labor, Bureau of Labor Statistics.
2/ Rate for former West Germany. Using OECD standardized unemployment data, the unemployment rate for unified Germany for July was 9.1 percent.

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THE PRESIDENT HAS SEEN
9-27-99

WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

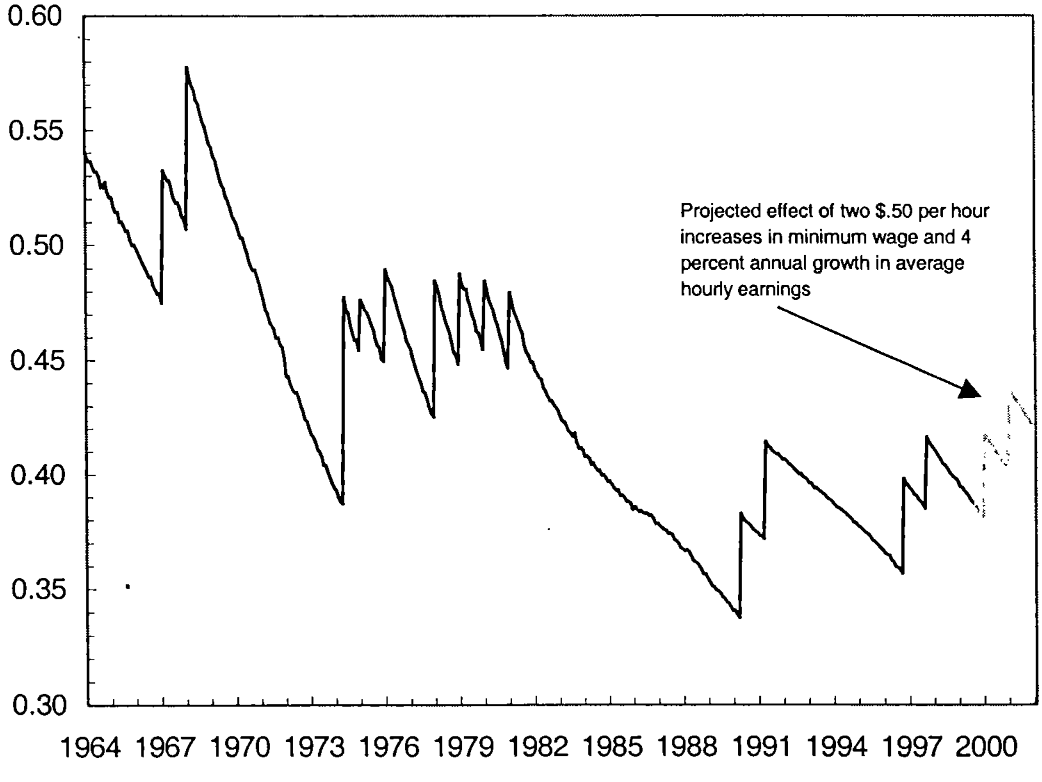
Prepared by the Council of Economic Advisers
with the assistance of the Office of the Vice President

