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WEB Articles

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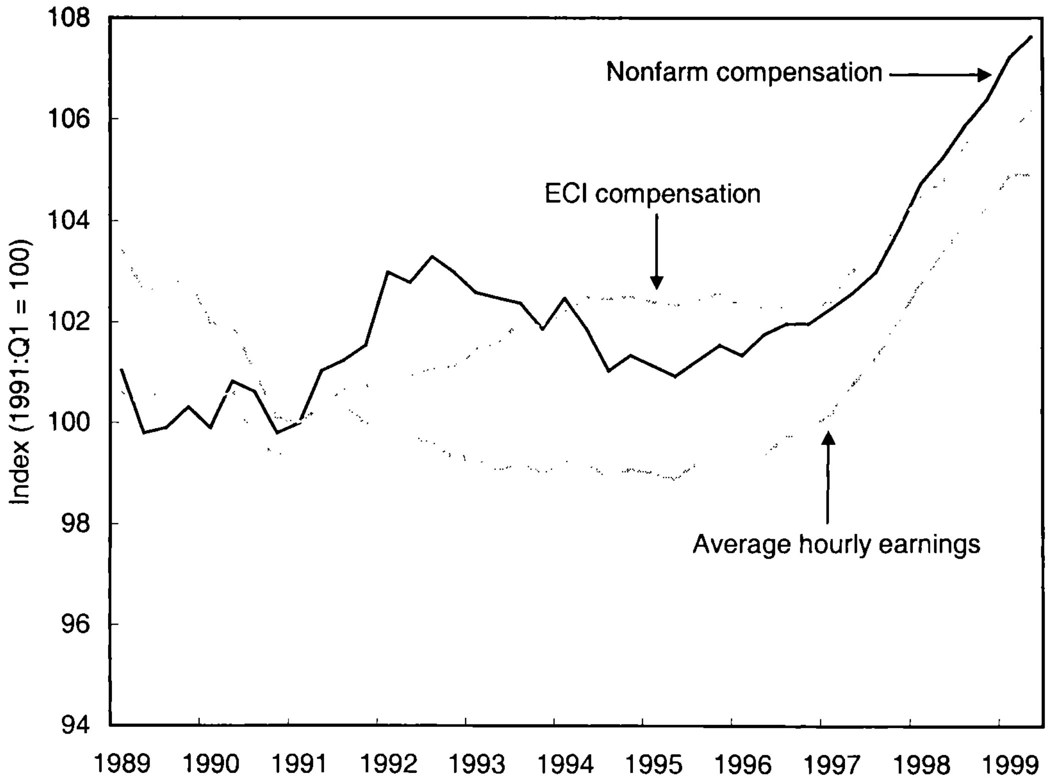
WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

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

August 6, 1999

CHART OF THE WEEK

Three Measures of Real Wages



Over the past few years, both average hourly earnings of production or non-supervisory workers (reflecting the wages of about 80 percent of private employment) and nonfarm compensation (which includes non-wage benefits) have increased faster than compensation measured by the employment cost index (ECI). The ECI is based on a constant mix of industries and occupations, while the other two reflect changes in the composition of jobs. Thus, the job-mix seems to be shifting toward higher-paying jobs.

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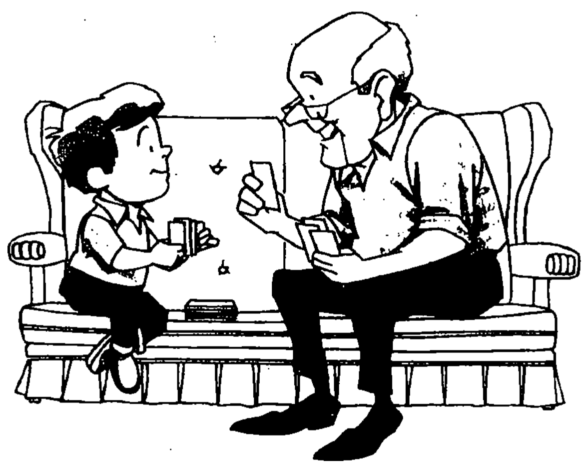


"Some would say I'm retired, but I like to think of myself as a stay-at-home grandfather."

EYES ONLY

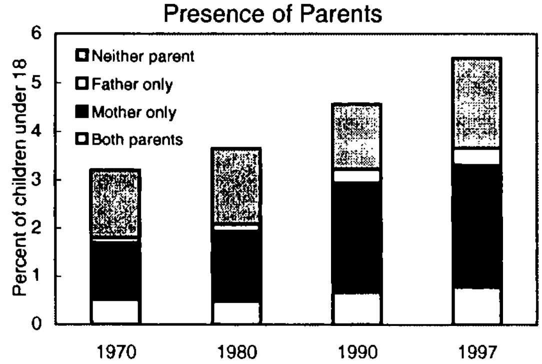
SPECIAL ANALYSIS

Balancing Work and Childcare: the Role of Grandparents

The past decade has witnessed a marked increase in grandparent involvement in raising grandchildren. An examination of this involvement over the last three decades suggests that intergenerational ties may have strengthened. Recent studies have examined the reasons for these trends and their implications for labor force participation.

Trends in living arrangements of grandchildren. Over the last three decades, the share of children under age 18 living in a household headed by a grandparent has risen by more than 70 percent to 5.5 percent of all children in 1997 (see chart). The driving force in the 1990s has been an increase in the share of children living in households with neither parent present. Between 1980 and 1990, by contrast, the increase came from children living in grandparent-headed households with just a single parent present. The share in such households with the father as the single parent present, while small, continued to grow in the 1990s.

Grandchildren in Grandparents' Homes by Presence of Parents



Interactions between caregiving and labor force participation. The rise in female labor force participation has created a greater overall demand for grandchild care that extends beyond living arrangements. Among grandparents caring for grandchildren in a non-custodial relationship, the employment of the grandchild's parents and the desire to help the grandchild's parents financially are commonly cited reasons for providing care. In addition, in a sample of working mothers aged 19-26 with a youngest child under 5 years old, nearly 25 percent utilized grandmothers as the principal caregiver. Evidence from another study suggests an intergenerational labor-force tradeoff: among women aged 51-54, 73 percent of those without grandchildren were engaged in some form of work, whereas among those caring for grandchildren, only 54 percent were in the labor force.

Impact on work and families. Evidence that caregiving is associated with labor market outcomes such as reduced hours, increased absenteeism, and missed promotions has largely been based on studies of caregiving for elderly parents or infirm spouses rather than grandchildren. While some of the effects found in this research may be present in grandchild care, other factors could be at work as well. First, grandchild care may be seen more as an opportunity than as a burden and therefore contribute to the attractiveness of retiring. Second, because employer-provided health insurance rarely covers grandchildren, the need to keep working to maintain dependents' health insurance is not the issue it could be in other caregiving situations. Third, grandchild care may allow a middle-generation individual to participate in the labor force or obtain schooling, both of which may have positive long-term effects.

Conclusion. Grandparents face an intergenerational tradeoff between work and caregiving. Choosing to provide care for a grandchild is associated with decreased labor force attachment of the grandparent but increased attachment of the middle-generation child. By participating in grandchild care, retirement-age individuals play a key role in shaping the economic well-being of future generations.

SPECIAL ANALYSIS

Farm Program Costs and the WTO

Until recently, the United States was comfortably below the limits set on trade-distorting farm supports in the Uruguay Round Agreement on Agriculture. But the recent rapid increase in farm program payments is eroding that cushion.

Trends. After record-low expenditures in 1996, Federal spending on agriculture through the Commodity Credit Corporation (CCC) is rising. The CCC's net expenditures were $4.6 billion in fiscal year 1996, $7.3 billion in 1997, and $10.1 billion in 1998. CCC net expenditures could reach $18.4 billion in 1999. USDA projects a subsequent decline, but such projections are highly uncertain. A share of these annual expenditures, along with certain other forms of support, count against the United States' Uruguay Round commitment.

Uruguay Round commitments. In total, 28 WTO members, including most major agricultural producers and traders, have made binding commitments to reduce so-called "amber box" trade-distorting supports (such as market price support payments, storage payments, marketing loans, and some forms of crop insurance) according to fixed schedules. Like other developed countries, the United States agreed to a 20 percent cut over 6 years from a 1986-88 base level. For the United States, the base level "aggregate measure of support" (AMS), which quantifies amber-box programs, was $23.9 billion. For 1999, the U.S. ceiling is $19.9 billion.

U.S. performance. For 1995-1997, the U.S. AMS averaged about $6 billion, primarily for dairy, sugar, and peanut supports. In 1998, however, low market prices resulted in higher commodity payments, especially for corn, wheat, and soy. The projected AMS for 1998 is $9 to $10 billion and that for 1999 will likely be higher, even before including amounts from any currently proposed emergency farm aid legislation. Moreover, the totals for 1995-1998 do not include non-product specific support, such as crop and revenue insurance, because such support did not meet a *de minimus* threshold of 5 percent of the total value of agricultural production.

The non-product-specific "wild card." Non-product-specific support could play an important role in determining whether foreigners might allege that the United States has not met its WTO commitments. If such support exceeds the 5 percent threshold of roughly $10 billion, the entire category would then be included in the AMS. Among other factors, the amount of crop and revenue insurance subsidies, which already account for a substantial share of all U.S. non-product-specific support, could be critical.

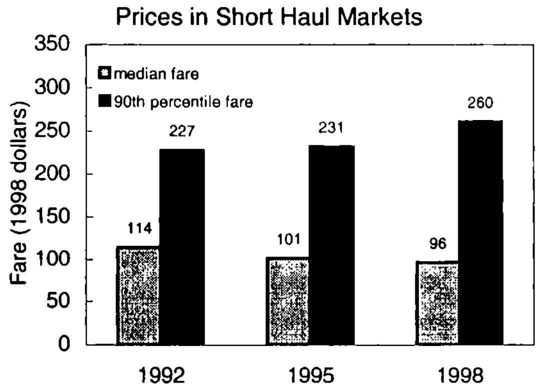
Conclusion. If farm program spending continues to rise, the distinction between amber-box support and so-called "green box" non- and minimally trade distorting support (such as research and extension, pest and disease control, domestic food aid, and income support payments that are de-coupled from prices or production) will become even more important. There are no WTO limits or reduction commitments if support qualifies for the green box. To the extent that spending on any new farm programs or policy instruments, including government-backed risk management tools, can be tailored to meet green-box provisions, the United States stands less chance of being accused of overshooting its AMS ceiling.

EYES ONLY

ARTICLE

Why Are Fares Flying Higher for Business Travelers?

Are recent trends in the airline industry threatening the lower fares and increased service that followed airline deregulation in 1978? A recent report from the National Research Council's Transportation Research Board finds evidence that leisure travelers continue to benefit from low fares, while prices paid by business travelers have been rising.



Increased fare dispersion. This finding of divergent trends for different groups of consumers comes from an analysis of trends in fare dispersion. The Board presents evidence that on short haul routes (those less than 750 miles), the median fare (in 1998 dollars) declined from $114 in 1992 to $96 in 1998 (see chart). By contrast, the fare at the 90th percentile rose from $227 to $260 over the same period.

Airline pricing. The disparity in fares paid for essentially the same seat on any given flight reflects the widespread use of fare restrictions by airlines to separate travelers into different groups based upon their willingness to pay for tickets. Leisure travelers who plan ahead can generally get significant discounts off of the fares charged to last-minute business customers. Although this practice seems "unfair" to those paying higher fares for potentially the same seat, the cost to the airline of providing a seat to a business traveler is higher. An airline that wants to serve business customers must reserve some capacity for the last-minute business traveler, and that capacity sometimes goes unused even though it could have been sold earlier to another leisure traveler.

Competing explanations. Two different explanations have been suggested to explain why airline fares for business travelers are increasing even though fares for leisure travelers appear to be declining.

- Tighter capacity. One explanation for the increase in fares to business travelers is that airline capacity has become tighter as the economy continues to expand. As capacity becomes scarce, holding additional capacity empty for business travelers becomes increasingly costly, and business fares would be expected to increase. The Board found some evidence for this view, noting that between 1992 and 1997, the load factor for domestic carriers (a mileage-weighted ratio of passengers to seats) has risen from about 63 percent to about 69 percent.

- Insufficient competition. An alternative explanation for the increases in business fares relative to leisure fares is insufficient competition from low-cost carriers. For example, the Board found that in markets where Southwest Airlines is present, its fares are substantially below those of the incumbent airlines for both leisure and business travelers. In addition, unlike the incumbent airlines, Southwest has not sharply increased the disparity between its business and leisure fares over the 1992-1998 period.

Implications. In light of these findings, the Transportation Research Board has recommended that increasing efforts be made to ensure that airport facilities remain readily available to new entrants like Southwest and other low-cost carriers. For example, the Board notes that administrative limits (such as slot controls designed to control congestion) have also blocked new airlines from particular airports. The report recommends that airlines pay a fee to fly into congested airports during peak hours to control congestion rather than using slot mechanisms to control the number of arrivals and departures. The report also finds that limited access to airport gates can be an obstacle to entry, and that Federal rules and airport funding should be designed to encourage sufficient gate supply for new competitors.

Conclusion. While airlines may have legitimate business reasons for charging different prices for seats on the same flight, they may also be able to exploit such opportunities when competition is limited. Appropriate policies to allow competitive entry can help ensure that the benefits of airline deregulation are achieved.

EYES ONLY

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

Career Academies Show Positive Results. Career academies represent one of the fastest-growing high school reforms in the nation, combining elements of the school restructuring and school-to-career movements. Organized as schools-within-schools, career academies use classroom- and work-based learning centered around an occupational area to help students gain the necessary skills to make successful transitions to post-secondary education, employment, or a combination of the two. A recent study of 10 career academies in disadvantaged areas around the country found that each was successful in establishing partnerships with a group of local employers and developing a range of career-awareness and work-based learning activities. The percentage of academy students participating in career-awareness activities outside of the school was more than twice as high as that of the control group. The gains in in-school career activities, employment during high school, and participation in high-quality work-based learning were more modest. The study found that increasing the quantity and quality of academy activities remains a challenge, as does fuller integration of classroom- and work-based learning.

A New Explanation for the Education Wage Differential among Men. Common explanations for the widening wage differential between college- and high-school-educated workers include increased technology in the workplace, immigration, and decreased unionization. But a new study finds a different explanation, at least for men, in the forces of supply and demand. In particular, since the mid-1970s male college graduates have benefited from relative pay gains because younger generations of men have been attending college at smaller rates than their predecessors, thereby decreasing the supply of college-educated workers in each successive cohort. Thus, steadily increasing demand for college-educated workers would lead to an increased relative wage. According to the study, this relative earnings gain for younger college-educated male workers is the reason for the rise in the wage differential between college- and high school-educated workers from 25 percent in the mid-1970s to 40 percent in 1998. While the earnings differential has remained the same for older workers over the past 25 years, it has doubled for younger workers.

Online Shopping Rate Shows First Decline. The latest findings from an ongoing survey of Internet users found that the percentage who made purchases online decreased for the first time last quarter. Between April 1998 and March 1999 the percentage of users who made online purchases grew from 47 to 74 percent, but it then dropped slightly to 71 percent last quarter. These findings are based on a sample drawn from a private firm's database of Internet users who have volunteered to participate in online research. Of course, continued growth in Internet usage should keep the volume of Internet purchases rising even if the percentage stops growing. The survey found that three-quarters of buyers are making multiple purchases, and 95 percent of online shoppers say that they plan to buy the same amount or even more online in the future. CDs, books, computer software and hardware, and airline tickets were the top items purchased.

EYES ONLY

INTERNATIONAL ROUNDUP

OECD Releases Latest Science and Technology Indicators. After a decline in R&D spending in OECD countries in the early 1990s, investments have recovered since 1995, according to the OECD's semi-annual *Main Science and Technology Indicators.* This reversal is apparent in the United States, where the rate of growth of gross domestic expenditure on R&D jumped to 6.5 percent in 1998 (it was –0.2 percent as recently as 1994). The ratio of R&D expenditures to GDP increased from 2.5 percent in 1994 to 2.8 percent in 1998—well above the 1.8 percent average rate for the EU. Although the public sector is the primary source of R&D financing in smaller OECD countries such as Portugal and Iceland, the business sector is the main source in R&D-intensive countries like the United States, Japan, Korea, and Sweden. Business R&D funding represents more than 65 percent of total R&D expenditures for these countries. OECD governments have shown an increased interest in health- and environment-related R&D programs, as the share of spending for such programs in total government budgets grew steadily in the 1990s.

World Carbon Emissions Fall in 1998. Last year, global emissions of carbon from the combustion of fossil fuels declined for the first time since 1993, according to a report by the Worldwatch Institute. The report estimates that emissions fell 0.5 percent to 6.32 billion tons. The decline occurred even though the world economy grew 2.5 percent in 1998. During the last 2 years, the amount of carbon emissions required to produce $1,000 of income fell by 6.4 percent. The report cites improved energy efficiency, falling coal use, and the growth of information technology and service industries that are not major energy users as explanations for the decline in carbon emissions. The de-linking of economic growth and carbon emissions was particularly dramatic in China, which grew 7.2 percent in 1998 while experiencing a 3.7 percent drop in emissions. In the United States, emissions rose only 0.4 percent in 1998, while the economy grew 3.9 percent. However, U.S. emissions in 1998 were still 10.3 percent above 1990 levels, compared with the Kyoto Protocol target for greenhouse gas emissions of 7 percent below the 1990 level by 2010.

Mexico Imposes Tariffs on U.S. Beef. In response to an anti-dumping petition against beef imports from the United States, the Mexican Secretary of Commerce and Industry announced this week that it would place tariffs of up to 215 percent on various U.S. beef products. This ruling comes following a preliminary determination by Mexico that U.S. producers were sending beef products across the border at artificially low prices and causing injury to the Mexican beef industry. Tariff amounts range from 5 percent to 215 percent across different product categories. Within these categories, however, four specific U.S. corporations were granted substantially lower tariffs than other U.S. producers. Mexico is the second largest importer of American beef, accounting for roughly 15 percent of the total value of U.S. beef exports in the January-April 1999 period.

EYES ONLY

RELEASES THIS WEEK

Employment and Unemployment

****Embargoed until 8:30 a.m., Friday, August 6, 1999****

In July, the unemployment rate was unchanged from June at 4.3 percent. Nonfarm payroll employment rose by 310,000.

Productivity

Nonfarm business productivity rose 1.3 percent at an annual rate in the second quarter. Manufacturing productivity rose 4.9 percent.

Leading Indicators

The composite index of leading indicators increased 0.3 percent in June, following an increase of 0.3 percent in May.

NAPM Report on Business

The Purchasing Managers' Index declined 3.6 percentage points to 53.4 percent in July. (A reading above 50 percent indicates that the manufacturing economy is generally expanding.)

MAJOR RELEASES NEXT WEEK

Retail Sales (Thursday)
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	2.3
GDP chain-type price index	5.4	0.9	0.8	1.6	1.6
Nonfarm business (NFB) sector:					
Productivity (chain-type)	1.5	**2.6**	**4.1**	**3.6**	**1.3**
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**	**3.3**
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	4.6
Exports	8.2	11.3	11.3	10.9	10.9
Imports	9.2	13.0	13.1	13.2	13.5
Personal saving	5.2	0.3	−0.0	−0.5	−0.8
Federal surplus	-2.7	0.9	0.8	1.4	N.A.

	1970-1993	1998	May 1999	June 1999	July 1999
Unemployment Rate (percent)	6.7**	4.5**	4.2	4.3	**4.3**
Payroll employment (thousands)					
increase per month			**28**	**273**	**310**
increase since Jan. 1993					**19243**
Inflation (percent per period)					
CPI	5.8	1.6	0.0	0.0	N.A.
PPI-Finished goods	5.0	0.0	0.2	−0.1	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, August 6, 1999**.

EYES ONLY

FINANCIAL STATISTICS

	1997	1998	June 1999	July 1999	August 5, 1999
Dow-Jones Industrial Average	7441	8626	10704	11052	10794
Interest Rates (percent per annum)					
3-month T-bill	5.06	4.78	4.57	4.55	4.61
10-year T-bond	6.35	5.26	5.90	5.79	5.88
Mortgage rate, 30-year fixed	7.60	6.94	7.55	7.63	7.89
Prime rate	8.44	8.35	7.75	8.00	8.00

INTERNATIONAL STATISTICS

Exchange Rates	**Current level August 5, 1999**	**Percent Change from** Week ago	Year ago
Euro (in U.S. dollars)	1.079	0.7	N.A.
Yen (per U.S. dollar)	114.0	–1.1	–21.1
Major currencies index (Mar. 1973=100) (trade-weighted value of the U.S. $)	94.28	–0.8	–5.9

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	4.1 (Q2)	**4.3** (Jul)	2.0 (Jun)
Canada	3.2 (Q1)	8.1 (May)	1.5 (Jun)
Japan	0.1 (Q1)	4.7 (May)	0.0 (Jun)
France	2.3 (Q1)	11.4 (Apr)	0.5 (Apr)
Germany	0.8 (Q1)	7.2 (May)[2]	0.4 (Jun)
Italy	0.9 (Q1)	12.1 (Apr)	1.4 (Jun)
United Kingdom	1.2 (Q2)	6.2 (Mar)	1.4 (Jun)

U.S. unemployment data **embargoed until 8:30 a.m., Friday, August 6, 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 May was 9.1 percent.

EYES ONLY

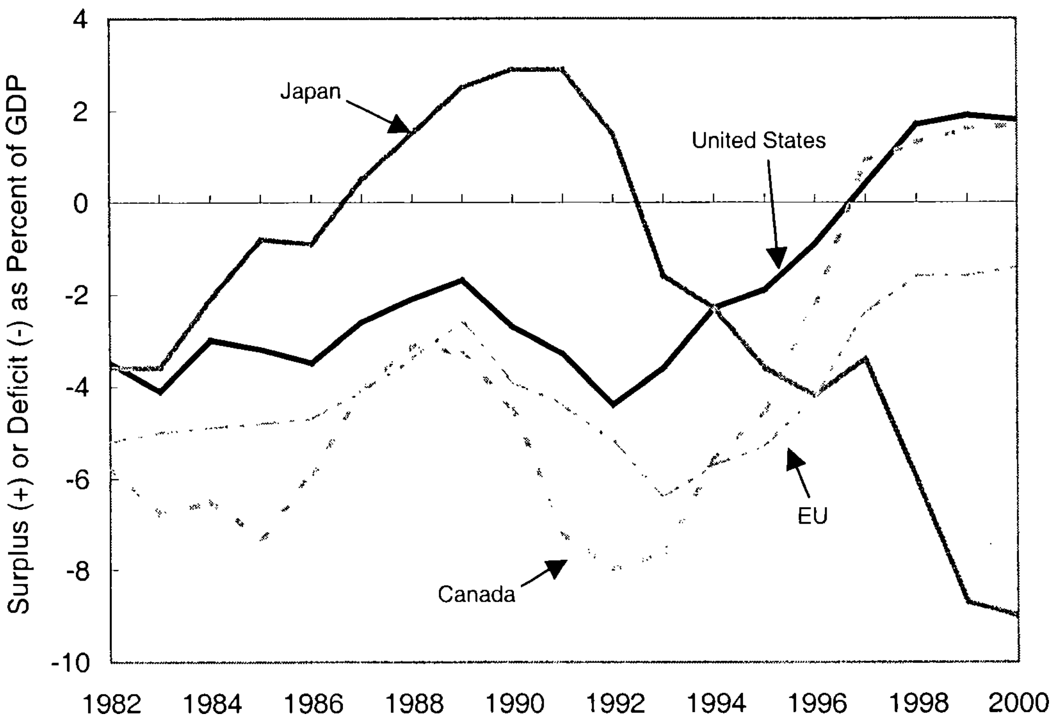
WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

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

November 5, 1999

CHART OF THE WEEK

Fiscal Balances Generally Improving Outside of Japan

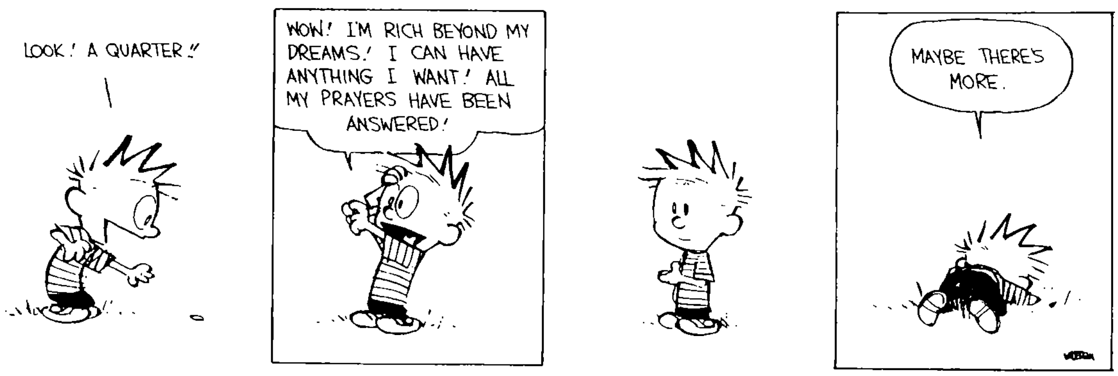


Data for 1999 and 2000 are projections

The government balance sheets of many industrialized countries improved markedly over the last decade, except in Japan where they have gone from a sizable surplus of about 3 percent of GDP to a deficit of about 9 percent of GDP. Only part of the deterioration in Japan's budget position is related to its macroeconomic performance: OECD estimates of Japan's structural deficits (deficits adjusted for the state of the business cycle) show a similar trend.

EYES ONLY

CONTENTS



EYES ONLY

SPECIAL ANALYSIS

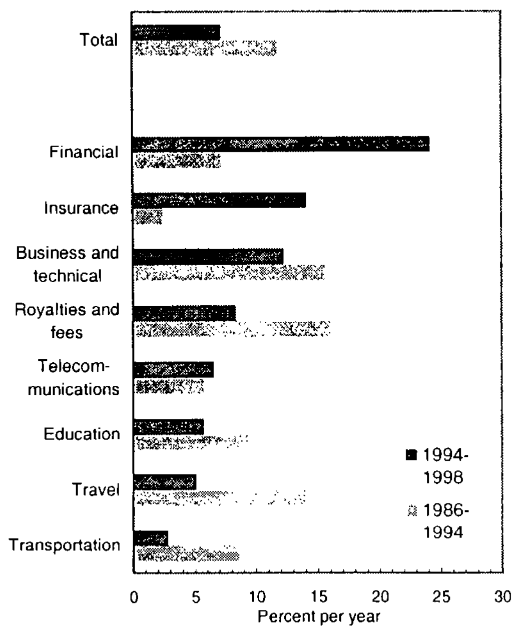
U.S. Service Sector Poised to Gain from New WTO Round

The CEA has prepared a report on America's interest in the WTO. The report finds that the trading system has played a central part in opening foreign markets, establishing an effective rule of law, and promoting economic development internationally. A key finding is that services are becoming increasingly important to the U.S. economy and that U.S. firms are highly competitive in global markets and stand to gain from additional market access.

Background. The Uruguay Round, which concluded in 1994, brought trade in services into the multilateral trading system by creating the General Agreement on Trade in Services (GATS). The GATS covered all traded services (except most air transport services) but did not open markets fully. Nevertheless, it provided a framework for ongoing liberalization. Post-Uruguay Round negotiations have yielded additional commitments in financial and basic telecommunications services, opening up new opportunities in areas in which the United States is competitive. Moreover, countries agreed to begin a new round of negotiations on services no later than January 1 of next year.

Services account for a large and growing share of U.S. economic activity. Services accounted for about 55 percent of U.S. GDP in 1998, up from 32 percent in 1950. U.S. service exports have also grown dramatically, at a rate exceeding that of merchandise exports. Service exports accounted for about 29 percent of total exports last year, up from 17 percent in 1950.

Growth in U.S. Private Service



U.S. services are highly competitive in the global market. In 1998, the United States accounted for over 18 percent of all commercial service exports, ranking first in the world. The top five categories of U.S. private service exports, ranked by export value, were: travel services; transportation services; royalties and license fees; business, professional, and technical services; and financial services. Recent data on U.S. exports suggest areas of potential gain from the GATS:

- Between 1994 and 1998, total U.S. exports of private services increased from $186 billion to $246 billion, a 7 percent annual growth rate (see chart). The top gainers were financial services which increased about 24 percent per year; insurance services which grew about 14 percent per year; and business, technical, and professional services which grew about 12 percent per year. For the most part, these types of service exports have experienced more rapid growth since 1994 than they did during the period in which the Uruguay Round was negotiated.

- In the post-Uruguay Round period, U.S. exports of travel and transportation services grew less rapidly than they did in the earlier period. The slowing of growth in U.S. exports of travel and transportation services reflects a number of factors: most aviation services were not covered under GATS, these markets are more mature, and the growth slowdown in many Asian and European economies.

Services agreements provide first steps toward potential gains. As a leader in the global services market, the United States is highly competitive in many areas of services and stands to benefit from future negotiations to open markets.

EYES ONLY

SPECIAL ANALYSIS

Gun Industry Innovation and Gun Violence

Faced with limited growth opportunities in the market for hunting and sporting firearms over the past two decades or so, gun manufacturers have turned to the development and marketing of increasingly lethal pistols. This development has contributed to an increase in the economic and societal costs of gun violence.

The changing market for firearms. Major (non-criminal) sources of demand for firearms include military and police purchases, hunting and sport shooting, and self-protection. Into the mid-1960s, rifles and shotguns accounted for more than two-thirds of all civilian firearm purchases. While the total U.S. production of civilian firearms has fluctuated in the range of 3.3 to 7.8 million guns per year since then, the mix of guns produced has changed along two dimensions:

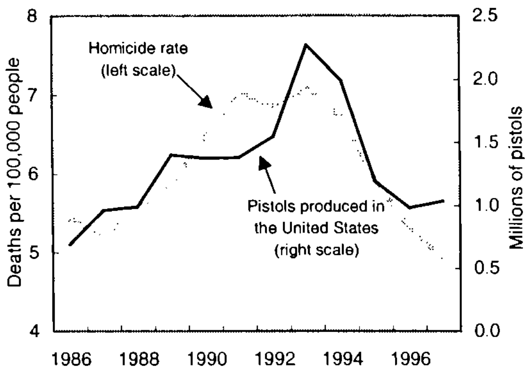
- More handguns. With the declining importance of demand for hunting and sporting guns, in part because of increased levels of urbanization, rifles and shotguns have declined, while handguns have increased as a share of all guns available for sale. The number of hunting licenses issued by states dropped 11 percent between 1982 and 1997 and target-shooting participation has been flat in recent years. Handguns represented more than 40 percent of guns available for sale in every year between 1980 and 1997 and more than half of guns available for sale in some years.

- More pistols. Within the handgun category, pistols (which carry their extra cartridges in a magazine usually located in the handle of the gun) became more important than revolvers (whose rotating cylinder functions as both the magazine and the chamber). Pistols typically hold more rounds than a traditional six-shot revolver and can be fired more quickly.

Lethal innovation. With limited demand growth and a growing stock of existing firearms (well-maintained guns are highly durable), the gun industry appears to have viewed the development of pistols as an area where innovation and product differentiation might boost sales. U.S. pistol production doubled in the late 1980s, and pistols represented 74 percent of handgun production in 1998. In addition to increasing the production of pistols relative to revolvers, manufacturers have increased the magazine capacity of pistols (allowing more bullets to be fired between reloadings) and their caliber (allowing more deadly bullets to be used). Finally, to cater to the self-protection market and with the enactment of concealed-carry laws in some states, manufacturers have tried to develop smaller but still powerful weapons that can more easily be concealed. Although these innovations may have contributed to an increase in pistol sales for a time, pistol production has recently fallen back to mid-1980s levels.

Social costs. The industry's innovations have had important consequences for the social costs of gun violence. In addition to being a factor in increased rates of unintentional death and suicide, handguns are the primary weapon used in homicide. In 1998, over 80 percent of all firearm-related homicides involved a handgun—while handguns represent only about a third of all guns in existence.

Firearm Homicide Deaths and Pistol Production



The increased prevalence of pistols shows up in the crime statistics as well. In 1989-90, only 3 or 4 of the top 10 guns that were used in crimes and traced by the Bureau of Alcohol, Tobacco, and Firearms were pistols, but this number rose to 7 to 9 in 1992-95. Firearm homicide death rates rose into the early 1990s with the increased production of pistols, but both have since declined sharply (see chart). The increasing prevalence of pistols may also account for research findings such as the increase in the average number of wounds per gunshot victim in the late 1980s and the increase in the caliber of bullets recovered in autopsies into the early 1990s.

Conclusion. Limited demand for traditional hunting and sporting guns has led gun producers to pursue product innovations that have raised the economic and social costs of gun violence. The challenge for public policy is to create incentives that would encourage the industry to pursue innovations that would reduce the cost of gun violence, such as the development of child safety locks or reliable "smart guns" that could only be fired by their owners.

EYES ONLY

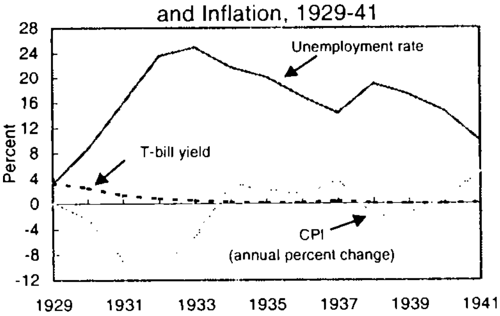
ARTICLE

The "Liquidity Trap" and Monetary Policy

Monetary policy primarily affects the economy through the control of short-term interest rates. But what if an economy were in a recession and interest rates were already near zero? Monetary policy would be unable to push interest rates below zero—and thereby stimulate the economy—because people can always hold currency yielding a zero interest rate. Economists refer to this situation as a "liquidity trap." A recent Federal Reserve conference explored the policy implications of liquidity traps.

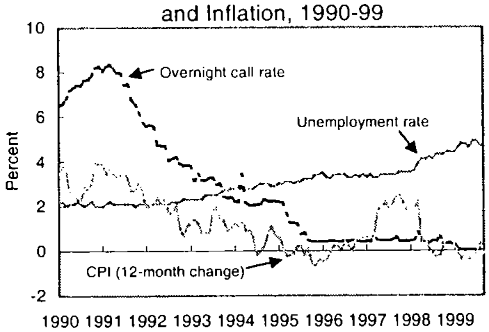
Liquidity traps in practice. The Great Depression in the United States provided a clear example of a liquidity trap. In the early 1930s, the unemployment rate exceeded 20 percent (see upper chart). The Fed brought Treasury bill rates to nearly zero percent, but was then unable to lower rates further. This constraint likely increased the severity and duration of the Depression.

U.S. Interest Rates, Unemployment, and Inflation, 1929-41



The Japanese recession of the 1990s provides a more recent, albeit less dramatic, example of a liquidity trap. The unemployment rate in Japan has more than doubled since 1993 and consumer price inflation, which had been running at about 3 percent per year in the early 1990s, turned to deflation (see lower chart). The Bank of Japan reduced overnight rates to below 1 percent 4 years ago and reduced them again to below 0.1 percent earlier this year, but it has been unable to cut rates further because of the liquidity trap. This has likely delayed Japan's recovery.

Japanese Interest Rates, Unemployment, and Inflation, 1990-99



The potential for a liquidity trap in the United States. Research presented at the conference suggests that the likelihood of an economy finding itself in a liquidity trap depends in part on the average rate of inflation. Over the last 40 years, the inflation rate in the United States averaged about 4 percent and short-term rates averaged about 6-1/2 percent, providing monetary policy with a sizable cushion to lower rates in an economic downturn. In contrast, if the average inflation rate were zero, short-term interest rates would likely average around 2-1/2 percent, leaving the Fed with little room to reduce rates in a recession. Some economists have therefore argued that the Federal Reserve should aim for an average inflation rate a few percentage points above zero.

Implications. One way to avoid or lessen the impact of the liquidity trap is for monetary policy to move quickly and decisively at the first signs of recession or deflation in order to avoid a severe downturn. A firm commitment to continue with a zero-interest-rate policy until the economy has fully recovered may also help restore confidence and bring down long-term interest rates. However, if interest rates are near zero, other policies may be needed. Some economists have argued that a central bank could attempt to bid down the exchange value of its currency through massive purchases of foreign exchange, thereby boosting net exports. Another approach would be to use stimulative fiscal policies designed to substitute for monetary policy when interest rates are near zero.

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

Study Finds Benefits from High-Quality Childcare. Low-income children who received high-quality child care at a young age scored better on tests into early adulthood and were more likely to have attended college relative to those who did not receive such care, according to a recent evaluation of the Abecedarian Project. The 57 children from low-income families who received full-time high-quality childcare from infancy to age 5 had higher average scores on cognitive tests at ages 12, 15, and 21, were twice as likely to be in school at age 21, and were more than twice as likely to have attended a 4-year college or university. The study provides evidence that early childhood education can significantly improve scholastic success and educational attainment of poor children well into early adulthood.

Americans Lacking Adequate Life Insurance. A significant share of American couples approaching retirement do not possess adequate life insurance, according to a recent study. The study uses survey data from nearly 2,300 couples aged 51 to 61 in 1992. It finds that nearly one-third of wives and more than 10 percent of husbands would have suffered reductions in living standards of 20 percent or more had their spouses died in the year of the survey. A striking finding of the study is that households most vulnerable to economic hardship resulting from the death of a spouse do not adequately protect themselves against this risk.

Beige Book Reports Strong but Slowing Growth. Most districts continue to report strong economic growth but some slowing is noted. Manufacturing activity continues to advance in almost all districts and for most industries. Although four districts report some slowing in consumer outlays, spending generally remains strong and most retailers are expecting increases in holiday sales from last year. Real estate and construction are still robust in most districts, though there are signs of some moderation in activity. The mining and energy industries are showing signs of recharging. In terms of agriculture, most of the country is having a good harvest. Labor markets remain tight across the country, with numerous districts reporting continued difficulty in finding and retaining qualified workers. Many districts report a pickup in wage increases, but overall prices remain stable with some notable exceptions: Increases in prices were noted for some manufacturing inputs, health care, memory chips and construction materials. By contrast, low prices continue to weigh heavily on some important segments of the agricultural sector.

EYES ONLY

INTERNATIONAL ROUNDUP

New Polls on Global Corruption. A report released by Transparency International, a global anti-corruption organization, indicates that of 99 countries included in its survey, officials in Cameroon are perceived to be the most corrupt and those in Denmark the least. The survey included business people, risk analysts, and the general public. The United States ranked 18th best on the "Corruption Perceptions Index," little changed from its rank in the past 2 years. Although many major industrial countries do well at combating corruption at home, companies based in these countries often pay bribes while doing business abroad, according to a survey of respondents from 14 emerging markets. Among 19 leading exporting countries, companies from China were viewed as the most likely to pay bribes in order to win business overseas, while those from Sweden the least. The United States ranked in the middle of the "Bribe Payers Index".

EU Adopts Cuts in Agricultural Export Subsidies. Responding to financial constraints in the Common Agricultural Policy (CAP) budget, the European Commission has started to cut export subsides for certain agricultural products. Last Thursday, the EU decided to cut certain milk product subsidies up to 7 percent and subsides for sugar used in certain products will be cut up to 4.5 percent. More cuts are expected with the total amount of cutbacks likely to be around 200 million euros ($192 million), according to EU officials. However, even with these cuts, the European Union remains one of the largest users of export subsidies and the U.S. has stated that the elimination of export subsidies is a priority in the next round of WTO negotiations.

Nissan Plans Radical Restructuring. The Japanese car company Nissan has unveiled a radical corporate restructuring plan which is likely to include massive job cuts and dramatically reduce its number of suppliers. Nissan has been losing money in recent years and is currently operating at only 53 percent of capacity. Earlier this year, Nissan formed an alliance with Renault and Nissan's new chief operating officer is an executive from Renault. The goal of the restructuring plan is to reduce costs by 1 trillion yen ($9.5 billion) by 2002 and return Nissan to profitable growth. Many features of this plan are at odds with traditional Japanese employment and management practices. The plan foresees the closure of five plants and the elimination of 21,000 jobs, of which 16,500 are in Japan. Nissan has stated that the reduction in employment will take place through a combination of attrition, an increase in part-time employment, spin-off of non-core businesses, and early retirement. In another change from traditional Japanese practices, Nissan plans to establish a performance-based career advancement program in Japan.

EYES ONLY

RELEASES THIS WEEK

Employment and Unemployment

****Embargoed until 8:30 a.m., Friday, November 5, 1999****

In October, the unemployment rate was 4.1 percent; it was 4.2 percent in September. Nonfarm payroll employment increased by 310,000.

Leading Indicators

The composite index of leading indicators fell 0.1 percent in September, following no change in August.

NAPM Report on Business

The Purchasing Managers' Index fell 1.2 percentage points in October to 56.6 percent. (A reading above 50 percent indicates that the manufacturing economy is generally expanding.)

MAJOR RELEASES NEXT WEEK

Producer Prices (Wednesday)
Retail Sales (Friday)
Productivity (Friday)

EYES ONLY

U.S. ECONOMIC STATISTICS

	1970-1993	1998	1999:1	1999:2	1999:3
Percent growth (annual rate)					
Real GDP (chain-type)	3.0	4.6	3.7	1.9	4.8
GDP chain-type price index	5.2	1.1	2.0	1.3	1.0
Nonfarm business (NFB) sector:					
Productivity (chain-type)	1.5	2.6	3.6	0.6	N.A.
Real compensation per hour:					
Using CPI	0.6	2.5	2.9	1.5	N.A.
Using NFB deflator	1.3	3.7	3.0	3.7	N.A.
Shares of Nominal GDP (percent)					
Business fixed investment	**11.4**	12.5	12.6	12.6	12.8
Residential investment	**4.5**	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	**6.6**	2.6	2.2	1.8	1.5
Federal surplus	**-2.8**	0.5	1.1	1.3	N.A.

	1970-1993	1998	August 1999	September 1999	October 1999
Unemployment Rate (percent)	6.7**	4.5**	4.2	4.2	**4.1**
Payroll employment (thousands)					
increase per month			**129**	**41**	**310**
increase since Jan. 1993					**19794**
Inflation (percent per period)					
CPI	5.8	1.6	0.3	0.4	N.A.
PPI-Finished goods	5.0	0.0	0.5	1.1	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, November 5, 1999**.

EYES ONLY

U.S. ECONOMIC STATISTICS

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EYES ONLY

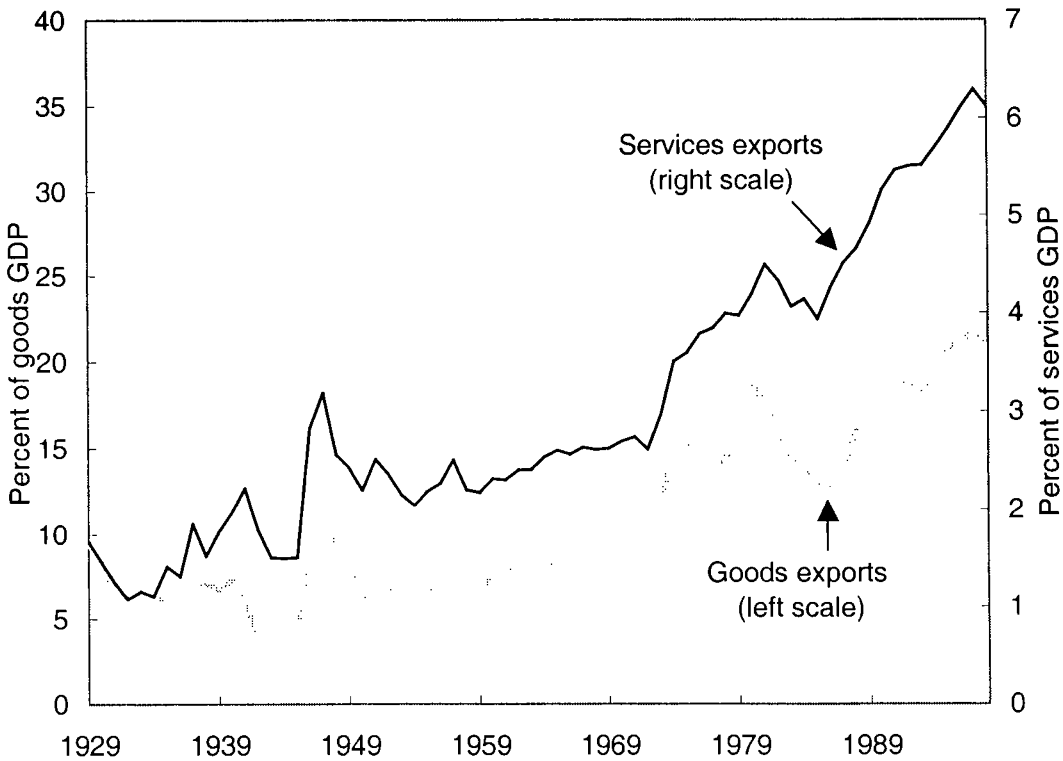
WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

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

November 12, 1999

CHART OF THE WEEK

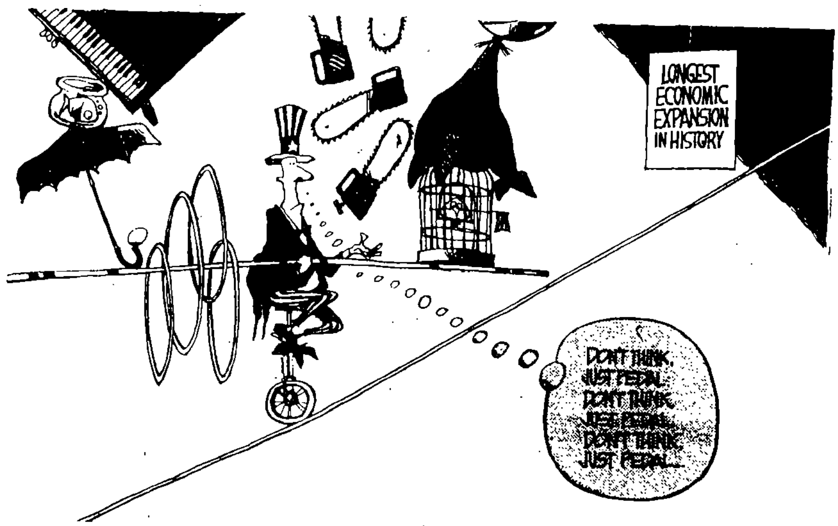
Goods and Services Exports as Share of Sector GDP



For both goods and services, exports have grown much faster than output, especially in the last decade. For services, which include travel and transportation, telecommunications, education, and a variety of financial and business services, exports were more than 50 percent greater as a share of services GDP in 1998 than they were in 1985.

CONTENTS

EYES ONLY



EYES ONLY

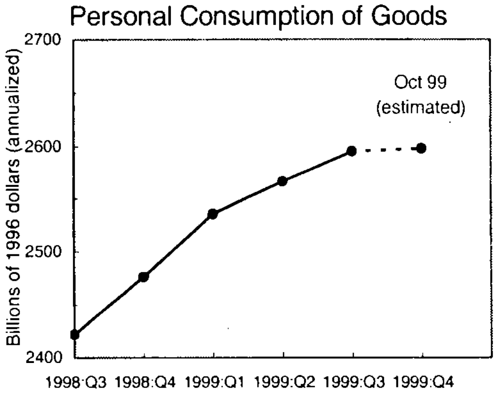
MACROECONOMIC UPDATE

Fourth Quarter Starts Out Strong

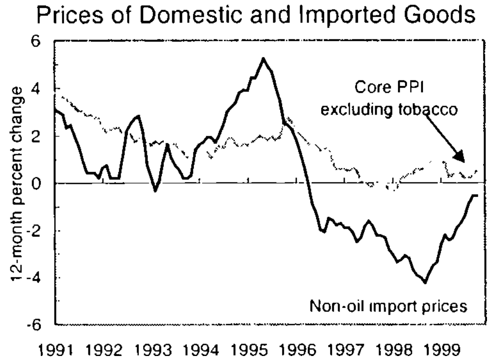
Macroeconomic forecasters (on average) are expecting the economy to grow at about a 4 percent annual rate in the fourth quarter. This rate is consistent with October's strong labor market and may reflect expectations of extra inventory accumulation aimed at creating a buffer against possible Y2K disruptions.

Jobs. The jump in payroll employment of 310,000 in October showed that the labor market remains very strong and that the anemic September job growth was probably attributable to Hurricane Floyd. Weekly data on initial claims for unemployment insurance suggest that demand for labor remained strong through the first week of November.

Personal Consumption of Goods



Prices of Domestic and Imported Goods



Spending. Personal consumption of goods thus far in the fourth quarter appears to have slowed substantially from the pace of earlier quarters (see upper chart). Motor vehicle sales dropped in October for the second consecutive month, but 1999 is still likely to be the best sales year on record. Spending on other goods has posted sizable gains in the past 3 months—though October's gain was smaller than that of the past 2 months

Inflation. Strong productivity growth and falling non-oil import prices have held inflation in check for the past 4 years. Productivity, which increased 2.9 percent over the past 4 quarters, remains as strong as ever. However, import prices are no longer falling sharply, possibly because of a resurgence of growth abroad. Prices of imported oil dropped sharply in 1998 but rebounded dramatically in 1999. Falling prices of non-oil imports had restrained the pricing power of domestic goods producers (illustrated by the core PPI excluding tobacco in the lower chart). Non-oil import prices fell through April but have been roughly flat since then.

Conclusion. The economy appears to be growing strongly in the fourth quarter. With continued tight labor markets and the change in the import price environment, continued strong productivity growth appears to be the key to keeping inflation tame in the coming year.

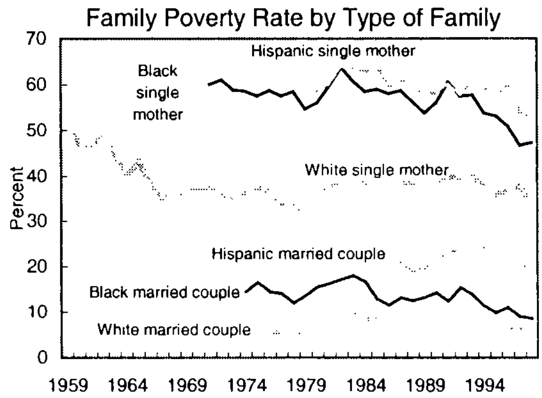
EYES ONLY

SPECIAL ANALYSIS

Poverty and Family Structure

The good news is that in 1998 the poverty rate among female-headed families with children under age 18 was the lowest it has been in data that go back to 1959. The bad news is that it was still 38.7 percent. This rate stands in marked contrast to the 6.9 percent poverty rate among married-couple families with children. The question naturally arises whether encouraging families to form and stay together could significantly reduce the overall poverty rate.

Trends. Whether white, black, or Hispanic, married-couple families with children under age 18 have much lower poverty rates than single-mother families (see chart). Although black and Hispanic rates have come down in recent years, they remain higher than those of whites in each family type. Nevertheless, it is noteworthy that the poverty rate for black married-couple families with children (about 40 percent of all black families with children) fell to 8.6 percent in 1998. This rate is close to the rate for whites of 6.6 percent.



Why are single-parent rates higher? A one-parent family typically has less earning capacity than a two-parent family simply because it has fewer potential adult earners. Moreover, single mothers who work often earn less than adult men in married-couple families, because less-skilled women typically have much lower earnings than less-skilled men. Single parents might also be seriously limited by parental responsibilities and child-care availability as to when and how much they can work. Finally, married-couple families can benefit from economies of scale in living costs. For example, the income required to keep two single-parent-with-one-child families out of poverty is almost $6,000 greater than the income required to keep a married couple with two children out of poverty, according to the current official poverty thresholds.

Selection issues. People who become single parents may also have different characteristics from those who marry and stay married, and these differences may increase the likelihood of adverse economic outcomes. In the case of teenage mothers (the majority of whom are unmarried), for example, recent evidence suggests that factors other than the disruptive effects of having a child at a young age (such as family background) may explain a large portion of why teenage mothers fare worse economically than young women who delay their childbearing.

Race differences. Racial and ethnic differences in the proportion of single mothers who have never been married or are divorced can explain some of the disparity in poverty rates across racial and ethnic groups. In particular, 63 percent of black female family heads have never been married, compared with 28 percent for whites; only 17 percent are divorced, compared with 44 percent for whites. This means they are likely to receive fewer resources from fathers. In 1993, for example, never-married mothers were less likely to have a child support award than divorced mothers (44 percent versus 73 percent) and, if they actually received support, it was a much smaller amount ($1,700 versus $3,600).