copied entire report: Baily / Podesta
pg 6: Sperling / Podesta

September 24, 1999

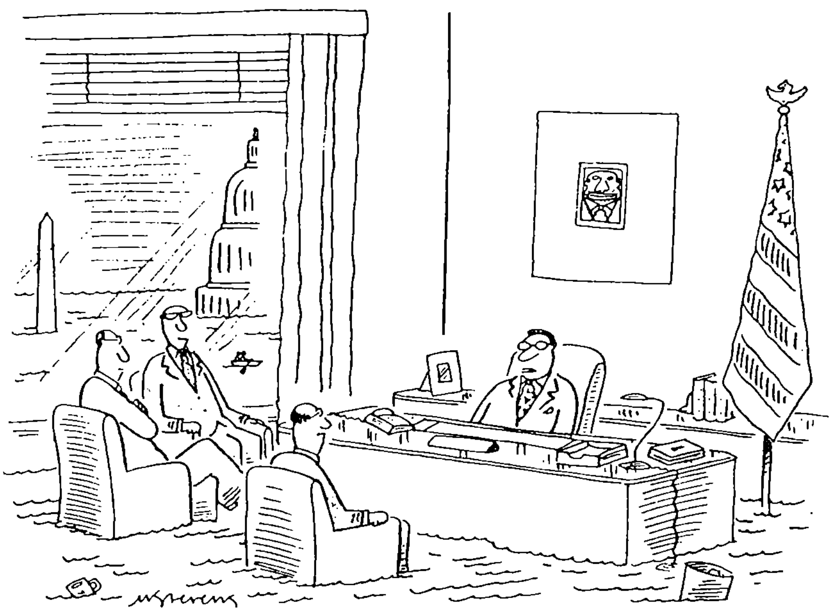
CHART OF THE WEEK

Ratio of the Minimum Wage to Average Hourly Earnings



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

CONTENTS



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

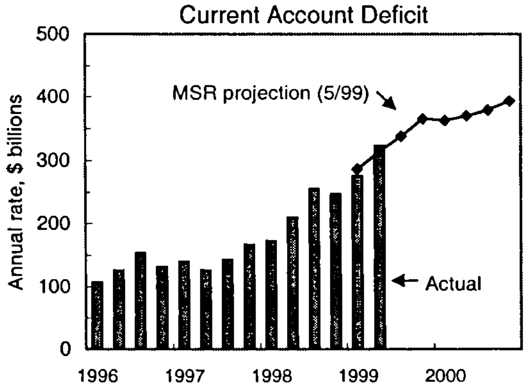
MACROECONOMIC UPDATE

Third Quarter Should Be Strong

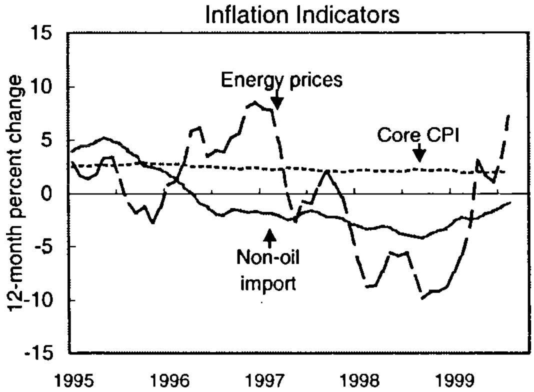
Labor market and consumption indicators point to an acceleration of GDP in the third quarter.

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

Current Account Deficit



Inflation Indicators



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

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

THE PRESIDENT HAS SEEN
9-27-99

SPECIAL ANALYSIS

Hot Economy, Cool Emissions?

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

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

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

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

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

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

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

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

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

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BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

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

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

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

THE PRESIDENT HAS SEEN
9-27-99

INTERNATIONAL ROUNDUP

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

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

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

RELEASES THIS WEEK

U.S. International Trade in Goods and Services

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

MAJOR RELEASES NEXT WEEK

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

U.S. ECONOMIC STATISTICS

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

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

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

FINANCIAL STATISTICS

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

INTERNATIONAL STATISTICS

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

International Comparisons [1/]	**Real GDP growth** (percent change last 4 quarters)	**Unemployment rate** (percent)	**CPI inflation** (percent change in index last 12 months)
United States	3.9 (Q2)	4.2 (Aug)	2.3 (Aug)
Canada	3.7 (Q2)	7.7 (Jul)	2.1 (Aug)
Japan	1.1 (Q2)	4.9 (Jul)	-0.1 (Jul)
France	2.1 (Q2)	11.3 (Jun)	0.3 (Jun)
Germany	0.6 (Q2)	7.1 (Jul)[2/]	0.6 (Jul)
Italy	0.8 (Q2)	12.1 (Apr)	1.7 (Aug)
United Kingdom	1.4 (Q2)	6.1 (May)	1.1 (Aug)

1/ For unemployment data, rates approximating U.S. concepts as calculated by the U.S. Department of Labor, Bureau of Labor Statistics.
2/ Rate for former West Germany. Using OECD standardized unemployment data, the unemployment rate for unified Germany for July was 9.1 percent.