Policy implications. The benefits of marriage and raising children with two parents are clear and can be seen in this comparison of poverty rates. Unfortunately, research suggests that the reasons for high poverty rates among single mothers reflect more than just the absence of a spouse. Addressing these underlying problems would seem to be an important complement to policies aimed at discouraging out-of-wedlock births and encouraging families to stay together. That said, efforts to improve paternity establishment and child support enforcement can play an important role in providing greater resources to single-parent families.

EYES ONLY

ARTICLE

What Comes Next in the Microsoft Case?

Last Friday Judge Thomas Penfield Jackson released findings of fact in the antitrust case against Microsoft. The next scheduled step is the issuance of conclusions of law, followed if necessary by the determination of appropriate remedies. It is possible that the parties could negotiate a settlement at any time in the process.

Findings of fact. Judge Jackson found that Microsoft had monopoly power in the manufacture of operating systems and that it used that power to preserve its position by forestalling competition. He found that an operating system, such as Windows 98, includes a collection of programs called Application Product Interfaces (APIs), designed to provide other programs with a means of interacting with the computer's hardware. He concluded not only that Microsoft was the major supplier of these APIs but also that the company tried to prevent other companies from developing their own APIs or programs that might perform similar functions.

Effects on competitors. Judge Jackson cited numerous instances in which Microsoft leveraged its monopoly status to the detriment of competitors, including ones involving Sun's Java, Netscape's Navigator, IBM's OS2, and Intel. In the mid-1990s, for example, Intel developed new PC microprocessor features that it felt Microsoft's Windows did not fully support. Intel decided to write its own interface programs to allow software developers to access these advanced features. The Judge found that Microsoft, in order to prevent Intel's entry into the API market, pressured major computer manufacturers not to install the software and threatened not to support Intel processors in subsequent versions of Windows unless Intel stopped developing interface software. Faced with such pressure, Intel relented.

Effects on consumers. Judge Jackson found that Microsoft's actions had serious and far-reaching impacts on consumers besides limiting access to new hardware features. First, by unnecessarily tying its Web browser Explorer to Windows, Microsoft forced all manufacturers to ship computers with this browser. This forced businesses and consumers who did not want to use Explorer to incur the cost of using an operating system that was unnecessarily slow and took up more storage space than one without a browser. Similarly, the Judge concluded, Microsoft forced consumers to use overly complicated technology by preventing software manufacturers from adding software that eased consumers' introduction to their new computers. What the judge found most problematic, however, was that Microsoft deterred other companies from producing any software that could intensify competition against one of its core products by developing a reputation for punishing such efforts.

EYES ONLY

Next steps. Judge Jackson has ordered the parties to file memoranda of law with respect to the conclusions of law that the Court should draw. He further ordered that these memoranda should *not* address the subject of remedy, or injunctive relief, which will be addressed in a separate briefing if warranted. The current schedule calls for the Judge to have these memoranda of law by January 31, 2000.

The issue of remedy thus remains speculative at this point. However, remedies in antitrust cases typically fit into two basic categories:

- Structural remedies such as the AT&T divestiture try to eliminate monopoly by breaking firms with monopoly power into pieces. In the case of AT&T, the settlement separated the long-distance company from the local telephone companies, removing any ability for AT&T to use monopoly control of the local market to limit competition in the long-distance market. Some have argued that a break-up of Microsoft might not resolve the underlying competitive problem identified by the Court, because separation of the applications segment of the company (word processors and spreadsheets) from the operating system market would not end the monopoly in the latter.

- Behavioral remedies would require Microsoft to abandon problematic business practices without changing the structure of the company. Behavioral remedies in the Microsoft case might include providing universal access to technical specifications, requiring uniform pricing, or separating the browser functions from the operating system. It remains a question, in light of the findings of fact, whether such behavioral remedies would work if Microsoft is allowed to retain its monopoly in the operating system market, because the company would still have an incentive to deter future entry and because no list of prohibited activities could ever be exhaustive. In fact, in the consent decree from Justice's previous suit against Microsoft, Microsoft agreed to avoid specific contractual relationships with manufacturers and to avoid using other exclusionary practices that achieve similar effects.

Conclusion. The Court found that Microsoft has monopoly power, which it has used to forestall competition. If the Court subsequently rules that Microsoft has violated the antitrust laws, the design of appropriate remedies will involve complicated economic and legal considerations.

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

Study Examines Medicaid Enrollment Decline. National Medicaid enrollment for low-income children and their parents declined by 2 percent in 1996 and by an estimated 3 percent in 1997, despite program eligibility expansions in many states and enhanced Federal funding through the Children's Health Insurance Program (CHIP). A recent study investigated these declines by examining Medicaid eligibility policies and operations in five states—California, Colorado, Florida, Minnesota, and Wisconsin. The study found that policy changes from Federal legislation, state decisions, and litigation have created complicated Medicaid eligibility rules that are often difficult for applicants, beneficiaries, and staff to understand. States' automated eligibility determination systems (which handle applications for Medicaid, welfare, and food stamps) were also found to be inadequate because they were designed to meet welfare, not Medicaid, needs. The study concludes that, along with better outreach, states should reassess their Medicaid eligibility requirements and systems to make them more efficient, accessible, and understandable. It also urges better coordination between welfare and Medicaid systems so that families who leave welfare understand the availability of Medicaid coverage.

Racial Differences in Sources of Small Business Financing. According to a recent study examining small businesses in two ethnic Chicago neighborhoods, the start-up capital in black-owned businesses was an estimated 46 percent less than that in comparable Hispanic-owned businesses. However, the amount of personal funding used to start businesses was roughly the same for black and Hispanic owners after adjusting for business and individual characteristics other than race. Although they were unable to estimate precise numbers for other sources of funding, the authors inferred from their data that the smaller amount of start-up capital for black owners may reflect a lack of access to informal capital (such as loans and gifts from family, friends, and business associates). The authors argue that the apparent importance of informal sources of funding suggests that it is worth exploring ways to combine the presumed flexibility and informational advantages of informal networks with the formal sector's ability to raise capital—perhaps through community development financial institutions and micro-lending pools.

Economic Conditions Have Helped Lower Juvenile Crime. According to a new study, declines in the unemployment and poverty rates between 1993 and 1996 explain 28 percent of the reduction in juvenile crime during the period. The study uses nationally representative data on over 16,000 high school students in 1995 to estimate the effect of personal, family, and neighborhood characteristics—as well as deterrence measures such as police spending and arrest rates by county—on juveniles' propensities to commit crime. It then uses these results to estimate how the decline in unemployment and poverty rates have affected juvenile crime. The study concludes that juveniles respond to both incentives and sanctions, and that employment opportunities, increased family income, and more strict deterrence are effective tools to reduce juvenile crime.

EYES ONLY

INTERNATIONAL ROUNDUP

Europe Tightens Monetary Policy. Amid signs that European growth is strengthening, the European Central Bank (ECB) raised interest rates by 0.5 percentage point last week, bringing the main refinancing rate to 3 percent. This was accompanied in London by the Bank of England's raising rates by 0.25 percentage point to 5.5 percent. The ECB's decision reversed the rate reductions made in April and reflected a view that the balance of risks had shifted toward higher inflation—though it is worth noting that the euro-zone unemployment rate was 10 percent in September and consumer prices were only 1.2 percent higher than a year earlier. The rate hike appears to be motivated by a desire to keep inflation expectations safely below the ECB's target ceiling of 2 percent per year.

New Venture Launched to Fight Malaria. In a first for international public health, public agencies and the private sector recently joined together to create a unique organization to develop anti-malarial drugs that would not otherwise be brought to market. The World Health Organization (WHO), the International Federation of Pharmaceutical Manufacturers Associations, and the World Bank are among the sponsors of the partnership—dubbed the Medicines for Malaria Venture (MMV). The MMV aims to register, on average, one new anti-malarial drug every 5 years. According to the WHO, about $150 million will be required to bring each new drug to market and make it accessible. The pharmaceutical industry will complement this financial outlay with "in kind" support, such as access to chemical libraries. An estimated 300 to 500 million malaria cases are contracted worldwide each year, resulting in one million deaths. The direct and indirect costs of malaria in sub-Saharan Africa exceed $2 billion per year, according to one estimate.

Unrealized Hopes in Transition Economies. Hopes that privatization in transition economies would create the foundation for improved governance and transform the ties between the state and firms have not been fully realized, according to the European Bank for Reconstruction and Development's *Transition Report 1999.* Rather, enterprises in these economies spend considerable resources lobbying state officials, paying bribes, and adjusting to state interference. In return, enterprises receive benefits in the form of subsidies, soft finance, preferential tax treatment, and the tolerance of arrears. A survey of 3,000 firms in 20 transition economies confirms that corruption is a major problem in these countries, particularly for small businesses. Thirty-seven percent of small enterprises report paying bribes frequently, compared with only 16 percent of large enterprises. The average bribe paid by small firms is also higher, absorbing 5.4 percent of annual revenues, nearly double the 2.8 percent paid by large firms. New firms also tend to pay higher bribes. The average "bribe tax" is generally higher in the Commonwealth of Independent States (5.7 percent of company revenues), than in central and eastern Europe (3.3 percent). The report also finds that privatized firms pay a bribe tax similar to that paid by state-owned firms.

EYES ONLY

RELEASES THIS WEEK

Productivity

Nonfarm business productivity rose at an annual rate of 4.2 percent in the third quarter. Manufacturing productivity rose 3.4 percent.

Retail Sales

Advance estimates show that retail sales were unchanged in October following a decrease of 0.1 percent in September. Excluding sales in the automotive group, retail sales rose 0.5 percent following an increase of 0.6 percent.

Producer Price Index

The producer price index for finished goods fell 0.1 percent in October. Excluding food and energy, producer prices rose 0.3 percent.

MAJOR RELEASES NEXT WEEK

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

EYES ONLY

U.S. ECONOMIC STATISTICS

	1970-1993	1998	1999:1	1999:2	1999:3
Percent growth (annual rate)					
Real GDP (chain-type)	3.0	4.6	3.7	1.9	4.8
GDP chain-type price index	5.2	1.1	2.0	1.3	1.0
Nonfarm business (NFB) sector:					
Productivity (chain-type)	N.A.	**3.1**	**2.7**	**0.6**	**4.2**
Real compensation per hour:					
Using CPI	N.A.	**3.9**	**2.8**	**1.2**	**2.2**
Using NFB deflator	N.A.	**4.7**	**2.9**	**2.9**	**4.4**
Shares of Nominal GDP (percent)					
Business fixed investment	11.4	12.5	12.6	12.6	12.8
Residential investment	4.5	4.2	4.4	4.5	4.4
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Imports	9.2	12.7	12.9	13.4	13.9
Personal saving	6.6	2.6	2.2	1.8	1.5
Federal surplus	-2.8	0.5	1.1	1.3	N.A.

	1970-1993	1998	August 1999	September 1999	October 1999
Unemployment Rate (percent)	6.7**	4.5**	4.2	4.2	4.1
Payroll employment (thousands)					
increase per month			129	41	310
increase since Jan. 1993					19794
Inflation (percent per period)					
CPI	5.8	1.6	0.3	0.4	N.A.
PPI-Finished goods	5.0	0.0	0.5	1.1	**-0.1**

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

New or revised data in **boldface**.

EYES ONLY

FINANCIAL STATISTICS

	1997	1998	September 1999	October 1999	Nov. 10, 1999
Dow-Jones Industrial Average	7441	8626	10714	10397	10598*
* The close on Nov. 11 was 10595					
Interest Rates (percent per annum)					
3-month T-bill	5.06	4.78	4.68	4.86	5.05
10-year T-bond	6.35	5.26	5.92	6.11	6.00
Mortgage rate, 30-year fixed	7.60	6.94	7.82	7.85	7.67
Prime rate	8.44	8.35	8.25	8.25	8.25

INTERNATIONAL STATISTICS

Exchange Rates	**Current level November 10, 1999**	**Percent Change from Week ago**	**Percent Change from Year ago**
Euro (in U.S. dollars)	1.044	-0.0	N.A.
Yen (per U.S. dollar)	104.6	0.1	-14.9
Major currencies index (Mar. 1973=100) (trade-weighted value of the U.S. $)	92.56	0.2	-1.8

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)	4.1 (Oct)	2.6 (Sep)
Canada	3.7 (Q2)	7.5 (Sep)	2.5 (Sep)
Japan	0.9 (Q2)	4.7 (Sep)	-0.2 (Sep)
France	2.1 (Q2)	11.0 (Sep)	0.7 (Sep)
Germany	0.6 (Q2)	9.1 (Sep)[2]	0.6 (Sep)
Italy	0.8 (Q2)	12.1 (Apr)	1.8 (Sep)
United Kingdom	1.8 (Q3)	5.9 (Jul)	1.1 (Sep)

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 unified Germany.

EYES ONLY

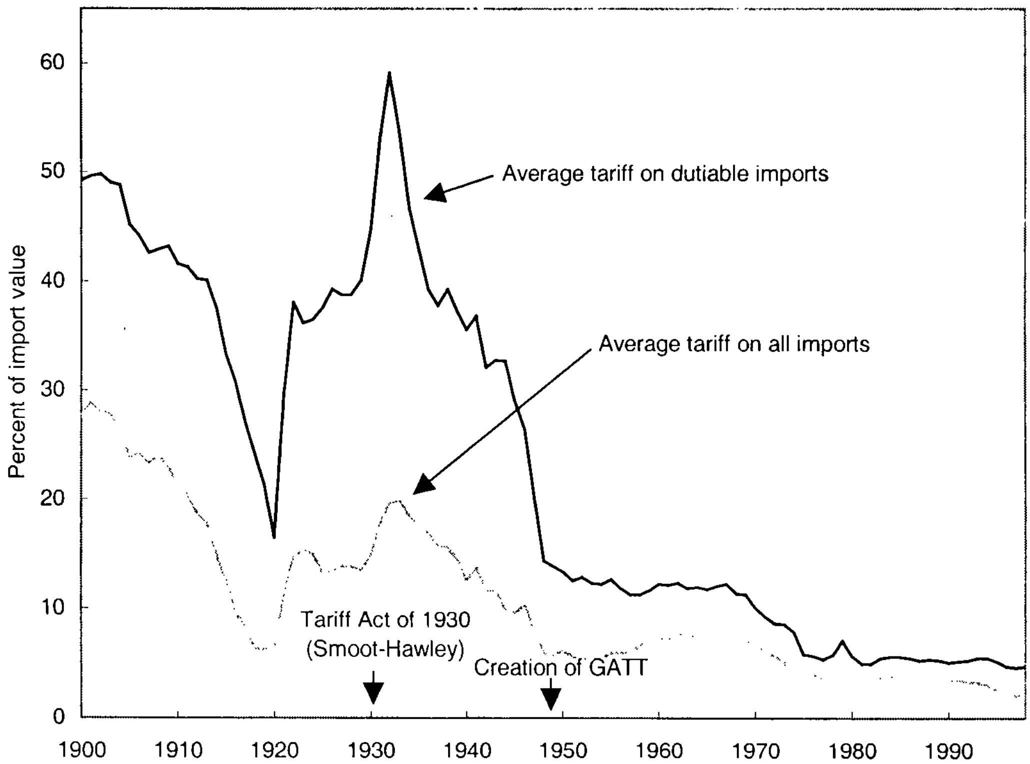
WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

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

November 19, 1999

CHART OF THE WEEK

U.S. Tariff Rates, 1900-1998



Until the rounds of multilateral trade negotiations after World War II, U.S. tariff rates were quite high. Tariffs on dutiable imports reached almost 60 percent under the Smoot-Hawley tariff act. By 1998, however, the average tariff rate was 4.7 percent on dutiable imports and 2.0 percent on all imports.

EYES ONLY

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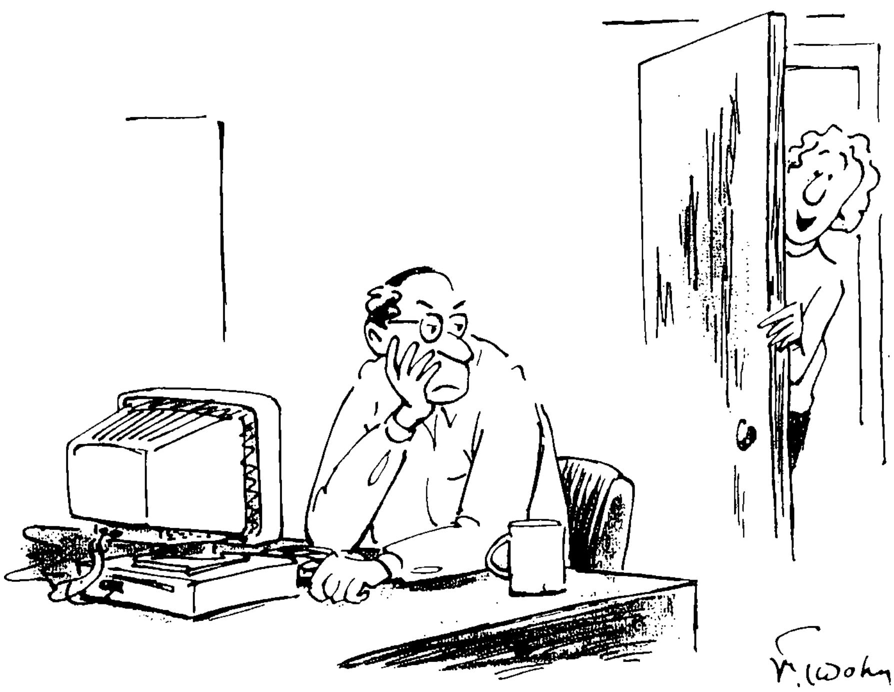
DEPARTMENTS



"Any intellectual property yet, honey?"

EYES ONLY

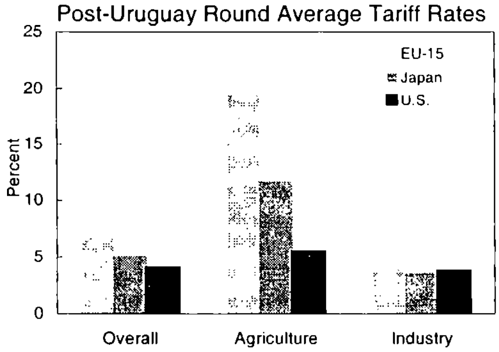
SPECIAL ANALYSIS

Who Is the Most Open of Them All?

Through successive GATT/WTO rounds, world tariffs have been reduced from an average of 40 percent in 1947 to roughly 4 percent today. However, tariffs still exhibit wide variation, both across countries and across sectors within a country. One motivation for U.S. participation in negotiating lower tariffs at the WTO is that, on average, our rates are lower than those of our major trading partners. It also turns out that although we have a few products with very high tariff rates, we have fewer high tariffs than Japan or the European Union.

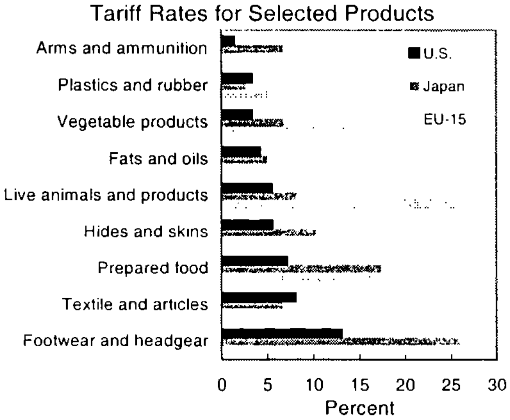
Uruguay Round commitments. At the WTO, the United States has committed to "binding" its overall MFN tariff rates to an average of 4.1 percent. This compares with 5.1 percent for Japan and 7.4 percent for the EU (see upper chart). These differences are due mainly to the higher protection accorded to agricultural products elsewhere: 19.5 percent in the EU and 11.7 percent in Japan, compared with the much lower 5.5 percent in the United States. Rates for industry (manufacturing products) are much more uniform.

Post-Uruguay Round Average Tariff Rates



Highly protected sectors. The lower chart compares the average tariff rates for several product groups, ranked by the degree of protection received in the United States. The footwear industry is the most protected U.S. sector, with an average rate of 13 percent for the combined footwear, and headgear product group. While this exceeds the EU rate of 8 percent, it is much lower than the Japanese average of 26 percent. The textile and apparel industry, another highly protected sector in the United States, has an average tariff of 8.0 percent, similar to the average for the EU (7.9 percent) and above that for Japan (6.6 percent).

Post-Uruguay Round Average Bound Tariff Rates for Selected Products



Distribution of tariff rates. As averages may conceal as well as reveal, it is also useful to examine the dispersion of tariff rates. Out of roughly 10,000 tariff rates recorded for each group of countries, 66 percent of the U.S. tariffs are 5 percent or lower. By contrast, 54 percent of EU tariffs and 59 percent of Japanese tariffs are 5 percent or under. While both the EU and the United States have 98 percent of their rates at or below 20 percent, only 94 percent of Japanese rates lie in this range.

Who has the highest of them all? The United States actually has a few products whose tariff rates exceed any in Japan or the EU. Seven tobacco products have rates above 300 percent, and five peanut products have rates over 100 percent. The highest EU rate is 89 percent (also for a tobacco product) while the highest Japanese rate is 60 percent. However, the United States has fewer of these high-rate categories than either the EU or Japan. While the United States has only 170 categories with rates between 20 and 60 percent, the Europeans have 242 such categories and the Japanese 514.

Tariff peaks are costly. From a purely economic perspective, tariff-induced economic costs rise with the square of the tariff rates, as a rough rule of thumb. Thus a 2 percent tariff is four times as inefficient, and a 3 percent tariff is nine times as inefficient as a 1 percent tariff. Because businesses and firms make production decisions based on price signals, distorting prices by putting 10 percent tariffs on some, but not all, products is probably more inefficient than applying an across-the-board 5 percent rate.

Possible benefits. While economic arguments point to evening out tariff peaks, there may nonetheless be important political reasons for preserving them. Granting high protection to a few politically sensitive sectors may allow more tariff reductions in other sectors, resulting not only in lower overall protection, but also in greater economic benefits.

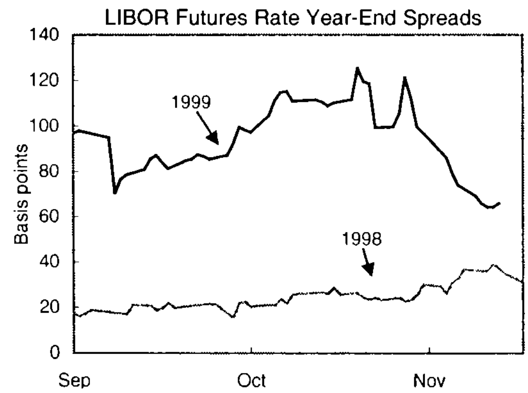
EYES ONLY

SPECIAL ANALYSIS

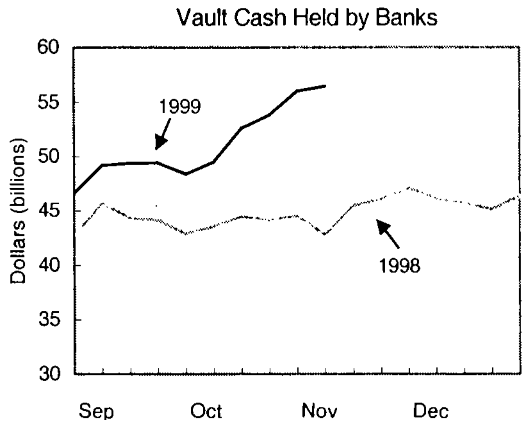
Y2K Effects in Financial Markets

Financial sector disruptions both here and abroad have been a central concern related to the coming century date change. The smooth and efficient operation of financial markets and the banking sector relies on the extensive use of computers for record keeping, financial accounting, and electronic transactions. Studies by the Federal Reserve and the President's Council on Year 2000 Conversion report that federally insured financial institutions are very well-prepared for the year 2000 date change. Data from banks and financial markets provide additional information on the preparations underway and the magnitude of anticipated Y2K-related disruptions to the financial system.

Year-end interest rate indicators. One measure of expected Y2K disruptions is the premium lenders receive for providing funds around the end of the year. This is measured in the chart by the difference between the rate on futures contracts in one important market for deposits running from mid-December to mid-January and the average of the rate on contracts running from mid-November to mid-December 1999 and the rate on contracts running from mid-January to mid-February 2000. The spread on year-end 1999 contracts has been running well above the spread on comparable year-end 1998 contracts at comparable times a year ago and reached a peak of 120 basis points in October. Partly as a result of Fed actions to assure markets that ample liquidity will be available at year-end, and partly as a result of a general easing of concerns regarding Y2K-related risks to financial markets, this spread has fallen to about 65 basis points. Other comparable year-end premiums (on fed funds futures and Treasury repurchase agreements) are even smaller. Evidently, market participants generally expect that Y2K disruptions will have only minor repercussions on financial markets.



Banks are building up stockpiles of vault cash. In addition to its role in soothing concerns over year-end liquidity, the Federal Reserve has also acted to ensure that sufficient quantities of cash are available to the public at year-end. It is widely believed that many people intend to withdraw abnormally large amounts of cash near the end of the year as a precaution against Y2K-related failures at banks and ATMs. In anticipation of this rise in demand for cash, the Fed increased the value of its order for currency through September by over 50 percent from the previous year. It has also implemented measures making it easier for banks to order and take delivery of cash. Starting in September, banks began building up their holdings of vault cash, which now stand about 30 percent



higher than at the same time last year (see chart). One of the reasons this build-up started so early is that armored carriers are normally in short supply during the Christmas shopping season. So far, however, public holdings of currency are running at normal levels. Evidently, the public plans to wait until the last minute to get its Y2K cash.

Conclusion. Indications from banks and financial markets suggest that the combined efforts by government agencies and private financial institutions to prepare for Y2K have been successful overall. Financial markets appear to expect relatively minor century-date change disruptions.

EYES ONLY

ARTICLE

Patents and Innovation in the On-line World

Three recent lawsuits raise the question of how Internet-based companies' ability to patent their business processes would affect on-line competition.

Background. On October 13, priceline.com sued Microsoft for infringing on its patent for a sales mechanism that allows buyers to submit price bids to sellers for airline tickets and other products. Then, on October 21, Amazon.com sued barnesandnoble.com for infringing on its patent for a purchasing method that allows customers to buy products with a single mouse click. Finally, on October 22, Trilogy Software alleged that CarsDirect.com infringed on its patent for a method that allows shoppers to customize their purchases by choosing among a variety of options. These companies might have decided to bring their suits in any case, but the legal environment may also have changed following an appeals court decision last year that some commentators have interpreted as possibly making it easier to patent business processes.

The economics of patents. An Internet company would want to patent a business practice for the same reason that a pharmaceutical company would want to patent a new drug—to gain a competitive advantage. Moreover, without some protection against competitors' simply appropriating an innovation, companies would have little incentive to invest in R&D. Society's decision to offer patent protection involves a trade-off between the costs of granting temporary monopoly power and the benefits from stimulating more innovation. Patents are inappropriate in cases where the costs clearly outweigh the benefits. For example, "natural laws," such as the laws of physics, are not patentable. On economic grounds, this would be justified to the extent that they are so inextricably embedded in a wide variety of innovations that the costs of their being monopolized would most likely be huge. Finer gradations than simply granting or denying a patent are also possible (for example, restricting the scope of a patent based on the novelty of the innovation). Once again, the economic decision is whether the benefits of encouraging innovation outweigh the costs of monopolization.

The case for on-line business process patents. Five years ago, no one sold products on-line. The first electronic commerce companies had to adapt standard business practices like the use of credit cards to the on-line environment. But they also had to develop new solutions to new problems. Amazon.com, for example, developed its patented, streamlined purchasing process, because it believed that it was losing sales by requiring customers to enter billing and credit card information with each purchase. However, such investment may be difficult to protect from imitators without patent protection. One reason is that imitation may be easier in cyber space than it is in the physical world, where other barriers, such as start-up costs, can provide protection even without a patent. For example, the New York Times invested $350 million for a printing press to print the first page of the newspaper in color. On-line, the ability to display color graphics is an integrated part of web browsers like Netscape's Navigator and Microsoft's Explorer.

The case against on-line business patents. Ironically, the case for limiting the patenting of on-line business processes draws on many of the same features of e-commerce as the case for expanding the scope of such patents. The fact that all on-line business practices are new means that a large number are potentially patentable. Restricting access to these innovations could seriously hamper the on-line world's famously frenetic pace of innovation and growth and might provide too great an advantage to the early holders of broad patents. In the extreme, it could amount to the physical equivalent of building a fast food restaurant while having to pay one party for the use of a drive-through window, someone else for incorporating a playground, and another for the very idea of running a fast food restaurant.

Finally, even though conventional barriers to entry like start-up costs may be low, the on-line world may have barriers of its own. One might be the importance of reputation. As the number of processes for facilitating sales (such as 1-click shopping) grows, the job of an on-line merchant may well become amalgamating components so as to make accessing the merchant's core product easier. The use of specific processes will become less important than having a reputation for providing an easily accessible site. Gaining a reputation for being the first to develop and incorporate new services might provide a powerful incentive for research and development even in the absence of patent protection.

Conclusion. On-line companies are looking to protect their investments in developing innovative business practices. The challenge for policymakers is to determine whether the unique characteristics of the on-line world call for striking a balance between the costs of granting a temporary monopoly and the gains from stimulating greater innovation that is different from the balance that is embodied in current patent law and practice.

EYES ONLY

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

FCC Issues High-Speed Internet Access Decision. Yesterday, the Federal Communications Commission adopted rules to promote competition in providing high-speed Internet access by directing local telephone companies to share their telephone lines with other access providers. This decision will enable competitive carriers to provide Digital Subscriber Line (DSL)-based services over the same telephone lines simultaneously used by the incumbent phone company for basic telephone service, a technique referred to as "line-sharing." Incumbents are already using line sharing technology to offer basic telephone service and DSL services over the same line. Now customers can use an alternative provider of high-speed Internet access without having to purchase a second line. The FCC's Order is intended to ensure that as many companies as possible will be able to deploy new technologies on a faster, more cost-effective basis, and should benefit residential and small business customers.

Lending to Minority Home Buyers Is up, but So Are Denials. Home-purchase lending to low-income and minority households has expanded faster than lending to other borrowers in recent years, according to a new Federal Reserve study. For example, the number of conventional (non-government backed) home-purchase loans extended to low-income borrowers increased by 75 percent between 1993 and 1998, compared with a 52 percent rise among upper-income borrowers. At the same time, however, an increasing proportion of mortgage applicants, including low-income and minority applicants, have been denied. The study concludes that increased lending for subprime and (especially) manufactured-home mortgages plays a key role in explaining both the increased availability of credit to lower-income borrowers and the recent rise in denial rates for conventional home-purchase loans. (Subprime mortgages are those that exceed the level of credit risk that the government-sponsored enterprises Fannie Mae and Freddie Mac are willing to accept; manufactured homes are assembled in a factory and transported to the purchaser's site.) These mortgages are oriented toward lower-income and relatively less-creditworthy buyers and thus tend to be characterized by higher denial rates. Such mortgages were 14 percent of all conventional home-purchase mortgages in 1998, up from 5 percent in 1993.

EITCs Spread to States and Now to Counties. Last month, Montgomery County, Maryland, enacted what appears to be the first county "EITC" in the nation—a refundable tax credit equal to 10 percent of the Federal EITC. Eight states currently have refundable credits (Colorado, Kansas, Maryland, Massachusetts, Minnesota, New York, Wisconsin, and Vermont) and three states have non-refundable credits (Iowa, Oregon, and Rhode Island). Seven of these 11 states have enacted or expanded their state credits since 1997. Most state credits range in generosity from 5 percent to 27 percent of the Federal EITC, although some offer higher credits in certain circumstances. Families in Wisconsin and Minnesota, for example, may be eligible for credits of up to 43 percent and 46 percent, respectively, of the Federal EITC. States finance their credits mainly through general funds, although states can use their TANF block grant to cover a portion of the cost of refundable credits.

INTERNATIONAL ROUNDUP

ILO Concludes That Child Labor Can Be Reduced. In a recent report on the achievements of the International Program for the Elimination of Child Labor (IPEC), the International Labor Organization suggests that eliminating child labor is a feasible objective. Major accomplishments of the IPEC include introducing an innovative process of workplace monitoring along with social protection for affected children and their families, intensifying efforts to target the worst forms of child labor, and expanding IPEC in Africa. The report estimates that 130,000 working children directly benefited from the program during 1998-99, including 16 percent who were withdrawn from work or trafficking, 11 percent who were removed from hazardous working conditions, and 20 percent who went into the formal education system One notable success was a workplace monitoring system introduced in the Bangladesh garment industry in 1995, at a time when 43 percent of factories employed children. By 1998, this percentage had fallen to 5 percent. An estimated 250 million children aged 5 to 14 are engaged in economic activities worldwide. Seventy percent are in the agricultural sector, but the worst injury and illness rates are found in construction, mining, and transport.

Assessing Developing Countries' Telecom Reform. Liberalization of telecommunications policies in developing countries since the 1980s has substantially improved industry performance, and the more radical has been the reform, the greater has been the improvement, according to a recent study. The paper notes that a monopoly is likely to exist, at least temporarily, in the early stages of liberalization, and it advises countries to control monopolistic behavior in order to benefit consumers and the national economy. However, good regulation may be too expensive for some countries. Hence, the study recommends that developing nations create joint regional authorities to regulate telephone companies. This approach would allow the regulator to develop specialized expertise at a scale that a lone developing country cannot afford; it would also allow the regulator to use information about technology, costs, and demand in one country to detect inefficiencies in another country.

U.S. Tax Burden Is Low among OECD Countries. New estimates released by the Organization for Economic Co-operation and Development show that in 1997 the United States continued to have one of the lowest ratios of tax revenues to GDP among OECD countries. Revenues collected at all levels of government were 29.7 percent of GDP in the United States, compared with rates in excess of 45 percent in Sweden, Denmark, Finland, Luxembourg, Belgium, and France. Sweden (51.9 percent) was the lone country whose general government revenue exceeded 50 percent of GDP. Only Mexico, Korea, Turkey, and Japan had tax shares lower than the United States', with Mexico's 16.9 percent the lowest of all. Between 1965 and 1997, revenues as a share of GDP increased from 28 to 42 percent in the European Union 15, compared with a rise from 25 to 28 percent in the North American countries (the United States, Canada, and Mexico).

EYES ONLY

RELEASES THIS WEEK

U.S. International Trade in Goods and Services

The goods and services trade deficit was $24.4 billion in September; it was $23.5 billion in August.

Housing Starts

Housing starts in October were virtually unchanged from September at 1.628 million units at an annual rate. For the first 10 months of 1999, housing starts are 3 percent above the same period a year ago.

Consumer Price Index

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

Industrial Production and Capacity Utilization

The Federal Reserve's index of industrial production increased 0.7 percent in October. Capacity utilization rose 0.3 percentage point to 80.7 percent.

MAJOR RELEASES NEXT WEEK

Advance Durable Shipments and Orders (Tuesday)
Gross Domestic Product (Wednesday)

EYES ONLY

U.S. ECONOMIC STATISTICS

	1970-1993	1998	1999:1	1999:2	1999:3
Percent growth (annual rate)					
Real GDP (chain-type)	3.0	4.6	3.7	1.9	4.8
GDP chain-type price index	5.2	1.1	2.0	1.3	1.0
Nonfarm business (NFB) sector:					
Productivity (chain-type)	**1.7**	3.1	2.7	0.6	4.2
Real compensation per hour:					
Using CPI	**1.0**	3.9	2.8	1.2	2.2
Using NFB deflator	**1.5**	4.7	2.9	2.9	4.4
Shares of Nominal GDP (percent)					
Business fixed investment	11.4	12.5	12.6	12.6	12.8
Residential investment	4.5	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	6.6	2.6	2.2	1.8	1.5
Federal surplus	-2.8	0.5	1.1	1.3	N.A.

	1970-1993	1998	August 1999	September 1999	October 1999
Unemployment Rate (percent)	6.7**	4.5**	4.2	4.2	4.1
Payroll employment (thousands)					
increase per month			129	41	310
increase since Jan. 1993					19794
Inflation (percent per period)					
CPI	5.8	1.6	0.3	0.4	**0.2**
PPI-Finished goods	5.0	0.0	0.5	1.1	-0.1

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

New or revised data in **boldface**.

EYES ONLY

FINANCIAL STATISTICS

	1997	1998	September 1999	October 1999	Nov. 18, 1999
Dow-Jones Industrial Average	7441	8626	10714	10397	11036
Interest Rates (percent per annum)					
3-month T-bill	5.06	4.78	4.68	4.86	5.08
10-year T-bond	6.35	5.26	5.92	6.11	6.06
Mortgage rate, 30-year fixed	7.60	6.94	7.82	7.85	7.69
Prime rate	8.44	8.35	8.25	8.25	8.50

INTERNATIONAL STATISTICS

Exchange Rates	**Current level November 18, 1999**	**Percent Change from** Week ago	Year ago
Euro (in U.S. dollars)	1.030	-1.3	N.A.
Yen (per U.S. dollar)	105.9	1.2	-12.8
Major currencies index (Mar. 1973=100) (trade-weighted value of the U.S. $)	93.16	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)
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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 unified Germany.

EYES ONLY

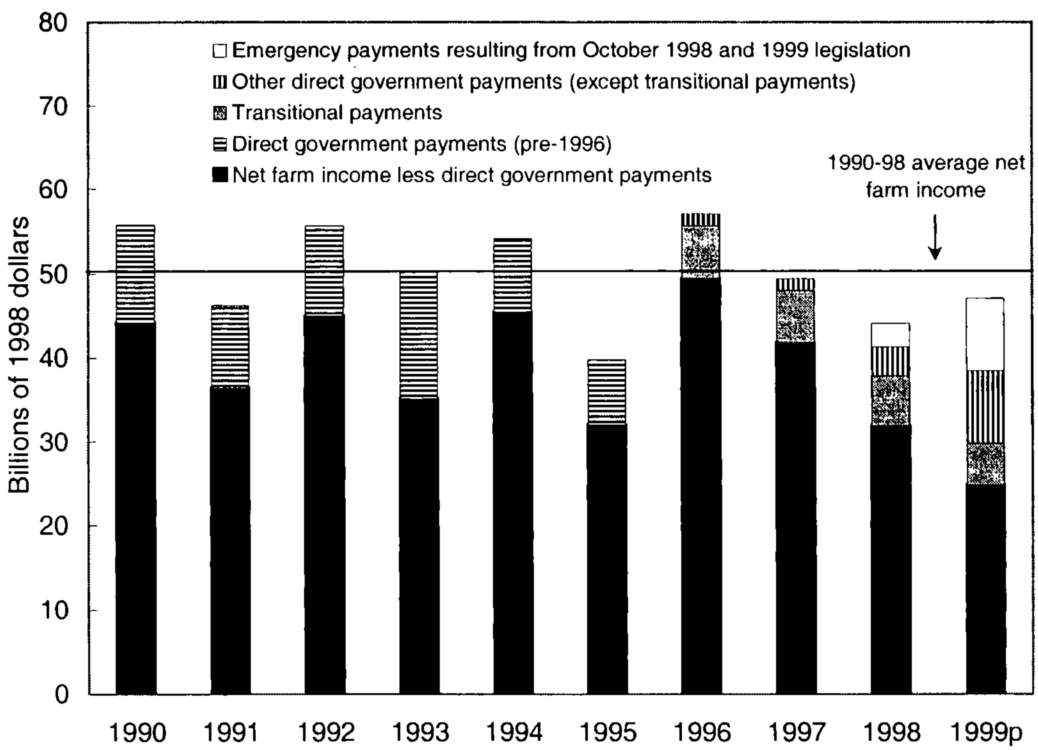
WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

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

December 17, 1999

CHART OF THE WEEK

Net Farm Income in the 1990s



In 1999, net farm income excluding direct government payments (the black part of the bars) was well below its average level for the 1990s. However, direct government payments excluding the emergency payments legislated in October 1998 and 1999 would have substantially moderated the effects of the 1998-99 decline in market income. With those emergency payments included, farmers were substantially shielded from the effects of market forces in 1998-99.

EYES ONLY

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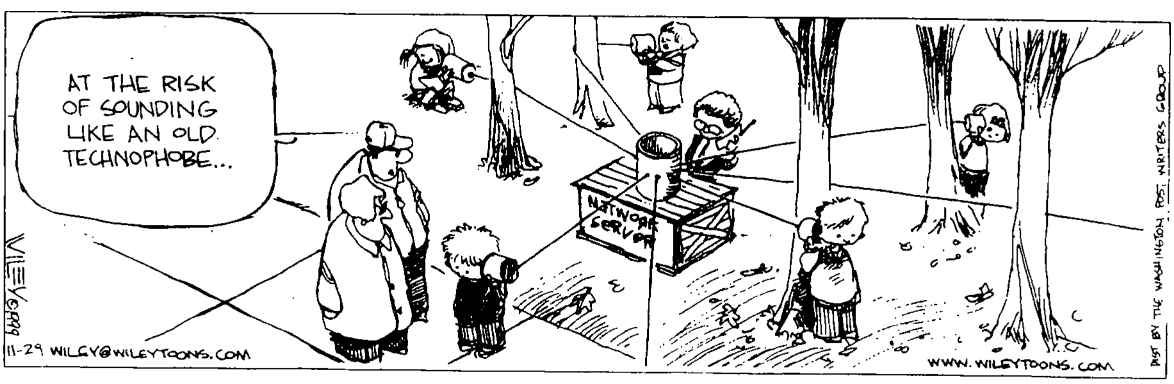


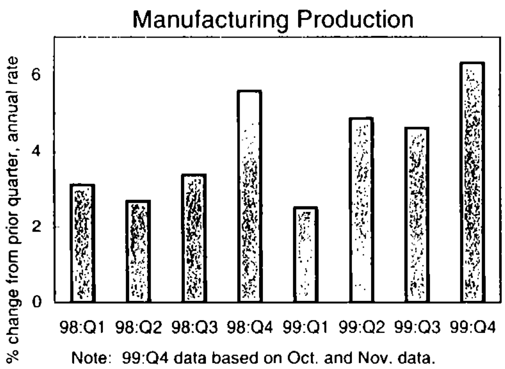
EYES ONLY

MACROECONOMIC UPDATE

More Strong Growth in the Fourth Quarter

The fourth quarter is shaping up as another of strong growth (around 4¾ percent at an annual rate) with low and stable inflation.

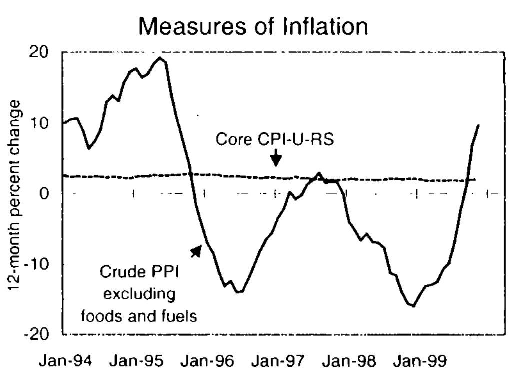
The labor market. Payroll employment grew by an average of 250,000 per month in October and November, and total hours of production workers have increased at a 2½ percent annual pace thus far in the fourth quarter. Adding trend growth in productivity (probably around 2¼ percent at an annual rate), these hours could support GDP growth of about 4¾ percent at an annual rate.



Production. Data on production are also robust. Manufacturing industrial production has grown at a 6¼ percent annual rate so far in this quarter—which promises to be the strongest quarterly increase in 2 years (see upper chart). The acceleration may reflect exports to improving foreign economies.

Spending. Spending data remain fragmentary. Solid data are available for consumer spending—where fourth quarter growth appears to be about 4¾ percent at an annual rate. Consumer sentiment is fluctuating around the high plateau at which it has persisted for most of the year. One worry is that some of the fourth-quarter spending may represent advance hoarding to buffer against potential Y2K disruptions. If so, the first quarter of next year may be weak.

Inflation. With the exception of energy and tobacco prices, consumer inflation remains low and stable. Core consumer prices rose just 2.1 percent during the past 12 months—down slightly from the year-earlier pace. However, some inflationary risk is on the radar screen: the rise in oil prices may get passed through to other goods, and a strengthening world economy may lead to higher import and export prices over the next year. Both influences may be pushing up prices at the earlier stages of processing. For example, the index for crude materials excluding foods and fuels has increased 10 percent over the past year—a dramatic acceleration from a 16 percent decline during the year-earlier period (see lower chart).

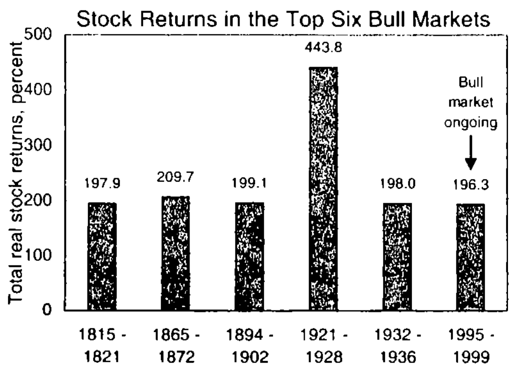


EYES ONLY

SPECIAL ANALYSIS

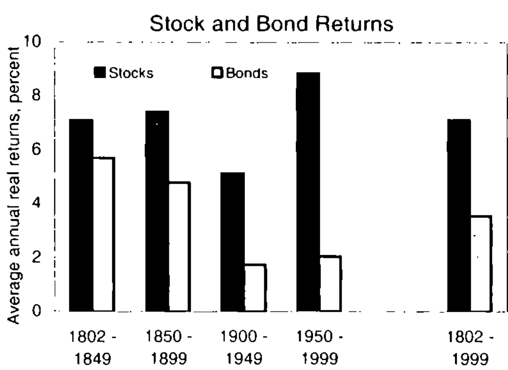
Trying to Make Sense of the Bull Market

In the exceptional stock market of the last 5 years, investors have earned an annual real return of over 24 percent—the highest 5-year average real return since 1936. Already, this market ranks as the sixth best of all U.S. bull markets of the last 200 years, based on the total real return to stocks (see upper chart). Although some economists remain puzzled by the exuberance of markets, others argue that changes in the economy help reconcile the stock market performance with economic theory.



Stock valuation in theory. Owning a stock provides an investor with the right to a share in the corporation's future profits. Hence, the stock's price should equal the discounted value of future profits. Future income is discounted to reflect two factors: the opportunity cost of waiting (equal to the return on a safe asset such as a Treasury bond) and the premium that compensates the investor for the greater riskiness of stock returns relative to bond returns. Strong growth in profits paid as dividends and falling real bond rates appear to explain part, but not all, of the nearly 200 percent increase in stock prices over the last 5 years.

A declining equity risk premium? Investors demand a higher return on stocks than on bonds because stocks tend to be riskier than bonds over horizons of a few years or less. What is surprising to economists is how large the equity premium has been, particularly in the last 50 years (see lower chart). The additional volatility of stock returns over that of bond returns does not appear large enough to justify this 7 percentage point premium, unless investors are extraordinarily risk-averse or their investment horizon is very short. One possible explanation for the recent run-up in stock prices, therefore, is that investors have re-evaluated the risks associated with holding stocks and have bid up stock prices until the rate of return on stocks has come down enough to reflect a new, lower equity risk premium.



A new economy? A second possible explanation for the strong performance of the stock market is that investors may have raised their forecasts of future growth in profits, based on an improved outlook for productivity growth. According to some models, holding other influences on stock prices constant, a one-half percentage point increase in the expected growth of future profits implies an increase in stock prices of up to 50 percent. Importantly, what is relevant for stock prices is not whether long-run growth trends have in fact changed, but only that investors perceive that they have. In the event that economic developments do not meet these expectations, investors will bid stock prices back down.

Conclusion. The truly exceptional performance of the stock market over the last 5 years is partly attributable to strong increases in profits and a fall in real bond rates. Other factors, including a more tolerant attitude toward risk and an increase in expected productivity growth, may also be boosting stock prices. A remaining question is whether these and other influences that have helped power the bull market have nearly played themselves out, in which case the stock market should cool, or whether we can expect more years of rapid increases in stock prices.

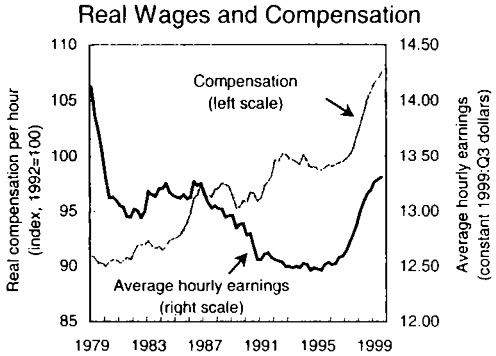
ARTICLE

Inequality in the 1990s: Is the Gini Back in the Bottle?

After increasing since the late 1970s or even earlier, many measures of income and wage inequality have remained stable since 1993-94. Interestingly, the usual suspects for the increase in inequality—globalization, technological change, and de-unionization—appear to have proceeded apace even as the rise in inequality has been arrested.

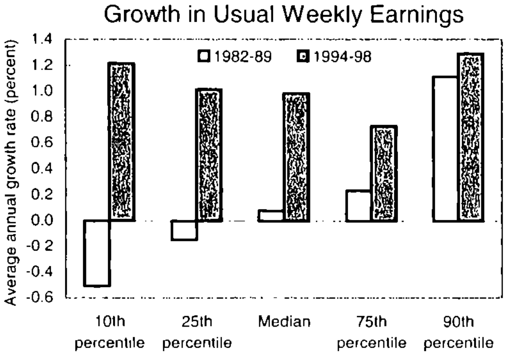
Trends. A range of indicators that showed sluggish wage growth and rising inequality from the early 1970s to the early 1990s appear to have turned around recently.

Real Wages and Compensation



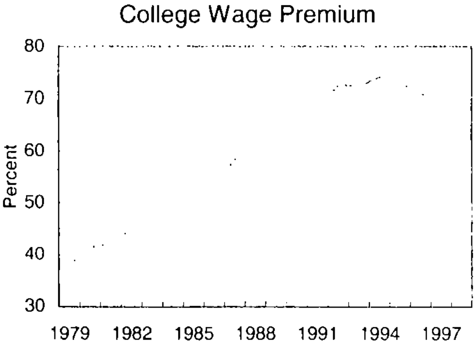
<u>Real wages and labor's share</u>. Both average hourly earnings and nonfarm real compensation per hour have increased sharply in the past few years (see upper chart). The share of income received by workers in the form of compensation has shown no long-term trend relative to capital's share (and has increased some since 1996).

Growth in Usual Weekly Earnings



<u>Income and earnings inequality</u>. Various measures of income inequality (including the index of income concentration known as the Gini coefficient) rose substantially between the mid-1970s and the early 1990s. But inequality has changed little since then. In this expansion, both wages and household income have increased roughly in the same proportion at different points in the income distribution. This contrasts with the 1980s expansion, when the gains were concentrated among higher income households and higher wage workers (see middle chart).

College Wage Premium



<u>The college wage premium</u>. After shooting up sharply in the 1980s, the wage premium earned by workers with a college degree has stabilized (see lower chart). The average weekly earnings of full-time workers with

college degrees, which in 1979 were about 40 percent higher than those of workers with a high school diploma, have been about 70 percent higher in the 1990s.

The paradox. The apparent trend shift in measures of inequality might not be surprising if the major forces adduced to explain the rise in inequality in the 1980s were not still operating in the 1990s. But they appear to be.

- Globalization. In the 1980s the increase in trade, particularly with developing countries, was seen as reducing demand for relatively less-skilled workers. Yet in the 1990s globalization has increased even more rapidly. For example, the sum of imports and exports as a share of GDP averaged under 19 percent in the 1980s and over 22 percent in the 1990s.

- Technological change. According to many, an even more important source of the increased relative demand for skilled workers in the 1980s was technological change, such as the broader application of computers and new management approaches emphasizing leaner and more flexible production. Yet in the 1990s, technological change seems to be even more rapid, as evidenced by the strong investment in computers and information technology, and the surge in productivity growth.

- Institutional and structural changes. In the 1980s, de-unionization and deregulation weakened the bargaining power of workers and the declining share of manufacturing in employment reduced high-wage opportunities for less-skilled blue-collar workers. Yet in the 1990s, union membership has continued to decline and, after rising through 1997, manufacturing employment has fallen.

Analysis. There are several plausible reasons why inequality has not been affected by these forces in the same way recently as it was in the 1980s.

- The high pressure economy. Tight labor markets generate increased employment opportunities for less skilled workers and may also launch a virtuous circle in which new opportunities lead to new skills and higher productivity, which in turn may allow for labor markets to operate at higher levels without upward pressure on prices.

- Feedback from globalization and technology to the economy. Ironically, the forces that were seen as working toward increased inequality may have helped to achieve a high pressure economy. First, lower import prices help keep inflation low; imports also reduce pressures on domestic capacity. Second, positive shocks to productivity from technological change allow firms to pay higher wages without having to raise prices. And third, it could be that a more competitive economy is less inflation-prone.

EYES ONLY

- The trends themselves may have been brought to a halt by offsetting microeconomic forces. Skill bias is not divinely ordained, and firms may increasingly find ways to employ relatively less-educated workers more effectively as their relative wages decline. Second, the pressure on employment patterns and wages from globalization may diminish as U.S. firms either exit from low-wage activities or learn how to compete using competitive strategies that offset cheaper foreign labor costs. Similarly, declining union membership may mean that those who remain are in areas with continued bargaining strength.

Conclusion. The halt to rising inequality is surprising in light of the usual explanations for why inequality increased in the first place. However, there are some plausible explanations for this development. While the macroeconomic explanation implies that inequality could reverse in the face of higher unemployment, the microeconomic considerations suggest that we may have a more resilient economy and may finally be reaping the benefits of having adjusted to some major structural challenges. Claims that globalization and rapid technological change inevitably increase inequality need to be re-appraised.

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

The Impact of Changes in Financial Services Industries on Cities. Financial services firms have been an important source of jobs, income, and tax revenue in cities, especially in central business districts. A recent study observes that, as of 1996, 8.5 percent of employment and 14.5 percent of earnings in 88 of the largest central cities were in financial services. Some cities, such as Hartford, Wilmington, and Jersey City, are highly specialized in financial services, with approximately 20 to 30 percent of city employment in this sector. In many larger cities—including New York City, Chicago, Boston, and San Francisco—over 10 percent of the jobs and 20 to 30 percent of the residents' earnings are found in financial services. The study finds that, especially in banking, heavy investments in information technology such as the automated teller machine, telephone calling centers, on-line banking and the in-store supermarket branch have led to decreases in employment, especially for lower-skilled workers. Mergers and acquisitions have concentrated banking assets in a number of core banking metropolitan areas, with Charlotte and New York currently in dominant positions. Geographic concentration is less noticeable in other sectors. For example, mutual fund assets have actually become less concentrated, with New York's share falling from 40 to 24 percent between 1986 and 1996.

Racial Digital Divide Extends Beyond Income Differences. The latest digital divide data from the Commerce Department show that in 1998 African American and Hispanic households were approximately half as likely to have computers at home and roughly two-fifths as likely to have Internet access than white households. While computer ownership and Internet access for all groups have soared, the racial/ethnic divide has also grown. Because computer and Internet use are correlated with income and education, some of the divide reflects lower average household income and lower average educational attainment among African Americans and Hispanics. However, a recent RAND analysis of the 1997 survey data finds that a digital divide persists even after controlling for education, income, location of residence, sex, and age. In other words, racial and ethnic characteristics appear to exert an independent and important influence on home computer access and network use.

Assessing the Costs of Student Loans. A recent report from the Department of Education demonstrates how budget rules mandated by the Credit Reporting Act of 1990 tend to obscure program costs for student loans. Under such rules, estimates of subsidy costs for student loans are calculated on a present value basis while estimates of Federal administrative costs reflect actual spending in a given year. When both subsidy and administrative costs are calculated on a net present value basis, the report concludes that providing a student with a $10,000 subsidized loan costs $1,407 whereas the government makes $411 when the same loan is provided directly to the student. This difference reflects the interest received on repayments of the direct loans, which more than offsets the higher administrative expenses of direct loans.

INTERNATIONAL ROUNDUP

Japan's Tenuous Recovery. Although output grew at an annual rate of around 5 percent in the first half of the year, recent data suggest that Japan's economic recovery has not yet fully taken hold. Last week, preliminary data showed that real GDP fell at a 3.8 percent annual rate in the third quarter. This week, the Bank of Japan's quarterly Tankan survey showed that while business sentiment improved somewhat, companies still had excess inventories and planned to further reduce investment in plant and equipment. Large enterprises, for example, planned to cut capital spending by 11 percent in the 1999 fiscal year; furthermore, many of these enterprises reported that they had too many workers, which bodes poorly for a revival in consumer confidence. Japan's Economic Planning Agency also cautions that high unemployment, weak private demand, and a sustained decline in business fixed investment remain obstacles to full economic recovery, despite recent improvement in exports, industrial production, and company profits.

Trade Unions to Unite. On January 1, 2000, a new international organization of trade unions will be launched, incorporating 16 million members in 800 unions from 140 countries. The organization, called Union Network International (UNI), will be the world's largest grouping of individual trade unions, and will cover a range of non-manufacturing sectors, including commerce, electricity, finance, media, entertainment, postal, private health care, telecommunications, and tourism. The organization is pressing for an overhaul of the WTO and for trade agreements to incorporate international core labor standards, including the right to organize into unions. UNI intends to use the latest communications technology to build networks with affiliates and to give union members a more effective voice with governments, multinational corporations, and international institutions.

Food Gap to Increase in Low-Income Countries. For 67 low-income developing countries, the food gap—defined as the shortfall between a) domestic food production plus commercial imports and b) the level required to meet minimum nutritional requirements—is estimated to be 15 million tons in 1999, according to a new USDA report. Global food aid shipments for 1998/99 are estimated at roughly 9.5 million tons, almost two-thirds of the shortfall. However, the distribution of this aid is not necessarily based on nutritional need; for example, only 23 percent of food aid goes to Sub-Saharan Africa, covering just 20 percent of the region's food shortfall. Distribution is likely to become more important over the next decade. The food gap for the 67 countries is expected to increase 54 percent to 23 million tons, with Sub-Saharan Africa accounting for 70 percent of the gap in 2009. The total number of people whose food consumption fails to meet nutritional requirements is projected to grow 13 percent to nearly 1 billion; however, the growth in Sub-Saharan Africa will be 40 percent, so that 60 percent of the region's population will be food deficient in 2009.

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RELEASES THIS WEEK

Housing Starts

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

Housing starts decreased 2 percent in November to 1.600 million units at an annual rate.

U.S. International Trade in Goods and Services

The goods and services trade deficit rose to $25.9 billion in October from $24.2 billion in September.

Industrial Production and Capacity Utilization

The Federal Reserve's index of industrial production increased 0.3 percent in November. Capacity utilization was unchanged at 81.0 percent.

Retail Sales

Advance estimates show that retail sales rose 0.9 percent in November following an increase of 0.3 percent in October. Excluding sales in the automotive group, retail sales rose 0.4 percent following an increase of 0.8 percent.

Consumer Price Index

The consumer price index increased 0.1 percent in November. Excluding food and energy, consumer prices rose 0.2 percent.

MAJOR RELEASES NEXT WEEK

Gross Domestic Product (Wednesday)
Advance Durable Shipments and Orders (Thursday)

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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	5.5
GDP chain-type price index	5.2	1.1	2.0	1.3	1.1
Nonfarm business (NFB) sector:					
Productivity (chain-type)	1.7	3.1	2.7	0.6	4.9
Real compensation per hour:					
Using CPI	1.0	3.9	2.8	1.2	2.1
Using NFB deflator	1.5	4.7	2.9	2.9	4.4
Shares of Nominal GDP (percent)					
Business fixed investment	11.4	12.5	12.6	12.6	12.8
Residential investment	4.5	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	13.8
Personal saving	6.6	2.6	2.2	1.8	1.5
Federal surplus	-2.8	0.5	1.1	1.3	1.4

	1970-1993	1998	September 1999	October 1999	November 1999
Unemployment Rate (percent)	6.7**	4.5**	4.2	4.1	4.1
Payroll employment (thousands)					
increase per month			103	263	234
increase since Jan. 1993					20043
Inflation (percent per period)					
CPI	5.8	1.6	0.4	0.2	**0.1**
PPI-Finished goods	5.0	0.0	1.1	-0.1	0.2

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

New or revised data in **boldface**.

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FINANCIAL STATISTICS

	1997	1998	October 1999	November 1999	Dec. 16, 1999
Dow-Jones Industrial Average	7441	8626	10397	10810	11245
Interest Rates (percent per annum)					
3-month T-bill	5.06	4.78	4.86	5.07	5.23
10-year T-bond	6.35	5.26	6.11	6.03	6.31
Mortgage rate, 30-year fixed	7.60	6.94	7.85	7.74	7.86
Prime rate	8.44	8.35	8.25	8.37	8.50

INTERNATIONAL STATISTICS

Exchange Rates	**Current level December 16, 1999**	**Percent Change from Week ago**	**Percent Change from Year ago**
Euro (in U.S. dollars)	1.017	0.1	N.A.
Yen (per U.S. dollar)	103.0	0.5	-10.9
Major currencies index (Mar. 1973=100) (trade-weighted value of the U.S. $)	93.26	0.2	1.1

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	4.2 (Q3)	4.1 (Nov)	2.6 (Nov)
Canada	4.2 (Q3)	7.2 (Oct)	2.3 (Oct)
Japan	1.0 (Q3)	4.7 (Oct)	-0.7 (Oct)
France	3.0 (Q3)	11.0 (Sep)	0.8 (Oct)
Germany	1.2 (Q3)	9.0 (Oct)[2]	0.8 (Oct)
Italy	0.8 (Q2)	12.1 (Apr)	1.8 (Oct)
United Kingdom	1.8 (Q3)	5.9 (Aug)	1.2 (Oct)

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 unified Germany.

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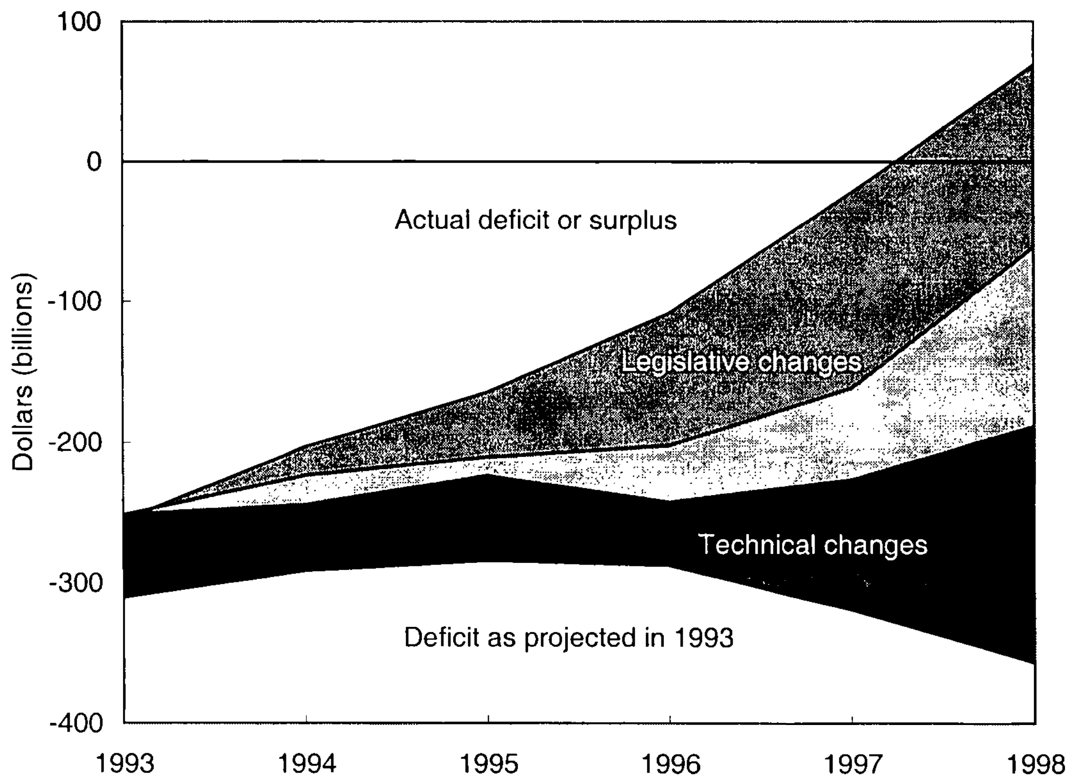
WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

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

February 4, 2000

CHART OF THE WEEK

Actual Deficits or Surpluses Compared with 1993 Projections



The Congressional Budget Office's 1993 budget projections showed the Federal budget deficit worsening to $357 billion in 1998. In fact, the budget was in surplus by $69 billion. CBO estimates that $130 billion of this swing resulted from legislative changes, $127 billion from better economic performance, and $169 billion from changes in technical factors (such as overall trends in health care costs that affect Medicare, or the weather, which affects farm programs).

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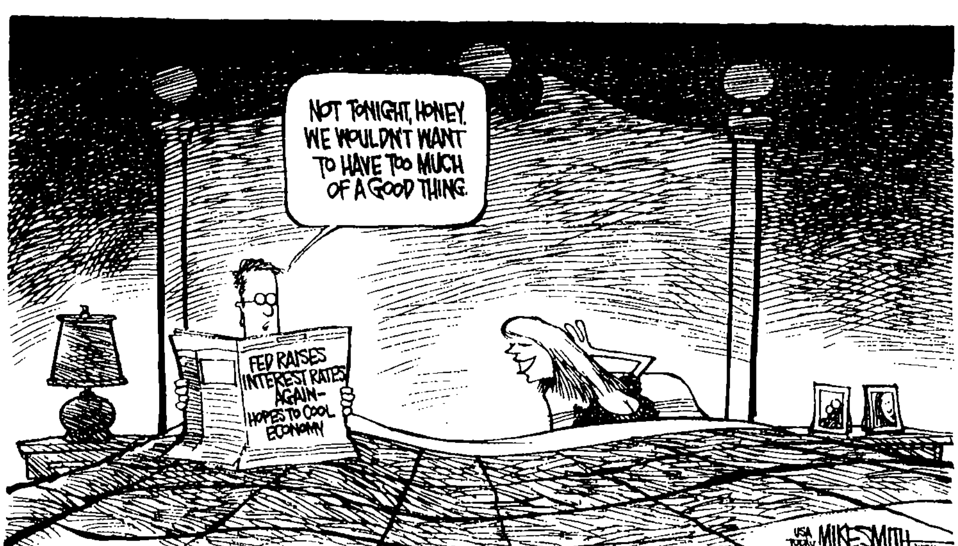
CONTENTS

CURRENT DEVELOPMENT

ARTICLE

DEPARTMENTS



POOR SUSAN, SHE MARRIED AN OFFICIAL OF THE FEDERAL RESERVE.

By Mike Smith, Las Vegas Sun, for USA TODAY

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CURRENT DEVELOPMENT

GDP Scorecard: Fourth Quarter 1999

Real GDP is estimated to have increased at a 5.8 percent annual rate in the fourth quarter of 1999 with strong growth in consumption, inventory investment, exports, and government spending. Growth over the four quarters of 1999 is estimated to have been 4.2 percent. Inflation—as measured by the price index for GDP—increased at a 2.0 percent annual rate in the fourth quarter, but only 1.6 percent over the whole year.

Component	Growth*	Comments
Total consumer expenditures	5.3%	Fourth-quarter consumption grew at the same rate as during the previous four quarters, and the saving rate fell further.
Equipment and software	4.9%	Growth was the weakest it has been in over a year. Investment in computers rose at only a 27 percent annual rate, well below the 46 percent pace over the previous 4 quarters. Motor vehicle investment fell.
Nonresidential structures	-5.3%	Spending has fallen in each of the past 4 quarters.
Residential investment	-1.2%	Housing starts peaked in the first quarter, and have come down since. Because housing starts remain high relative to what would be predicted based on demographics, this is not likely to be a growth sector.
Inventories (change, billions of 1996 dollars)	$65.4	Some of this very large inventory buildup may have been to buffer against feared Y2K disruptions. Nevertheless, final sales growth was strong enough to keep the inventory-to-sales ratio from rising.
Federal purchases	16.0%	Large gains were estimated in both defense and nondefense categories.
State & local purchases	4.4%	The fourth-quarter gain was similar to the pace over the previous four quarters. The surplus of state and local governments—about $46 billion over the most recent 4 quarters—has doubled over the past 2 years.
Exports	6.9%	Fourth-quarter growth was slightly better than the pace of the previous 4 quarters and may reflect emerging strength among our trading partners.
Imports	10.6%	About 40 percent of this large increase in imports was for capital goods. Another 30 percent of the increase was accounted for by consumer goods.

*Percent real growth in the fourth 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.

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ARTICLE

The 2000 *Economic Report of the President*

The 2000 *Economic Report of the President* will be released February 10. This article summarizes and highlights the chapters of the accompanying annual report of the Council of Economic Advisers.

Chapter 1: Sustaining a Record-Breaking Expansion.

This overview chapter describes how the Administration's policy strategy of investing in people and technology, opening international markets, and maintaining fiscal discipline has paid off in a record-breaking expansion. In addition, it contrasts this expansion with previous expansions and examines the question of whether we are in a new economy.

An expansion that is not just longer. Several features of this expansion are distinctive and heartening. First and foremost, the structural budget deficit shifted from deficit to surplus (rather than either growing or remaining large as in previous long expansions). This fiscal prudence has contributed to an investment-led expansion as relatively low real interest rates have spurred strong investment in technology and high-tech equipment. In addition, productivity growth has strengthened as the expansion has matured (typically it slows down); core inflation has declined despite falling unemployment (typically inflation rises with low unemployment); and capacity has roughly kept pace with output growth (typically capacity utilization rates increase more).

Rethinking inequality. The two-decade-long trend toward greater inequality has ended. Between 1993 and 1998, household incomes grew between 9.9 and 11.7 percent for each quintile of the income distribution. Since 1994, workers with only a high-school degree and those who have completed college have seen similar earnings growth; hourly wage growth for the lowest deciles has matched those in the top deciles. At the same time, however, the forces previously seen as causing greater inequality—technological change, the internationalization of the economy, and fiscal restraint—have never been stronger. Instead of aggravating inequality, however, rapid productivity growth and openness to trade have helped us to operate and sustain a high-employment economy, with opportunities for all. Deficit reduction has been compatible with more careful targeting of spending to increase funding for education, training and the Earned Income Tax Credit.

A New Economy? Since the previous cyclical peak in 1990, growth in GNP per capita has matched the 2.1 percent annual pace recorded for the century as a whole. Data from the past 5 years suggests, however, that we may have done better than just return to the good old days, and that the future could be even more prosperous. The challenge is to sustain this progress with the policy framework that has worked so well—maintaining fiscal discipline, investing in people and technology, and opening international markets.

Chapter 2: Macroeconomic Policy and Performance

This chapter provides a review of macroeconomic developments in the past year as well as the Administration's economic forecast and the near-term outlook for the economy. It also examines in detail the stock market boom, the changing nature of the business cycle, and the high investment economy.

A record-breaking year. A number of measures besides growth, unemployment and inflation show how strongly the economy performed in 1999. For example, the employment-to-population ratio of 64.3 percent topped last year's record. The proportion of American households owning their own homes climbed to a new high of 66.8 percent in 1999. Sales of new and existing homes also broke new ground last year and 16.8 million cars and light trucks were sold, the most ever.

The stock market boom. The bull market that began in 1995 is already the strongest since the 1930s and the sixth strongest in the last 200 years. The real return to stocks has averaged nearly 24 percent per year during the last 5 years, with technology stocks performing especially well in the past 2 years. No one has a definitive explanation for this run-up in stock prices, but the chapter analyzes two possibilities: a reduction in the equity premium owing to reduced costs of diversification and greater tolerance toward stock market risk; and improved prospects for future productivity growth related to investments in intangible capital and new technologies.

The end of the business cycle? Business cycles moderated in the second half of the 20th century, owing in part to fundamental changes in the economy, as well as changes in monetary and fiscal policy. For example, more cyclically sensitive sectors like manufacturing now account for a smaller share of employment and output than earlier this century, and volatile inventory stocks are less important.

The high-investment economy and productivity. The acceleration in productivity growth, from 1.4 percent per year between 1973 and 1995 to 2.9 percent per year since 1995, has been fueled by increases in real business investment—especially computers—along with increased productivity in the computer-producing sector. This pickup in productivity growth has supported real wage gains and temporarily lowered the unemployment rate consistent with stable inflation (the NAIRU), helping keep inflation in check.

The Administration forecast. Growth in real GDP is projected to moderate to 2.9 percent and 2.6 percent in 2000 and 2001, respectively. Although the 2000 figure was slightly above the consensus of professional forecasters when the GDP projection was finalized in November, it is now slightly below. Productivity is projected to grow an average of 2.1 percent per year over the next 4 years, similar to the average rate of growth since the last business-cycle peak. The unemployment rate is expected to remain at 4.2 percent for 2000, and then to edge upward slowly, reaching 5.2 percent in 2003—the middle of the range consistent with stable inflation in the long run. Inflation—as measured by the CPI—is projected to remain roughly stable over the 11-year projection horizon.

Chapter 3: Technology and the American Economy

This chapter examines the technological change that has driven growth in this expansion and in this century at the industry level. Technological change has created new industries and altered the competitive landscape of the American economy. Just as Ford changed manufacturing earlier in the century with his invention of the assembly line, today computers and information technology are changing how firms operate in our economy.

Growth in telecommunications and information technology. Two examples of these trends are evident in the telecommunications and information technology industries. The computer and telecommunications industries contributed between 21 and 31 percent of GDP growth in each of the years from 1995 to 1998. Investment in communications equipment grew by 13 percent annually from 1993 to 1998, spurred on in part by new investments by wireless phone companies that now serve more than 69 million subscribers. Computer usage in the home has also been rising, as has usage of the Internet. A recent survey found that more than 118 million Americans had access to the Internet, and more than 74 million were actively using this new communications medium.

The effect of information technology on the firm. Information technology has vast potential to enhance the economy's productivity and make firms more efficient. For example, one company found that by moving marketing and support functions online, it saved more than $300 million per year in operating costs. Use of information technology to support business-to-business e-commerce is also becoming increasingly important, as firms are finding new ways to use information technology to organize markets for selling industrial products like steel or conducting auctions among potential suppliers of customized parts. By one estimate, business-to-business e-commerce is expected to grow from $43 billion in 1998 to over $1.3 trillion by 2003.

Supporting new innovations. As technology becomes increasingly vital to our knowledge-based economy, a crucial task of government is to provide appropriate support for research and development. New technologies can create benefits with large spillovers to society, but firms may underinvest in R&D because they cannot appropriate the full benefits of that investment. By supporting research in a broad and balanced national R&D portfolio, the $43 billion investment in the 21st Century Research Fund proposed for fiscal 2001 has the potential to yield significant benefits in years to come.

Enhancing competition. Government can promote competition by changing the regulatory framework within which industries operate, as it did with the Telecommunications Act of 1996, which reduced barriers to entry in local telephone markets. Local competition is growing rapidly, and new entrants now account for 6 percent of revenues in these markets.

Chapter 4: Work and Learning in the 21st Century

This chapter analyzes how the nature of work has changed dramatically over the past 100 years and the challenges these changes pose for current policy. In 1900 over 40 percent of the work force was in agriculture, and another 28 percent was in manufacturing. Services, broadly defined, accounted for the remaining 31 percent. Today, agriculture accounts for less than 3 percent of employment, while the service-producing sector dominates with over 75 percent. The change in the industrial mix has been associated with a technological revolution—one that has touched the majority of jobs and put a premium on a new set of skills, including those related to the new information technologies.

The rising importance of skills and education. In 1940, 41 percent of whites and 12 percent of African Americans had completed high school. By 1998 both groups enjoyed about an 88 percent completion rate. Despite these impressive gains, it appears that in recent decades the demand for skilled workers outpaced the supply. The rise in the demand for basic computer skills illustrates this change. In 1984 about a quarter of all workers were using a computer at work, by 1997 that proportion had risen to virtually half. In fact, most jobs in today's labor market that are available to workers without a college degree require the ability to perform basic tasks involving reading, writing, or arithmetic, the use of computers, and the interpersonal skills to serve customers effectively. Only 8 percent of the jobs available to non-college graduates require none of these skills. Further, a sharp increase in the wages of college graduates relative to those without a college degree provides indirect but striking evidence of rising demand for workers with higher level skills. In 1999 male college graduates working full time were earning 68 percent more per week than comparable male high school graduates, and 147 percent more than those who had not completed high school. These figures are up from 29 and 57 percent, respectively, in 1979.

Growth in opportunities. This chapter also analyzes the increasing opportunities for women, minorities, and persons with disabilities. For example, through most of the 1960s and 1970s, the median full-time, full-year woman worker earned about 60 cents for every dollar earned by her male counterpart. More recently, this figure has been about 75 cents on the dollar (73 cents in 1998 in the series cited in the report). Women's earnings are even closer to men's when factors such as education and experience are held constant, but evidence of discrimination still exists.

Policy challenges. The challenge for public policy in the 21st century will be to develop an appropriate set of education and training policies: one that creates a framework of lifetime learning within which workers can acquire and maintain both the basic skills and the more technical skills they need in the new labor market. The last part of the chapter discusses the appropriate role of government in fostering this objective and Administration initiatives such as Head Start, the Technology Literacy Challenge, and the Workforce Investment Act.

Chapter 5: The Changing American Family

This chapter discusses how the opportunities and challenges facing American families have changed over the last hundred years as the increase in the number of dual-earner and single-parent families has eclipsed the traditional one-breadwinner, one-homemaker family. In particular, the chapter looks at the balance between the rewards of work and the needs and rewards of family time.

Key trends. The chapter identifies three important trends that have shaped the American family over the past century. First, 60 percent of females are now in the labor force, up from 20 percent in 1900. Second, increases in divorce and out-of-wedlock births mean that 28 percent of children now live in one-parent families, up from less than 10 percent in 1900. Finally, life expectancy has increased from less than 50 to well over 70 years, so that concern for their own retirement and care of elderly relatives are increasingly concerns of families today.

Increasing diversity across families. Traditional one-breadwinner, one-homemaker married couples have been declining as a share of all families (from 67 percent in 1952 to 27 percent in 1999). Dual-earner married couples, by contrast, now account for roughly half of all families, up from a fifth at mid-century. The share of families headed by a single householder is now 23 percent, up from 13 percent 50 years ago. Among these family types, the median income of dual-earner couples has always been higher than that of the others, and the gap has widened over the past half-century. The median income of married couples in which the wife has no earnings is less than three-fifths that of dual-earner married couples; the median income of families headed by single females is a little more than a third that of dual-earner married couples.

Increased educational attainment and greater labor force participation of wives have been particularly important in raising the incomes of dual-earner couples. Three-fifths of married mothers with earnings have at least some college (up from 22 percent in 1969). And 79 percent of married mothers with at least some college worked (up from 53 percent in 1969). Single mothers are also working more, but with lower average educational attainment, their earnings are lower.

Challenges: The "money crunch" and the "time crunch." Despite favorable income gains in the current expansion, many families experience a "money crunch" that makes it difficult to meet basic family needs. The money crunch affects poor and possibly also non-poor families, now that a car, a telephone, and perhaps even a computer are near-necessities and families have to set aside funds to educate their children and, increasingly, to take care of their aging parents. A second challenge families face is the "time crunch": a shortage of time to devote to family needs, because the increased participation of parents, especially mothers, in the labor force reduces time at home. The chapter's discussion of the money and time crunches includes a discussion of Administration policies to address them—including the Family and Medical Leave Act, expansions of the EITC, and the child care and long-term care initiatives.

Chapter 6: Opportunity and Challenge in the Global Economy

This chapter describes the importance of global economic integration in producing unprecedented prosperity in the United States and much of the rest of the world. It focuses on the role of technology and policy in driving integration, as well as the benefits and challenges globalization brings.

The fall and rise of the global economy. Trade and, to a much lesser extent, investment links were well established a century ago, but both deteriorated during the interwar period. Over the past 50 years, however, international trade and investment have risen sharply. Economic globalization—the worldwide integration of national economies through trade, capital flows, and shared production arrangements—has never before been as broad or as deep as today. U.S. trade (exports plus imports) has amounted to nearly 25 percent of GNP in recent years, its highest point in at least a century. Global capital flows have soared even more dramatically. Cross-border transactions in bonds and equities have exploded, amounting to about 223 percent of GNP in the United States in 1998, compared with only 9 percent of GNP in 1980.

The forces behind globalization. Technological improvements—in transportation, communications, information technology, and other areas—have reduced the costs of doing business internationally. In 1930, for example, a 3-minute phone call from New York to London cost $293 in 1998 dollars. By 1998, one widely subscribed discount plan charged only 36 cents for a clearer, more reliable 3-minute call. Such improvements have also increased the range of possible commercial transactions, particularly in financial markets. Policy has also played an active role in reducing barriers to trade and investment. Since the creation of the GATT in 1948, import tariffs on industrial products in industrial countries have dropped by about 90 percent. Especially since the 1970s, many countries have decided to remove restrictions on capital flows.

The benefits of a global economy. Globalization raises living standards. It improves efficiency, promotes innovation, encourages technology transfer, and otherwise enhances productivity growth. Through trade, countries can shift resources into their most internationally competitive sectors. Recent studies show substantial wage premiums in U.S. jobs supported by goods exports—on the order of 15 percent. Consumers also enjoy less expensive and more varied products. Global capital flows can help countries invest more effectively. Foreign direct investment, as well as trade, can help spread international best practices.

The challenges of globalization. International economic integration, like other sources of growth, involves tradeoffs. Even as the nation benefits overall, some industries and their workers may find themselves facing sharp international competition. Moreover, global capital flows help promote growth, but can disrupt economies when they reverse course. Sound policy can help ensure that the benefits of economic integration are shared as widely as possible.

Chapter 7: Making Markets Work for the Environment

Economic growth brings abundant benefits but it can also unleash a wide array of environmental problems. Fortunately the same economic dynamism that gives rise to these problems also provides the income and the know-how needed to address them. The challenge in addressing environmental problems lies in harnessing the power of markets to deliver continued economic growth and foster sound environmental practices.

Environmental problems through the 20th century. In 1900, one of the most common environmental problems was the accumulation of horse manure on city streets, which posed public health problems. While the automobile eventually solved this problem, it brought others in its wake. Over time, other environmental problems became apparent, often reflecting a growing and changing economy. Concerns about pesticide use, burning rivers, and smog-filled skies brought more attention to environmental problems culminating in the 1970 Earth Day, which spurred new legislation. While these laws' traditional, usually inflexible, regulatory approaches improved environmental quality since 1970, they also carried significant costs. By 1990, the costs of environmental pollution control had reached $125 billion annually.

The U.S. experience with market-based approaches. In light of the higher costs of traditional regulations, innovative efforts to address environmental problems through market-based incentives—such as emissions permit trading and emissions charges—have been pursued to achieve environmental goals at lower cost than traditional approaches. The experiences with tradable permit programs, including efforts to reduce local air pollutants, the lead content of gasoline, and acid rain-causing sulfur dioxide, illustrate the substantial cost-savings from market-based approaches. Compared with a traditional regulatory approach, the sulfur dioxide trading program has achieved annual cost-savings of up to $1 billion. Phasing down lead in gasoline resulted in an extraordinary reduction in lead emissions: 1997 lead emissions were 50 times lower than 1970 emissions. Charging households for each unit of solid waste set out for collection reduces waste sent to landfills. None of the market-oriented approaches undermined the achievement of environmental goals. More cost-effective attainment of environmental goals depends in large part on the design of markets tailored to the specific characteristics of an environmental problem.

Applying these lessons to climate change. Perhaps the leading environmental challenge of the 21st century will be to address the risks associated with global climate change. The characteristics of the climate change challenge create great potential for emissions trading and similar flexibility mechanisms to reduce greenhouse gas emissions. Lessons drawn from our domestic experience support the Administration's advocacy of rules that would promote an efficient international trading system. Expanding the number of countries participating in trading would both reduce the costs of U.S. compliance with its Kyoto target and promote technology transfer to and investment in developing countries.

Conclusion: A Century of Change: New Opportunities For The Future

The conclusion draws together the report's findings on how the 20th century was one of dramatic growth, change, and new opportunity. Technological innovation, globalization, and demographic shifts were key drivers of those changes, creating new industries, altering the nature of work, and reshaping the typical family.

A look back. At the turn of the century, fewer than 10 percent of homes had electricity. Fewer than 2 percent of people had telephones. A car was a luxury for only the wealthy. Health and sanitation problems, such as typhoid fever spread by contaminated water, were common. One in 10 children died in infancy. Average life expectancy was just 47 years. 80 percent of children lived in a family with a breadwinner-father and homemaker-mother. Fewer than 10 percent lived in single-parent homes. Widowhood was far more common than divorce. Fewer than 14 percent of Americans graduated high school.

More than 40 percent of the work force worked on farms. Average income per capita, in 1999 dollars, was about $4,200. About 80 percent of women worked at home or on the farm. Only about 30 percent of workers were employed in services, which made up just 2 percent of U.S. exports. International trade equaled about 15 percent of GNP, but there was relatively little integration of national economies through investment and production arrangements.

The American economy today. Infant mortality has dropped by more than 90 percent over the course of the century. Life expectancy has increased by about 30 years. Typhoid, cholera, smallpox, and polio have been dramatically reduced or even eliminated through improved sanitation and the widespread use of vaccines. Average income per capita is now $33,740, more than eight times what it was in 1900. Just 3 percent of the labor force now work on farms. More than 40 percent of employment is in industries that use information technology intensively. Services account for half of the 20 million new jobs created over the last 7 years and about 29 percent of exports. More than 80 percent of Americans over 25 have finished high school, and almost a quarter have graduated college.

Women now graduate high school and college at slightly higher rates than men. Over 75 percent of women aged 25-44 are in the work force. Women and minorities work in a broad range of industries that previously were closed to them. The "typical" family has been redefined. Some 28 percent of children now live in single-parent families; another 44 percent live in families where both parents work for pay. Only 24 percent of children live in what used to be the typical model of a breadwinner-father and homemaker-mother.

Looking ahead. Americans today are more prosperous and have more choices than ever before. But these new opportunities have also brought new challenges for policymakers—such as helping prepare workers for the increasingly global, competitive, technology-driven economy; and helping families cope with the competing demands of work and family.

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

Inventory Management Helps Make Economy More Stable. Since 1984 the variability of quarterly real GDP growth has been only half that of the preceding 25 years. Changes in all major components of GDP have contributed to the increase in stability, with inventory investment and consumer spending contributing the most, according to a New York Federal Reserve Bank study. Increased stability in inventory investment has been the most important contributor, possibly due to structural changes in inventory management. For example, just-in-time ordering methods enable firms to decrease the lead time in which they must purchase materials, thereby allowing them to react more quickly to unexpected shifts in demand and avoid extreme fluctuations in inventories. Increased stability in residential investment over these two periods was also found to have had a stabilizing effect. Regulatory and structural changes in the 1980s (such as the elimination of interest rate ceilings on deposits) very likely contributed to the sector's stability, largely by enabling banks and other financial institutions to stabilize the supply of funds for housing investment.

Study Examines Impact of Taking Leave. While the Family and Medical Leave Act legally guarantees 92 million workers the right to spend needed time with family members, it cannot guarantee how leave-takers are treated upon their return to the workplace. A recent study found managers who had taken leaves of absences in the early 1990s received significantly fewer promotions and smaller salary increases than managers who had not done so, even after controlling for performance ratings. The study found that there was no greater penalty attached to a family leave (which might be viewed as voluntary) than to sick leave. Also, women managers who took leaves of absence were not punished more severely than their male counterparts. (However, 89 percent of the leave-takers were women, indicating penalties did apply primarily to them.) The study notes that wage penalties incurred by women taking job-protected family leave were relatively small, particularly in comparison with the wage penalties associated with career interruptions—though the two are not strictly comparable.

Congregations Provide Social Services. Over one-third of religious congregations indicated in a recent survey that they might apply for government money to support human services programs, such as grants and contracts provided by government agencies implementing "charitable choice" provisions. Currently, 57 percent of congregations surveyed participate in social service projects. However, only a small minority administer their own programs. The majority either support projects run by other organizations or work in collaboration with other organizations. Congregations are more likely to engage in activities that address the immediate needs of individuals for food, clothing, and shelter than in projects or programs that require sustained involvement to meet long-term goals. The study also found that very large congregations, predominantly African American congregations, Catholic congregations, and theologically liberal or moderate Protestant congregations expressed the greatest interest in the proposed charitable choice provisions.

INTERNATIONAL ROUNDUP

World Bank Launches Global Emissions Trading Prototype. The World Bank recently launched a $150 million Prototype Carbon Fund ("PCF")—the world's first global emissions trading fund intended to address climate change. Using contributions from four European governments and nine primarily Japanese companies, the PCF will fund cleaner technologies in developing and transitional economies to reduce greenhouse gas emissions. After verification by an independent party, these reductions will be transferred to the Fund's contributors in the form of emissions reduction certificates. Depending on the rules developed at the next climate change negotiations at The Hague in November 2000, these certificates may eventually be used to satisfy future greenhouse gas emissions limits. The World Bank, which will aid in negotiating a price for the emissions reductions, hopes to establish prices of roughly $20 per ton of carbon reduced. This price, which is consistent with a range of abatement cost estimates made by the Administration, would allow industrialized countries to comply with their emissions limits at a reduced cost while simultaneously offering developing and transitional countries an opportunity to gain advanced technology and a new source of revenue. The PCF has already identified several potential projects and plans to begin operations in April 2000.

New Rice May Save Millions of Lives. Scientists at the Swiss Federal Institute of Technology's Institute for Plant Sciences have developed a new rice strain that could save millions of lives and improve maternal and child health in developing countries by increasing the iron and Vitamin A content of the rice grain. This development, which results from genetically modifying rice grains, should help alleviate Vitamin A deficiency, which afflicts 124 million children worldwide, causes over 1 million childhood deaths each year, and is the single most important cause of blindness among children in developing countries. In related research, the International Rice Research Institute, using traditional plant breeding techniques, has developed a rice high in iron and zinc. According to the World Bank, between 40 and 50 percent of children under age 5 in developing countries are iron deficient.

EYES ONLY

RELEASES THIS WEEK

Employment and Unemployment
****Embargoed until 8:30 a.m., Friday, February 4, 2000****

In January, the unemployment rate was 4.0 percent; it was 4.1 percent in December. Nonfarm payroll employment rose by 387,000.

Leading Indicators

The composite index of leading economic indicators increased 0.4 percent in December following an increase of 0.3 percent in November.

NAPM Report on Business

The Purchasing Managers' Index declined 0.5 percentage point to 56.3 percent in January. (A reading above 50 percent indicates that the manufacturing economy is generally expanding.)

MAJOR RELEASES NEXT WEEK

Productivity (Tuesday)
Retail Sales (Friday)

EYES ONLY

U.S. ECONOMIC STATISTICS

	1970-1993	**1999**	**1999:2**	**1999:3**	**1999:4**
Percent growth (annual rate)					
Real GDP (chain-type)	3.0	4.2	1.9	5.7	5.8
GDP chain-type price index	5.2	1.6	1.3	1.1	2.0
Nonfarm business (NFB) sector:					
Productivity (chain-type)	1.7	N.A.	0.6	4.9	N.A.
Real compensation per hour:					
Using CPI	1.0	N.A.	1.2	2.1	N.A.
Using NFB deflator	1.5	N.A.	2.9	4.4	N.A.
Shares of Nominal GDP (percent)					
Business fixed investment	11.4	12.6	12.6	12.7	12.5
Residential investment	4.5	4.4	4.5	4.4	4.4
Exports	8.2	10.8	10.7	10.8	10.9
Imports	9.2	13.5	13.4	13.8	14.1
Personal saving	6.6	1.7	1.8	1.5	1.4
Federal surplus	-2.8	N.A.	1.3	1.4	N.A.

	1970-1993	**1999**	**November 1999**	**December 1999**	**January 2000**
Unemployment Rate (percent)	6.7**	4.2**	4.1	4.1	**4.0**
Payroll employment (thousands)					
increase per month			**257**	**316**	**387**
increase since Jan. 1993					**20790**
Inflation (percent per period)					
CPI	5.8	2.7	0.1	0.2	N.A.
PPI-Finished goods	5.0	3.0	0.2	0.3	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, February 4, 2000**.

EYES ONLY

FINANCIAL STATISTICS

	1998	1999	December 1999	January 2000	Feb. 3, 2000
Dow-Jones Industrial Average	8626	10465	11246	11281	11013
Interest Rates (percent per annum)					
3-month T-bill	4.78	4.64	5.20	5.32	5.46
10-year T-bond	5.26	5.65	6.28	6.66	6.49
Mortgage rate, 30-year fixed	6.94	7.43	7.91	8.21	8.25
Prime rate	8.35	8.00	8.50	8.50	8.50 [p]

[p] As of February 3, 2000, the prime rate at a number of banks has moved to 8.75 percent.

INTERNATIONAL STATISTICS

Exchange Rates	Current level February 3, 2000	Percent Change from Week ago	Percent Change from Year ago
Euro (in U.S. dollars)	0.989	-0.0	-12.8
Yen (per U.S. dollar)	107.9	2.9	-4.0
Major currencies index (Mar. 1973=100) (trade-weighted value of the U.S. $)	94.58	1.0	2.6

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	4.2 (Q4)	**4.0** (Jan)	2.7 (Dec)
Canada	4.2 (Q3)	6.9 (Nov)	2.6 (Dec)
Japan	1.0 (Q3)	4.6 (Nov)	-1.1 (Dec)
France	2.9 (Q3)	10.7 (Nov)	1.3 (Dec)
Germany	1.3 (Q3)	9.0 (Nov)[2/]	1.2 (Dec)
Italy	1.2 (Q3)	12.1 (Apr)	2.1 (Dec)
United Kingdom	1.8 (Q3)	5.9 (Sep)	1.8 (Dec)

U.S. unemployment data **embargoed until 8:30 a.m., Friday, February 4, 2000**.
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 unified Germany.

EYES ONLY

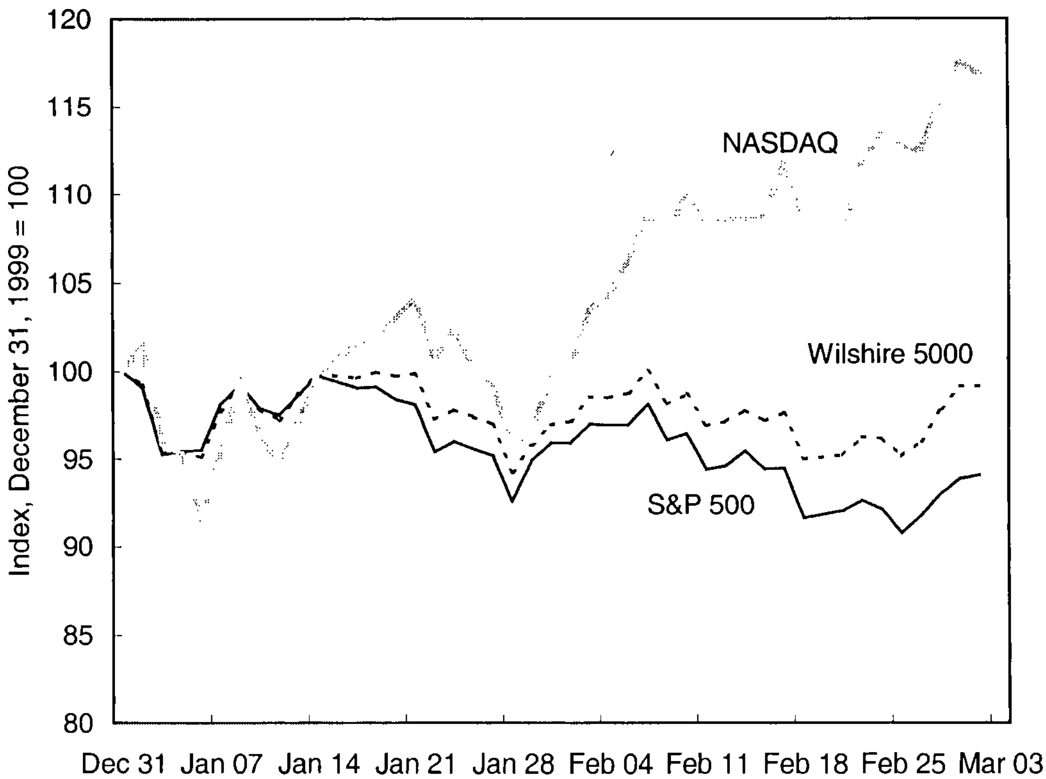
WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

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

March 3, 2000

CHART OF THE WEEK

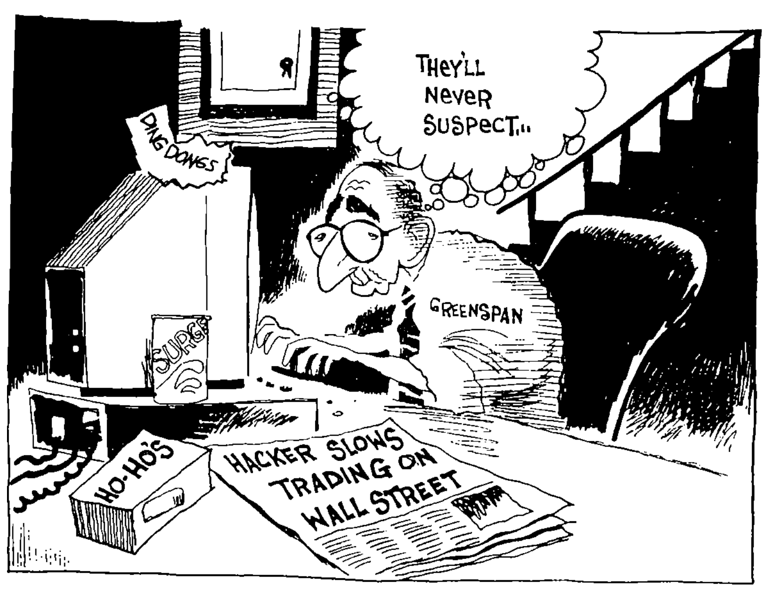
A Tale of Two Stock Markets



Thus far in 2000, the technology-heavy NASDAQ stock market index has risen another 17 percent (after an increase of 86 percent in 1999). The Standard and Poor's 500 index (as well as the Dow Jones Industrial Index), by contrast, has fallen in value. Reflecting these divergent trends, the broadly based Wilshire 5000 index has been essentially flat.

EYES ONLY

CONTENTS



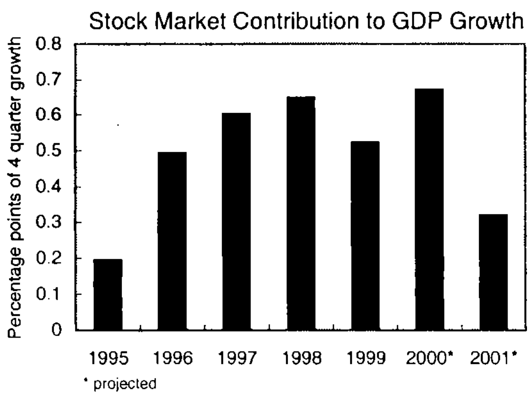
EYES ONLY

CURRENT DEVELOPMENT

The Wealth Effect: Past, Present, and Future

Despite the tepid performance of the stock market so far this year, last year's $3 trillion increase in stock market wealth will continue to affect household spending this year and into the future. In recent testimony, Federal Reserve Chairman Alan Greenspan emphasized the role of the "wealth effect" in spurring high spending growth, which he cited as contributing to the widening current account deficit, increasingly tight labor markets, and potential inflationary pressures.

Only 3½ cents on the dollar (but there are a lot of dollars). According to the standard "life-cycle" model of consumer behavior, an increase in wealth is not spent all at once; instead, people generally aim to raise their living standards over the remainder of their lives by spending only a portion each year. The evidence suggests that each dollar change in stock market wealth leads to a permanent change in the level of consumer spending in the future of about 3½ cents per year, with the full response kicking in after several years. Although the wealth effect is thought to be permanent, only *changes* in wealth affect the growth rate. The contribution of household spending to GDP growth from the rise in stock market wealth relative to overall income over the past 5 years has averaged about one-half percentage point (see chart, which assumes that the stock market grows in line with income during 2000 and 2001). Some of the increase in spending owing to the wealth effect goes to imported goods, however, which offsets a portion of the contribution to GDP growth.



The legacy of past stock market gains. Because the effects of last year's booming stock market have yet to be realized fully, the wealth effect will continue to contribute strongly to spending growth this year and, to a lesser extent, next year. An open question—discussed by Chairman Greenspan in his testimony and one we will examine in a later *Weekly Economic Briefing*—is the extent to which the stock market boom and other developments in aggregate supply and demand are related to the apparent acceleration in productivity growth.

EYES ONLY

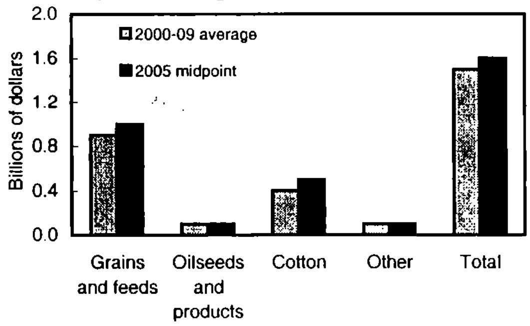
SPECIAL ANALYSIS

China, the WTO, and U.S. Agriculture

U.S. agricultural exports and farm income are projected to rise with China's entry into the World Trade Organization, according to a recent analysis by the USDA's Economic Research Service (ERS). Increased demand for agricultural products and higher farm prices would also raise consumer prices slightly.

More U.S. exports. The ERS estimates that with China's WTO accession, U.S. global exports of major field crops over the 2000-09 period would rise above baseline levels by an average of $1.5 billion per year, based on China's market opening commitments in our bilateral agreement. By 2005, the increase would be about $1.6 billion. Much of the increase in field crop exports would come from direct U.S. sales to China arising from significantly greater access to that large market. The largest absolute gains would be in grains and feeds, followed by cotton (see chart). Exports of oilseeds and products are expected to rise overall, with a shift from soybeans to processed soybean products. Other commodities not explicitly treated in the analysis (such as fruit and vegetables, animal products, and tree nuts) would also enjoy increased access once reductions in Chinese duties are implemented.

Potential Gains in U.S. Exports of Major Field Crops Resulting from China's WTO Entry



Higher farm income. ERS estimates that net farm income would rise above baseline levels by an average of $1.1 billion annually in the 2000-09 period, after accounting for changes in Federal government payments.

- Higher cash receipts. Stronger crop demand, resulting in higher prices, would raise annual cash receipts from crops by $1.5 billion per year. An additional $1.2 billion per year would come from sales of livestock products. However, this latter increase is driven by higher production expenses, which lead to lower output and higher prices for livestock products. In fact, ERS projects that overall farm production expenses would rise by roughly the same amount as livestock product sales, primarily as a result of higher feed costs. (Some additional net farm income might come from reduced tariffs for poultry, pork, or beef, which would boost U.S. exports of these products.)

- Lower government payments. Higher farm prices are projected to reduce Federal spending on loan deficiency payments by about $300 million per year.

A slight rise in consumer prices. ERS estimates that with higher prices for agricultural products, especially livestock products, under the WTO accession scenario, the consumer price index for all food would be about 0.2 percent higher, on average, over the 2000-09 period than under the baseline scenario. This translates into increased average annual food expenditures of about $1.2 billion (roughly 0.1 percent higher than in the baseline scenario).

Conclusion. USDA's analysis, which focuses on major field crops, suggests that China's WTO accession would result in additional U.S. exports, higher farm incomes for some producers, and lower government payments. The increase in demand for agricultural products would also result in a modest increase in retail food prices. On balance, the gains to U.S. producers, combined with the reduction in Federal spending, would outweigh the impact on U.S. consumers by an average of about $200 million annually.

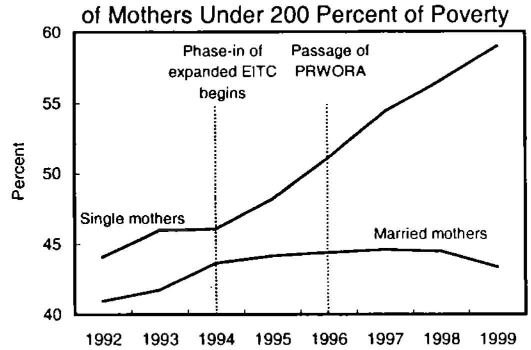
ARTICLE

Recent Growth in the Employment of Single Mothers

The strong labor market has surely been one reason for the rapid growth in employment among single mothers in recent years. But a forthcoming review of the research literature by the CEA and the Treasury presents persuasive evidence that policies such as the EITC expansions and welfare reform have played an important role as well.

Employment of low-income mothers. A comparison of employment growth among low-income single and married mothers (see chart) illustrates the nature of this evidence. In March of 1992 the employment/population ratio was only 3 percentage points higher for the single mothers than for the married mothers, but by 1999 this gap had increased to 16 percentage points. This comparison is instructive because reforms to welfare policy substantially affect the first group but not the second. And the EITC unambiguously encourages labor supply by single parents, while having ambiguous effects on work incentives for second earners in married households. (The EITC can reduce incentives to work for second earners in some households because the additional income would cause the couple to lose some or all of their EITC credits.)

Employment/Population Ratios
of Mothers Under 200 Percent of Poverty



The EITC. By raising the after-tax return to employment, the EITC is a powerful incentive to work for single parents. Single mothers receive more than two-thirds of EITC dollars. (The bulk of the remainder boost incomes of married taxpayers.) As a result of the expansions in the program enacted in 1993, the maximum EITC credit increased dramatically in 1994, 1995, and 1996. Over these same years, the employment/population ratio of single mothers increased relative to that of similar married mothers, and also relative to those of two other groups less affected by changes in the EITC, African American men and single women without children. A detailed statistical analysis concludes that the EITC accounted for about 36 percent of the increase in employment of single mothers between 1992 and 1996.

Welfare reform. The 1996 Personal Responsibility and Work Opportunity Reconciliation Act (PRWORA), and the Federal waivers that preceded the Act, transformed welfare by allowing states to establish work requirements, time-limit assistance, and improved child support. In addition to lowering caseloads dramatically, these policy changes have also affected employment, as many individuals previously on welfare get jobs. An aggregation of recent state reports indicates that more than 1.3 million welfare recipients nationwide went to work in just the 1-year period between October 1997 and September 1998. Further evidence comes from an analysis of Current Population Survey data. For the years 1988 to 1992 there was a 20 to 21 percent employment rate (in March of the year) for individuals on welfare the previous year. This rate increased steadily starting in 1993, rising to more than 36 percent by March 1999. Statistical analysis indicates that over the span 1992 to 1996, about 33 percent of the increase in employment of single mothers was due to the state-level changes in welfare policy that preceded PRWORA.

Other policies. There is some evidence to suggest that other policy changes, notably expanded funding for child care and the provision of training to welfare recipients, have effectively provided additional work incentives for low-income women. Among the proposals in the 2001 budget that can be expected to encourage additional labor supply are policies that reduce the "marriage penalty" for low- and middle-income families, proposals involving child care expenses, and further expansion of the EITC.

EYES ONLY

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

Census Provides First Official E-Commerce Estimate. Retail E-commerce sales were $5.3 billion in the fourth quarter of 1999, according to the first official estimate of such sales, released this week by the Census Bureau. Such sales, defined as sales of goods and services over the Internet and other online systems, were 0.64 percent of total retail sales of $821.2 billion in the quarter. Available evidence suggests that about 15 percent of retail firms are involved in E-commerce sales.

Boskin Commission Members See Smaller CPI Bias. Members of the Boskin Commission believe that methodological changes implemented by the Bureau of Labor Statistics have reduced the bias in the CPI from the 1.1 percentage point level reported by the Commission in 1996. Responding to a survey by the General Accounting Office, the individual members put the remaining bias at between 0.73 and 0.9 percentage point annually, and they attribute the remaining bias to what the Commission referred to as "new products/quality change bias."

Expanded Insurance Can Mean Fewer Avoidable Hospitalizations. By increasing access to hospital care, expansion of public health insurance should lead to more hospitalizations. At the same time, however, it might reduce avoidable hospitalizations—defined as those that might not have occurred had patients received effective, timely, and continuous outpatient medical care for certain chronic disease conditions. In the case of children, a recent study found that expansions in Medicaid eligibility between 1983 and 1996 led to a net increase of 10 percent in overall pediatric hospitalizations but a decline of 22 percent in avoidable ones. The study notes that because an average inpatient hospital visit is roughly 40 times more expensive than an average outpatient visit, this reduction in avoidable hospitalizations makes medical care more efficient. The eligibility expansions also appear to have been associated with a significant shift in the types of hospitals where children are treated, from public hospitals to for-profit facilities.

Homelessness Persists but Services Improve. Between 2.3 and 3.5 million people, nearly 40 percent of them children, are estimated to experience homelessness at least once during a year, according to a recent Urban Institute study based on 1996 data. People living at or below the poverty line are the most vulnerable to experiencing a homeless episode; between 6.3 and 9.6 percent of those in poverty are likely to be homeless at some point during the year. At the same time, the network of homeless services is larger and more diverse than it was in the late 1980s. The nation's shelter and housing capacity grew by 220 percent between 1988 and 1996. Soup kitchen and meal distribution services in central cities nearly quadrupled between 1987 and 1996, from 97,000 to 382,100 meals on an average day in February. Much of the new growth, according to the study, is due to new funding and to priorities placed on developing transitional and permanent housing.

INTERNATIONAL ROUNDUP

ECB Holds the Line on Rates. This week the European Central Bank decided to leave interest rates unchanged, keeping the main refinancing rate at 3.25 percent. A pickup in inflation, plus the recent decline of the euro, have provoked speculation that the ECB may raise rates in the near future.

African Skills Flight Hurting Development. According to United Nations data, an average of 20,000 African professionals (including doctors, university lecturers, and engineers) have emigrated from the continent annually since 1990, up from about 12,000 per year in the 1985-90 period. This human capital flight, or "brain drain," reduces the availability of skilled human resources that African countries badly need for self-reliant and sustainable development. The flight of doctors is most striking. For instance, 60 percent of all Ghanaian doctors trained locally in the 1980s left the country, and Nigeria suffers from an acute shortage of health personnel even as 21,000 Nigerian doctors practice in the United States. In part because of the brain drain, the entire continent has only 20,000 scientists, or 3.6 percent of the world total. Poor economic conditions, political violence, repression of human rights, and a lack of an open political atmosphere have contributed to the brain drain. Another contributing factor may be scholarship programs for study abroad coupled with a lack of training institutes in Africa.

India PM Vajpayee's First Budget. Amidst concern about growing fiscal deficits and sluggish progress in reducing poverty, India's Ministry of Finance released its budget for fiscal 2000/01 this week. The budget proposes to cut the central government's deficit from an estimated 5.6 percent of GDP to 5.1 percent, and to "abolish" poverty by boosting annual growth to 7 to 8 percent from the current rate of around 6 percent. In addition to loosening foreign investment rules and reducing state controls on banks, the budget continues to channel substantial resources into energy, transport, and communications. The budget disappointed some, however, because it fails to take tougher measures to reduce the fiscal deficit and makes little progress in eliminating subsidies to the power and irrigation sectors. The new budget proposes to increase defense expenditures by 28 percent, the largest-ever rise for the world's fourth-biggest military.

British Woman Files Patent Application on Herself. According to Reuters News, a British woman has become the first person to attempt to patent herself. The UK national patent office confirmed on Tuesday that it has received an application with the title "myself" from a poet and casino waitress who was angered at the patenting of gene sequences by businesses. "It has taken 30 years of hard labor for me to discover and invent myself, and now I wish to protect my invention from unauthorized exploitation, genetic or otherwise," the woman said. The patent office, however, said, "It is not really worth patenting something unless you make a lot of money from it."

EYES ONLY

RELEASES THIS WEEK

Employment and Unemployment

****Embargoed until 8:30 a.m., Friday, March 3, 2000****

In February, the unemployment rate was 4.1 percent; it was 4.0 percent in January. Nonfarm payroll employment increased by 43,000.

Leading Indicators

The composite index of leading indicators increased 0.3 percent in January.

NAPM Report on Business

The Purchasing Managers' Index increased 0.6 percentage point in February to 56.9 percent. (A reading above 50 percent indicates that the manufacturing economy is generally expanding.)

Consumer Confidence

Consumer confidence, as measured by The Conference Board, declined 2.9 index points in February, to 141.8 (1985=100).

MAJOR RELEASES NEXT WEEK

Productivity (Tuesday)

EYES ONLY

U.S. ECONOMIC STATISTICS

	1970-1993	1999	1999:2	1999:3	1999:4
Percent growth (annual rate)					
Real GDP (chain-type)	3.0	4.5	1.9	5.7	6.9
GDP chain-type price index	5.2	1.6	1.3	1.1	2.0
Nonfarm business (NFB) sector:					
Productivity (chain-type)	1.7	3.3	0.6	5.0	5.0
Real compensation per hour:					
Using CPI	1.0	1.8	1.2	2.0	1.1
Using NFB deflator	1.5	2.9	2.9	4.0	1.8
Shares of Nominal GDP (percent)					
Business fixed investment	11.4	12.6	12.6	12.7	12.5
Residential investment	4.5	4.4	4.5	4.4	4.4
Exports	8.2	10.8	10.7	10.8	10.9
Imports	9.2	13.5	13.4	13.8	14.0
Personal saving	6.6	1.7	1.8	1.5	1.3
Federal surplus	-2.8	N.A.	1.3	1.4	N.A.

	1970-1993	1999	December 1999	January 2000	February 2000
Unemployment Rate (percent)	6.7**	4.2**	4.1	4.0	**4.1**
Payroll employment (thousands)					
increase per month			**309**	**384**	**43**
increase since Jan. 1993					**20823**
Inflation (percent per period)					
CPI	5.8	2.7	0.2	0.2	N.A.
PPI-Finished goods	5.0	3.0	0.1	0.0	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, March 3, 2000**.

EYES ONLY

FINANCIAL STATISTICS

	1998	1999	January 2000	February 2000	March 2, 2000
Dow-Jones Industrial Average	8626	10465	11281	10542	10165
Interest Rates (percent per annum)					
3-month T-bill	4.78	4.64	5.32	5.55	5.60
10-year T-bond	5.26	5.65	6.66	6.52	6.40
Mortgage rate, 30-year fixed	6.94	7.43	8.21	8.33	8.27
Prime rate	8.35	8.00	8.50	8.73	8.75

INTERNATIONAL STATISTICS

Exchange Rates	**Current level March 2, 2000**	**Percent Change from**	
		Week ago	**Year ago**
Euro (in U.S. dollars)	0.962	-3.1	-12.0
Yen (per U.S. dollar)	107.4	-3.2	-10.9
Major currencies index (Mar. 1973=100) (trade-weighted value of the U.S. $)	95.88	0.4	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	4.5 (Q4)	**4.1** (Feb)	2.7 (Jan)
Canada	4.7 (Q4)	6.9 (Dec)	2.3 (Jan)
Japan	1.0 (Q3)	4.6 (Nov)	-0.9 (Jan)
France	3.2 (Q4)	10.4 (Dec)	1.6 (Jan)
Germany	2.3 (Q4)	8.8 (Dec)[2]	1.7 (Jan)
Italy	1.2 (Q3)	12.1 (Apr)	2.2 (Jan)
United Kingdom	2.9 (Q4)	5.9 (Oct)	1.9 (Jan)

U.S. unemployment data **embargoed until 8:30 a.m., Friday, March 3, 2000.**

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 unified Germany.

EYES ONLY

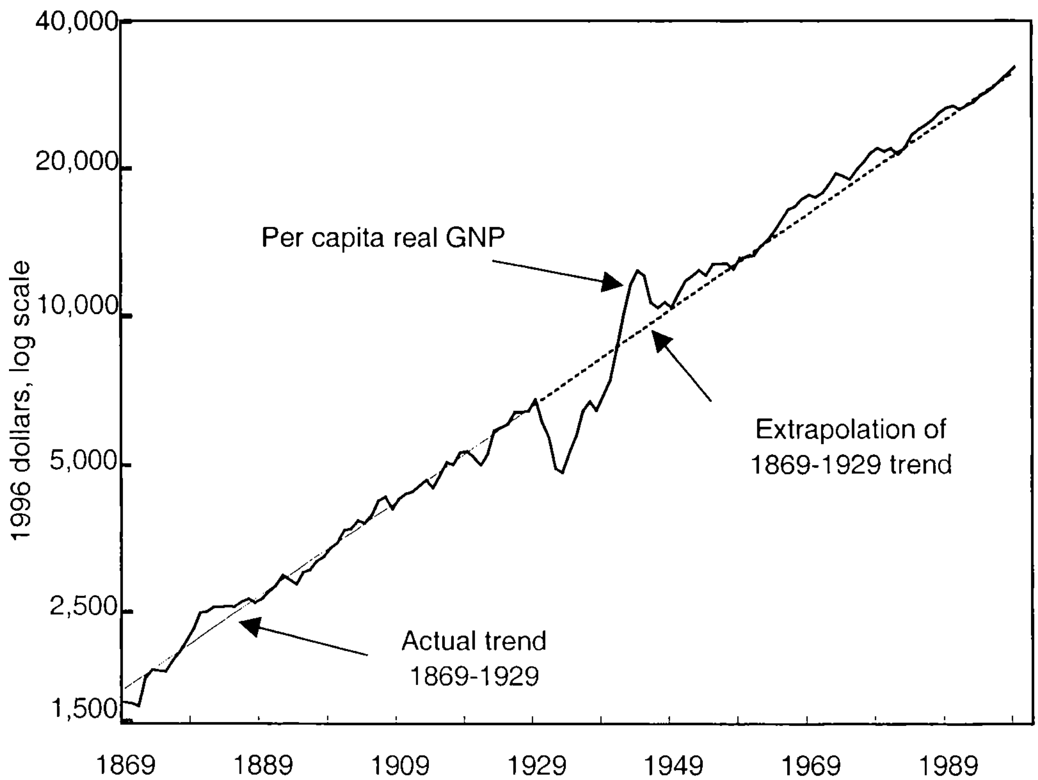
WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

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

May 19, 2000

CHART OF THE WEEK

The Long-Run Trend in Per Capita Real GNP



The BEA recently released revised estimates of GNP going back to 1929. The long-run trend in per capita real GNP growth has been amazingly constant at 2.2 percent per year over the last 130 years. In fact, if one simply extrapolates the trend from 1869 to 1929—shown by the dashed line in the chart—the error in predicting per capita real GNP in 1999 is only 2 percent. Of course, the economy has veered off this long-run trend for extended periods, the pronounced examples being the Great Depression and World War II.

EYES ONLY

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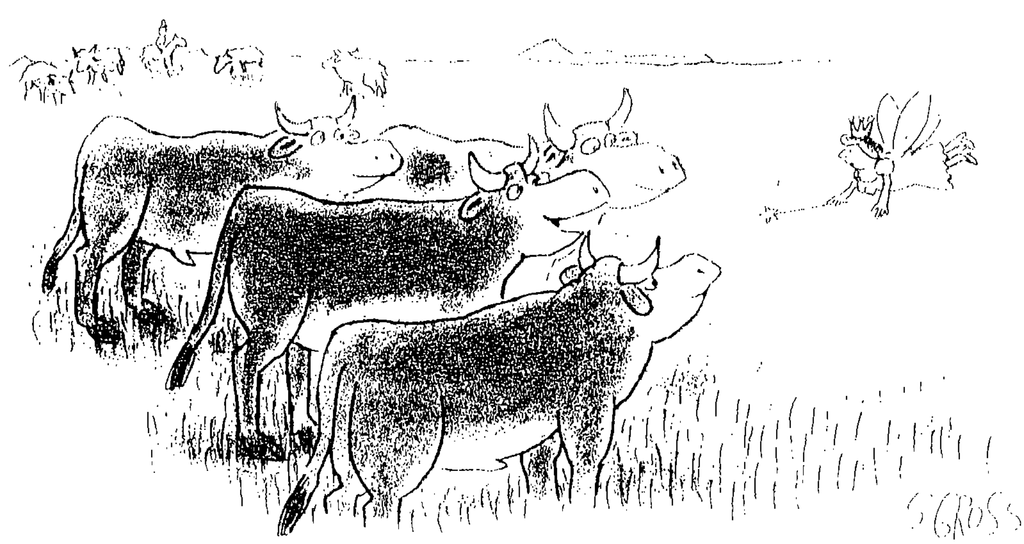


"We would like to be genetically modified to taste like Brussels sprouts."

EYES ONLY

SPECIAL ANALYSIS

South Africa: The Employment Struggle

The South African government has taken vital steps in improving its economy, including establishing fiscal discipline and reducing import barriers, but the abysmal performance of the labor market remains the economy's Achilles heel. Without a dramatic increase in economic growth, unemployment will remain stubbornly high.

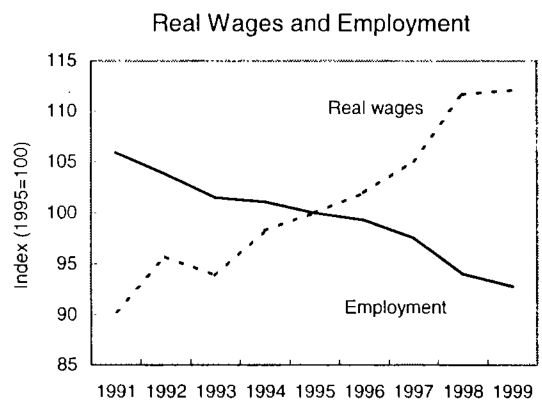
Working. Since assuming power in 1994, the African National Congress (ANC) has made progress in several dimensions. Budget policy has been disciplined. The consolidated general government deficit has been brought down from 5.6 percent of GDP in 1994/95 to 2.4 percent in 1998/99. At the same time, spending has been reoriented away from defense towards social needs such as education, health, and justice. In addition, tariff reductions have opened up the economy. Economic restructuring has boosted productivity growth, and GDP growth has averaged 2.5 percent per year—a marked contrast from the stagnation that characterized the final years of apartheid. Assuming recent problems in Zimbabwe do not have adverse effects, growth this year is expected to be between 3 and 4 percent.

Not working. But even growth rates of 4 percent are likely to be associated with higher unemployment. The South African labor force is growing at about 2.7 percent per year. This implies that if output per worker rises at 4 percent per year, as recorded between 1993 and 1998, output must grow at almost 7 percent annually simply to keep the unemployment rate from rising. But it has not done so. The result has been declining employment under ANC rule, continuing a worrying trend that has led to a 16 percent overall reduction in non-agricultural employment since 1990. The ratio of employment to population in South Africa is now just 21 percent, compared with 44 percent in Brazil and 61 percent in Mexico.

South Africa's official unemployment rate of 22 percent in 1997 understates the problem by not counting discouraged workers. An official census survey, which did count discouraged workers, placed the unemployment rate at 37 percent. As with most economic issues in South Africa, the burden has been borne along racial lines; while unemployment was a fairly modest 4.3 percent for white men, it was as high as 55 percent for black women! Even relatively more educated black South Africans with a high school diploma had unemployment rates of 50 percent. Since employment has continued to fall since 1997, today's unemployment rate is even higher.

It goes without saying that the social consequences of such unemployment levels are dire. Workers, particularly those who are young and without skills, must fend for themselves in the informal economy by scrounging a living as hawkers, receiving largesse from others, or turning to crime.

Remedies. Despite several major initiatives, the ANC has yet to find a compelling growth strategy. To grow more rapidly, South Africa clearly needs to stimulate more investment. With a domestic saving rate of about 15 percent—far lower than is common in economies with rapid growth—the government is particularly eager to attract foreign capital. But foreign investors remain leery, citing high crime rates and labor laws that add to costs.



Notwithstanding the high levels of unemployment, workers continue to receive significant increases in real wages (see chart). Labor remains militant: In 1998 there were 520 strikes and work stoppages involving 321 thousand workers. Moreover, the South African labor movement continues to call for even tougher labor market regulations and slower privatization.

A third way? A hands-off policy which depends on even higher unemployment to reduce costs is unlikely to work. Similarly, an effort to break the power of the unions is not viable (and not desirable) given the close links between the ANC and the unions that were forged on the anvil of fighting apartheid. Nonetheless, increased labor-market flexibility in both work rules and wages—particularly those for less-skilled workers—is clearly called for. The key challenge, therefore, lies in formulating a tri-partite grand bargain in which each social partner brings something to the table. One approach would have labor agree to permit increased flexibility in return for a business commitment to increase investment in skills and affirmative action, while government agrees to provide macroeconomic stimulus.

Conclusion. The reconciliation phase following apartheid has gone surprisingly smoothly. What is now needed is a much more decisive approach to labor market problems so that Africa's leading economy, which is richly endowed with human and natural resources, can realize its full potential.

EYES ONLY

ARTICLE

Competitive Effects of B2B Exchanges

Using the Internet, new Business-to-Business (B2B) electronic exchanges are being established where multiple buyers and sellers can negotiate contracts. For example, the big three automakers—Ford, GM, and Daimler-Chrysler—are planning to create a joint e-commerce exchange for automobile parts. Unlike a stock market where securities regulations govern transactions, these new exchanges are not heavily regulated. Antitrust laws still govern these businesses, however, and a reported antitrust inquiry into the automakers' operations has raised the issue of what type of oversight should be established in these new electronic marketplaces.

The growth of B2B exchanges. Many different industries are establishing Internet-based B2B exchanges for a variety of goods and services. In areas as diverse as paper, steel, aerospace, and defense, new B2B marketplaces are being announced. One major advantage of using electronic links to create these new marketplaces is that they lower the costs of reaching multiple buyers and sellers, creating deeper markets for many basic commodities. Where before specialized brokers were needed to match buyers and sellers in transactions, new websites today allow multiple buyers and sellers to find each other and enter into transactions for both commodity products and products needing more detailed specifications.

The automakers' joint venture. GM, Ford, and Daimler-Chrysler are planning to move a major portion of their procurement activity onto this new exchange. Together the three companies hope to move 60,000 suppliers and $250 billion worth of orders to the Internet and lower their supply costs. In addition to the automakers themselves, many of their suppliers may also use the site to obtain bids for items they need, adding as much as $500 billion in potential transactions to this new marketplace. Although they compete for automobile sales, each automaker would benefit from a more efficient and competitive purchasing system. GM has begun doing some electronic auctions for parts, and reports price reductions of 10 to 40 percent on some components.

Antitrust concerns. The Federal Trade Commission is said to be examining the automakers' joint venture. One potential concern is that if information on enough transactions between an automaker and its suppliers is available to competitors, that information could be used to facilitate coordination on output or pricing decisions. Paradoxically, having more information available in a concentrated industry can help a cartel raise prices. For example, airlines have long used electronic systems to convey information about airfares to consumers. These systems, however, also allow competitors to monitor each other's prices. In 1994, the Justice Department contended that major airlines used some types of information in this joint electronic fare system to increase fares and discourage discounting. A settlement with the airlines allowed them to continue to disseminate fares electronically, but prohibited some of the ancillary information that they used to communicate with each other about future prices for airline tickets.

Analysis. B2B exchanges are likely to become an increasingly important part of the supply chain in many industries. Where these exchanges enhance efficiency and lower prices, existing antitrust guidelines state that such cooperative ventures among competitors are fully consistent with the agencies' interpretations of antitrust law. Indeed, the likelihood of having a positive, efficiency enhancing outcome in the automaker case is suggested by the reaction of sellers to the new exchange. Many suppliers are concerned that their profit margins may decline due to the greater competition that these B2B exchanges are designed to promote. However, those competitive pressures should benefit consumers by holding down the cost of new cars.

EYES ONLY

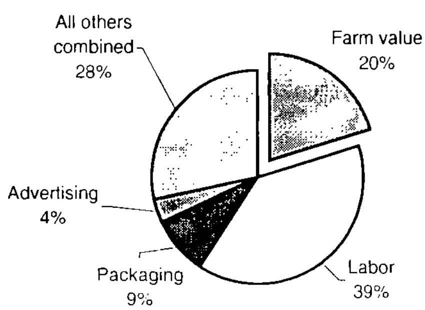
ARTICLE

Desire for Convenience Eats up Food Expenditures

Since 1980, the share of total personal consumption expenditures allocated to food in the United States has dropped from 18 percent to 13 percent, continuing a long-term trend downward. At the same time, more of America's food spending goes to convenience, both in the form of prepared foods and foods consumed away from home. This is one reason why the value of purchases from farmers is a diminishing fraction of the food dollar.

The farm value share has fallen... The USDA estimates that consumer spending on food originating on U.S. farms (including purchases at stores, restaurants, and other eating places) amounted to about $585 billion in 1998. Of that total, the farm value—the amount that U.S. farmers received—accounted for roughly 20 percent (see chart), down from about 30 percent two decades ago. The rest—what the USDA calls the marketing bill—represents all the major functions of the food industry, including processing, wholesaling, transporting, and retailing.

What a Dollar Spent for Food Paid for in 1998



...while the labor share has risen. Rising labor costs have largely replaced declining farm value. Labor costs are the largest component of the marketing bill, and they have increased from 31 percent of a food dollar in 1980 to about 39 percent in 1998. More food consumed away from home and greater demand for labor-intensive convenience foods prepared by supermarkets have likely contributed to this increase. (In fact, the USDA reports that expenditures for eating out accounted for 47 percent of total food spending in the United States in 1998, up from 39 percent in 1980.) The next largest component of the marketing bill is packaging, at about 9 percent of the food dollar. Somewhat surprisingly, advertising's share is relatively small—4 percent.

Implications. The quest for convenience is shaping consumer food expenditures. Away-from-home food expenditures are rising more rapidly than at-home food expenditures, and the farm value share of the food dollar is declining. In addition, some recent evidence suggests that greater convenience may, at times, result in poorer health. For example, when eating out, people often eat more or eat higher calorie foods and, according to the USDA, this tendency appears to be increasing.

EYES ONLY

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

Young Men Put Family First. Most young men highly value having a job schedule that allows for family time, with far fewer emphasizing money, power, or prestige, according to a new study. Eighty-two percent of men aged 21-39 said family time was very important, nearly the same percentage as women in that age group (85 percent). Breaking ranks with their fathers and grandfathers on the important issue of work-family integration, 71 percent of men aged 21-39 said they would give up some of their pay for more time with their families. While young men today are focusing on integrating work and family life, older generations of men tend to be more concerned with job satisfaction and status. The survey also showed that practically all young men claim to want to take an active role in raising their children.

Rural Health Woes. Residents of rural areas, in particular those not adjacent to metropolitan areas, are less likely to have health insurance or to have visited a doctor or health care professional, and are more likely to report fair or poor health. Much of these differences are probably linked to higher rates of poverty in rural areas. Only 63 percent of residents in rural counties not adjacent to urban areas had private insurance, well below the rates for residents of rural counties adjacent to urban areas (72 percent) and urban residents (75 percent). Public insurance coverage rates were higher in rural areas, but public coverage was not sufficient to overcome the private insurance gap: 22 percent of those living in rural areas not adjacent to urban areas were uninsured, compared to 18 percent of those in rural areas adjacent to urban areas and 14 percent in urban areas. Rural residents report worse health than urban residents on average, and they get less professional medical attention than their urban counterparts.

Health Insurance Tax Subsidy May be Costly. The continued rise in the number of Americans without health insurance has led to considerable interest in tax-based policies to raise the level of insurance coverage. A recent study estimates that a relatively generous tax subsidy—a refundable tax credit for health insurance spending capped at $1000 for single filers and $2000 for joint/head of household filers—would decrease the ranks of the uninsured by about 4 million, nearly 10 percent of the uninsured population. The average cost to government per newly insured person is estimated to be $3,300, which is 50 percent more than the cost of a typical non-group policy. The reason for the high cost is that most of those receiving the subsidy already have insurance. The policy would also induce a substantial shift from group to non-group insurance (the study estimates that 25 percent of those who would take the subsidy were previously covered by their employer). Moreover, almost one-half of those taking up the subsidy would be persons who are currently already purchasing non-group insurance.

INTERNATIONAL ROUNDUP

War and Uncertainty Mar Prospects for African Economic Integration. African leaders gathered in Mauritius this week to discuss the prospect of a Common Market for Eastern and Southern Africa (COMESA) Free Trade Area. The 21 member states of COMESA—with a total population of 385 million— had committed themselves in 1992 to the gradual elimination of all internal tariffs by October of this year. Nevertheless, progress remains slow and intra-COMESA trade remains paltry at $4.2 billion in 1998, compared to total foreign trade of over $60 billion, two-thirds of which are imports. A mechanism has been arranged to compensate qualifying members for the loss of government revenues associated with regional tariff removal, and COMESA is promoting numerous measures to appease protectionist sentiments that oppose exposing domestic industries to foreign competition. Wars and instability, however, continue to scar the continent and threaten progress on establishing the free trade area. More than half of COMESA members are either at war with each other or are fighting internal rebellions. Six are involved in the war in the Democratic Republic of the Congo, and Ethiopia and Eritrea last week resumed their border conflict.

College Enrollment Rising in OECD. While the United States continues to enjoy relatively high rates of university-level attainment, enrollment in other OECD countries appears to be catching up. According to new OECD data, enrollment in university-level programs grew by more than 50 percent between 1990 and 1997 in eight countries and by more than 20 percent in all but five OECD countries. At today's enrollment rates, 40 percent of young people in the OECD will enter bachelor degree or higher programs at some point in their lives, nearly equal to the 44 percent enrollment rate in the United States. While the percentage of students who enter these programs is increasing, not everyone completes a degree. On average, one-third of university-level entrants in the OECD drop out (the drop-out rate in the United States was 37 percent). The United States is one of the few countries where the private sector participates significantly in funding college and university education: 49 percent of funds for tertiary institutions come from private sources, more than twice the OECD average of 23 percent.

Developing Countries to Receive Free Genetically Modified Rice. The inventors of rice genetically modified to combat Vitamin A deficiency have struck a deal with the pharmaceutical company AstraZeneca that will give farmers in developing countries free access to the grain. This "golden rice" is a genetically altered grain fortified with beta-carotene that converts to Vitamin A. Vitamin A deficiency afflicts an estimated 124 million people worldwide and results in the deaths of up to 2 million children each year. Under the new agreement, the rice will be distributed free to national and international research organizations in developing countries. Local farmers will be permitted to earn up to $10,000 annually growing this rice, without paying royalties. AstraZeneca will market the rice in developed nations for profit. The company said that the earliest date of availability for local planting and consumption would be 2003.

EYES ONLY

RELEASES THIS WEEK

U.S. International Trade in Goods and Services
****Embargoed until 8:30 a.m., Friday, May 19, 2000****

The goods and services trade deficit was $30.2 billion in March; the deficit was $28.7 billion in February.

Consumer Price Index

The consumer price index was unchanged in April. Excluding food and energy, consumer prices rose 0.2 percent.

Housing Starts

Housing starts rose 3 percent in April to 1.663 million units at an annual rate.

Industrial Production and Capacity Utilization

The Federal Reserve's index of industrial production rose 0.9 percent in April. Capacity utilization rose 0.4 percentage point to 82.1 percent.

MAJOR RELEASES NEXT WEEK

Gross Domestic Product (Thursday)
Advance Durable Shipments and Orders (Friday)

EYES ONLY

U.S. ECONOMIC STATISTICS

	1970-1993	1999	1999:3	1999:4	2000:1
Percent growth (annual rate)					
Real GDP (chain-type)	2.9	4.6	5.7	7.3	5.4
GDP chain-type price index	5.2	1.6	1.1	2.0	2.7
Nonfarm business (NFB) sector:					
Productivity (chain-type)	1.7	3.7	5.0	6.9	2.4
Real compensation per hour:					
Using CPI	1.0	1.7	2.0	0.9	0.3
Using NFB deflator	1.5	2.9	4.0	1.8	1.8
Shares of Nominal GDP (percent)					
Business fixed investment	11.4	12.6	12.7	12.5	12.9
Residential investment	4.5	4.4	4.4	4.4	4.4
Exports	8.2	10.8	10.8	10.9	10.8
Imports	9.2	13.5	13.8	14.0	14.2
Personal saving	6.6	1.7	1.5	1.3	0.5
Federal surplus	-2.8	1.2	1.4	1.2	N.A.

	1970-1993	1999	February 2000	March 2000	April 2000
Unemployment Rate (percent)	6.7**	4.2**	4.1	4.1	3.9
Payroll employment (thousands)					
increase per month			27	458	340
increase since Jan. 1993					21615
Inflation (percent per period)					
CPI	5.8	2.7	0.5	0.7	**0.0**
PPI-Finished goods	5.0	2.9	1.0	1.0	-0.3

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

New or revised data in **boldface**.

EYES ONLY

FINANCIAL STATISTICS

	1998	1999	March 2000	April 2000	May 18, 2000
Dow-Jones Industrial Average	8626	10465	10483	10944	10777
Interest Rates (percent per annum)					
3-month T-bill	4.78	4.64	5.69	5.66	5.75
10-year T-bond	5.26	5.65	6.26	5.99	6.56
Mortgage rate, 30-year fixed	6.94	7.43	8.24	8.15	8.64
Prime rate	8.35	8.00	8.83	9.00	9.50

INTERNATIONAL STATISTICS

Exchange Rates	**Current level May 18, 2000**	**Percent Change from Week ago**	**Percent Change from Year ago**
Euro (in U.S. dollars)	0.895	-0.8	-16.1
Yen (per U.S. dollar)	108.7	0.2	-11.8
Major currencies index (Mar. 1973=100) (trade-weighted value of the U.S. $)	100.1	0.7	5.0

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	5.0 (Q1)	3.9 (Apr)	3.0 (Apr)
Canada	4.7 (Q4)	6.8 (Mar)	3.0 (Mar)
Japan	0.0 (Q4)	5.0 (Mar)	-0.5 (Mar)
France	3.1 (Q4)	9.8 (Mar)	1.5 (Mar)
Germany	2.3 (Q4)	8.4 (Mar)	1.9 (Mar)
Italy	2.1 (Q4)	11.3 (Jan)	2.5 (Mar)
United Kingdom	3.0 (Q4)	5.9 (Jan) [2/]	2.6 (Mar)

1/ For unemployment data, rates approximating U.S. concepts as calculated by the U.S. Department of Labor, Bureau of Labor Statistics, except as noted in footnote 2.
2/ Data from OECD standardized unemployment rates.

EYES ONLY

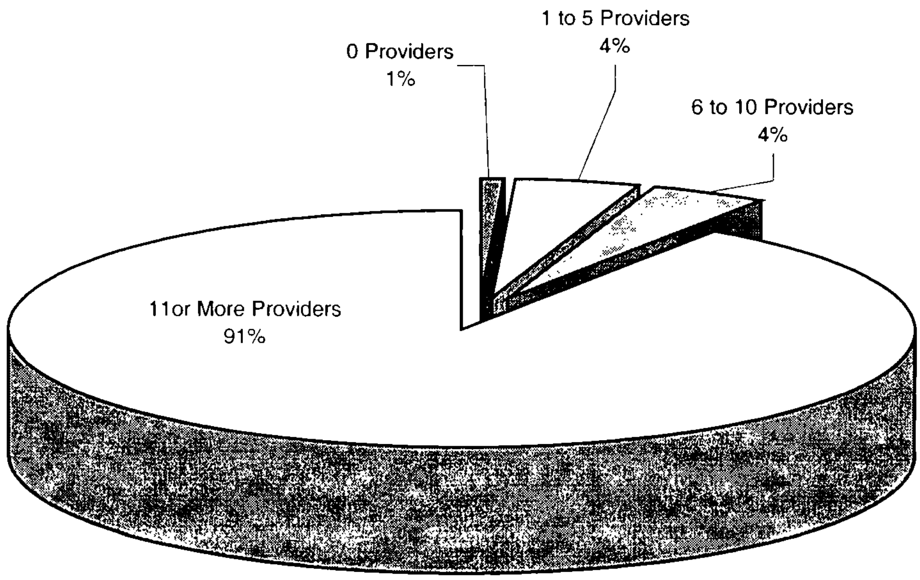
WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

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

October 15, 1999

CHART OF THE WEEK

Percent of Population with Local Internet Access



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

EYES ONLY

CONTENTS

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

EYES ONLY

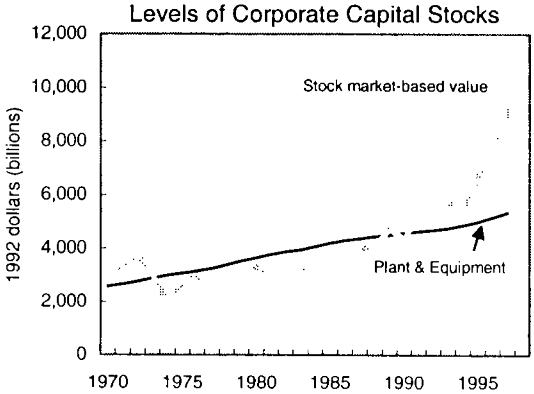
SPECIAL ANALYSIS

Intangible Capital and the Stock Market

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

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

Levels of Corporate Capital Stocks



Intangible capital and the IT revolution. Why might the stock of intangible capital have grown so rapidly in the 1990s? A number of explanations have been put forward. One is that businesses have intensified efforts at increasing efficiency and productivity. A second is that the explosion in information technologies has led to a surge in investment in intangible capital—including investments in computer software (not currently counted as business capital), the creation of new products and services, and the redesign of production processes and management strategies. In this view, businesses have invested considerable resources in order to take advantage of the opportunities provided by the IT revolution. Investors perceive that these investments will pay off and this is showing up in stock market valuations. One piece of evidence supporting the connection between information technologies and the accumulation of intangible capital is the fact that stock price gains in high tech firms have outpaced those in the rest of the economy, suggesting that these firms have been accumulating intangible capital at a rapid rate.

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

EYES ONLY

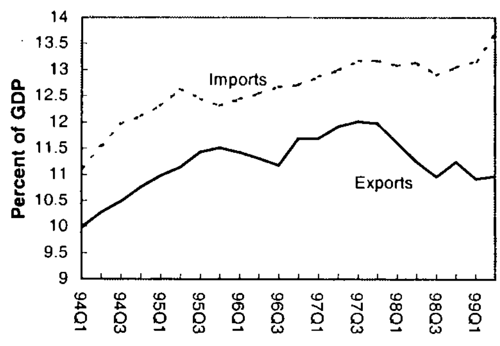
SPECIAL ANALYSIS

Recent Patterns of Trade and Growth

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

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

U.S Exports and Imports as a Percent of GDP



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

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

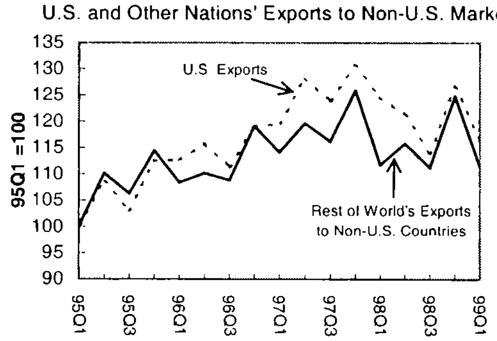
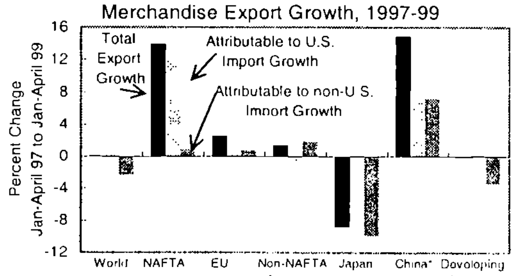


Chart derived from import data

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

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



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

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

ARTICLE

From Learning to Earning

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

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

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

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

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

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

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

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

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

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

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

EYES ONLY

INTERNATIONAL ROUNDUP

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

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

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

EYES ONLY

RELEASES THIS WEEK

Industrial Production and Capacity Utilization

****Embargoed until 9:15 a.m., Friday, October 15, 1999****

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

Producer Price Index

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

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

Retail Sales

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

MAJOR RELEASES NEXT WEEK

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

EYES ONLY

U.S. ECONOMIC STATISTICS

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

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

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

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

EYES ONLY

FINANCIAL STATISTICS

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

INTERNATIONAL STATISTICS

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

International Comparisons [1/]	Real GDP growth (percent change last 4 quarters)	Unemployment rate (percent)	CPI inflation (percent change in index last 12 months)
United States	3.9 (Q2)	4.2 (Sep)	2.3 (Aug)
Canada	3.7 (Q2)	7.8 (Aug)	2.1 (Aug)
Japan	1.1 (Q2)	4.7 (Aug)	0.2 (Aug)
France	2.1 (Q2)	11.3 (Aug)	0.5 (Aug)
Germany	0.6 (Q2)	7.1 (Aug)[2/]	0.6 (Aug)
Italy	0.8 (Q2)	12.1 (Apr)	1.7 (Aug)
United Kingdom	1.4 (Q2)	6.0 (Jun)	1.1 (Aug)

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

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

EYES ONLY

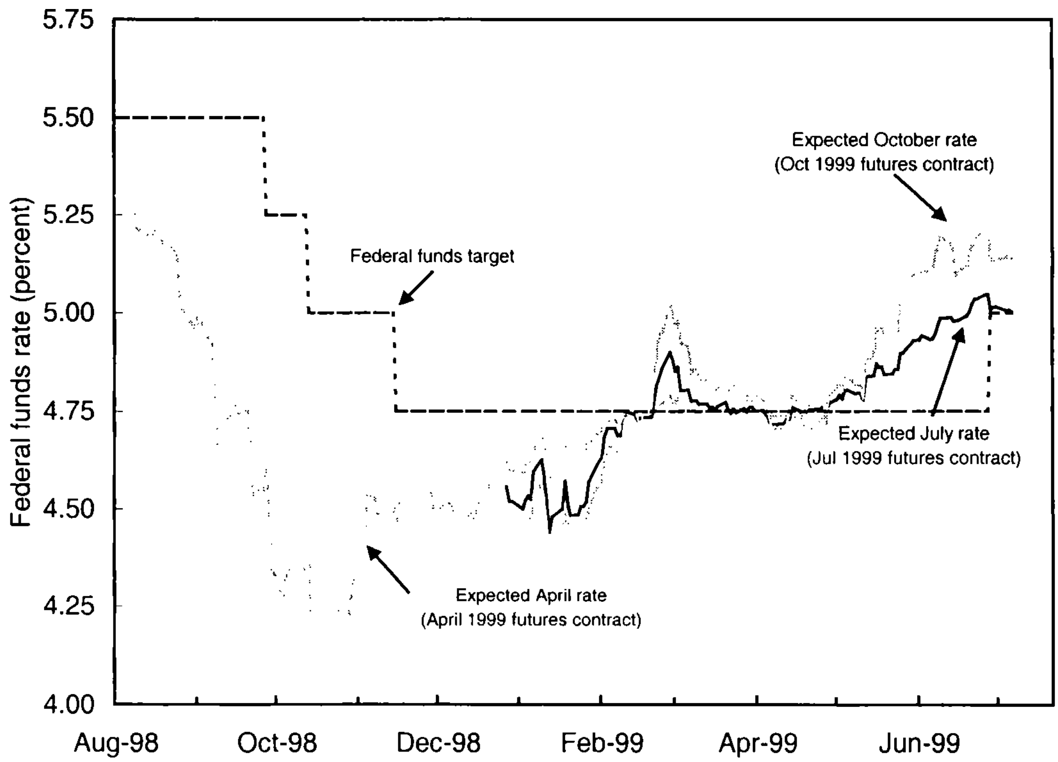
WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

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

July 9, 1999

CHART OF THE WEEK

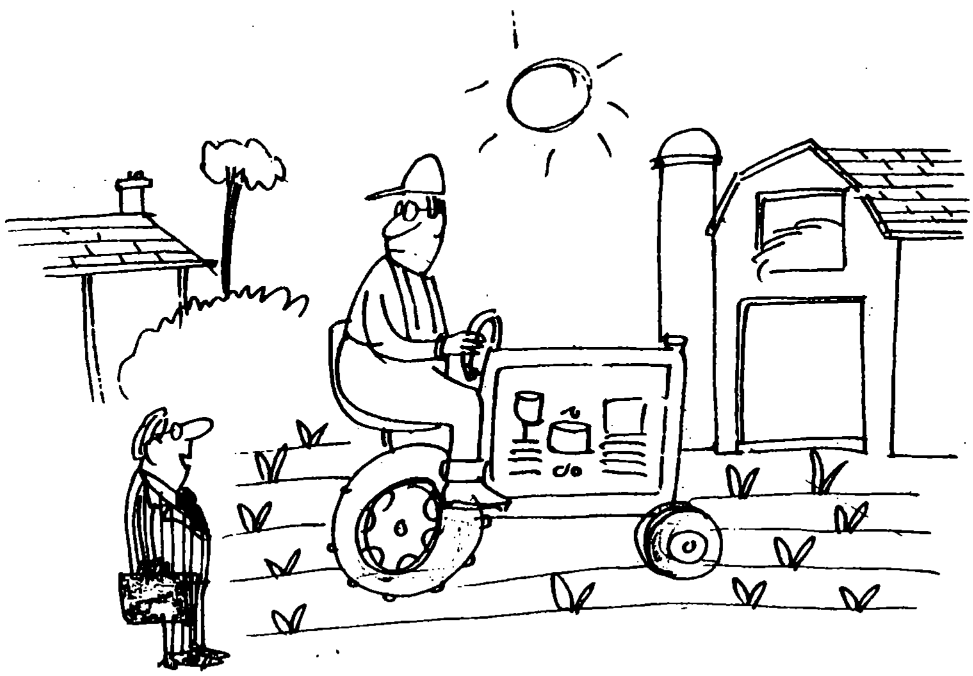
Market Expectations of Fed Actions



Federal funds futures contracts reflect market expectations about Federal Reserve actions. In the winter, for example, markets thought the Fed might cut rates further (the expected rate implied by the April 1999 contract was below the current Fed target). The subsequent rise in the expected July 1999 rate reflected growing market expectations of a rate increase. The October 1999 contract implies that the market still sees a reasonable chance of a further rate increase by then.

EYES ONLY

CONTENTS



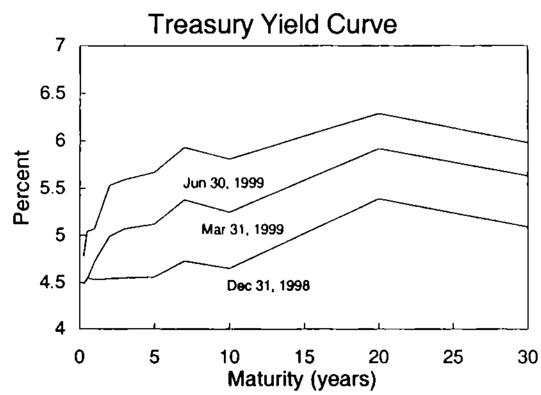
"I'm sorry, Dad. If I ever decide to get involved in farming, it will be strictly as a middleman."

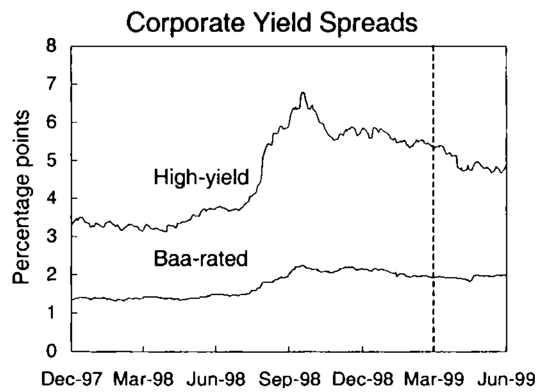
EYES ONLY

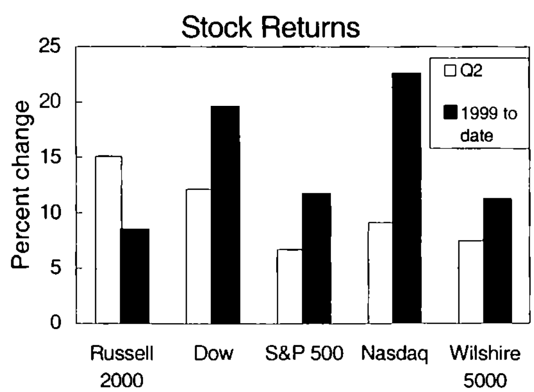
FINANCIAL MARKET UPDATE

Second Quarter 1999

Last week's decision by the Federal Reserve to raise its target for the federal funds rate by ¼ point was widely anticipated by financial markets (see Chart of the Week). Stock and bond markets rallied on the news that the Fed had also switched to a neutral stance on future rate changes, but interest rates remain near recent highs.







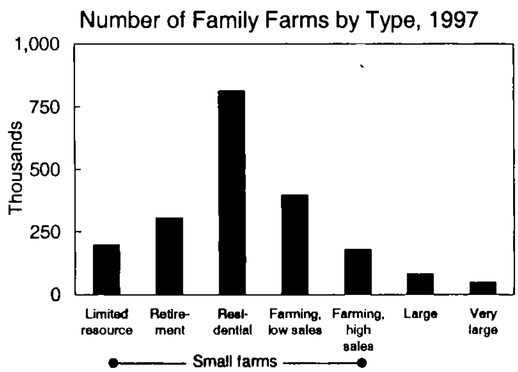
Interest rates. Yields on Treasury securities had been rising at most maturities since the end of last year (see upper chart), and the yield curve had reached a level not seen since late 1997. Rates rose in May when a higher-than-expected boost to core consumer price inflation and the Fed's announcement of an asymmetric bias toward tightening cemented expectations that the Fed would in fact raise rates in June. As Treasury rates have risen, yields on corporate debt have also moved up, keeping yield spreads between them roughly level (see middle chart). Spreads widened a little in May as markets reacted to the inflation news, but they have since remained stable.

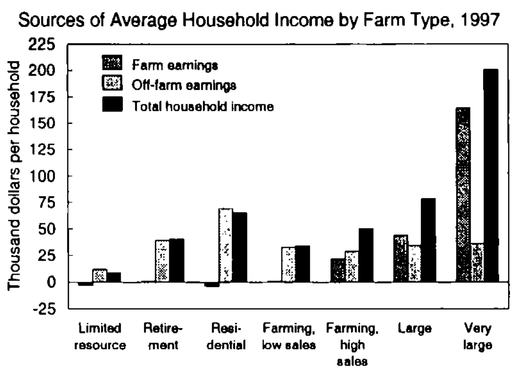
Stock prices. The major stock indexes all recorded substantial gains in the second quarter, though of varying size (see lower chart) and with different relative strengths compared with the first quarter. For example, price gains for Internet stocks cooled off significantly from their rapid first-quarter pace—perhaps reflecting expectations of higher interest rates, which depress more sharply the value of stocks whose payoffs are weighted more toward the future. Blue chip stocks in sectors such as utilities and basic materials enjoyed solid performances, owing to continued robust growth in the economy. The most distinct turnaround came among small stocks: the Russell 2000 index, which fell 6 percent in the first quarter, surged 15 percent in the second quarter, leaving it up 8 percent for the year.

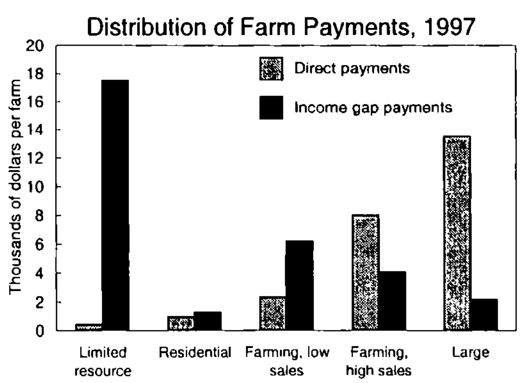
Special Analysis

Farm Households and the Distribution of Farm Payments

Although the average income of U.S. farm households was above that of nonfarm households in 1997, half a million farm households had incomes below $20,000 per year. However, current farm programs are not targeted at these low-income farm households and mainly support farm households with much higher incomes.







Farm size and farm income. The USDA has identified a number of different kinds of family farms, including several types of small farm (those with less than $250,000 of annual sales, see upper chart). In 1997, the majority of all farms were small residential farms (those whose operators reported that they had a major occupation other than farming) or small farms whose operators reported that they were retired. However, these two types only accounted for 9 percent of total farm production. USDA has a separate category for "limited resource" farm families (those with low income, few assets, and limited sales).

The typical small family farm had low or even negative farm income in 1997 (see middle chart), a year of strong aggregate farm income. Off-farm earnings were the major component of income for all of the small farm categories. Including off-farm earnings, approximately 27 percent of farm households had incomes below 185 percent of the poverty line (roughly the same percentage as nonfarm households). Small farms tend to specialize in beef and field crops such as tobacco (while higher-sales farms tended to specialize in grains and dairy).

Farm payments. The lower chart compares the distribution of actual direct farm program payments (excluding crop insurance subsidies) with the amounts that would be required to assure that household incomes were at least 185 percent of the poverty line (the chart excludes retirement and very large family farms). For limited-resource farms, direct payments in 1997 were negligible compared with what would have been required to meet this income standard. By contrast, larger sales family farms received substantial direct payments. The big grain states also received more direct payments than what would have been required to close the 185-percent-of-poverty income gap. Total direct payments in 1993-1997 were $1.2 billion larger than the amount that would have closed this income gap.

Conclusion. Current safety net programs were primarily designed to protect farmers from unforeseen drops in average revenue due to either yield or price fluctuations—regardless of whether average revenue is high or low. When farm program payments are distributed on the basis of production (as are AMTA and commodity loans), the bulk of payments automatically go to larger farmers, and not necessarily to the neediest farm families.

EYES ONLY

ARTICLE

Census Releases Experimental Poverty Measures

This week the Census Bureau released illustrative estimates of poverty rates calculated using improvements proposed in a 1995 report by the National Academy of Sciences (NAS). The trends in poverty rates during the 1990s and the distribution of poverty among subgroups in the population differ considerably from the official poverty statistics.

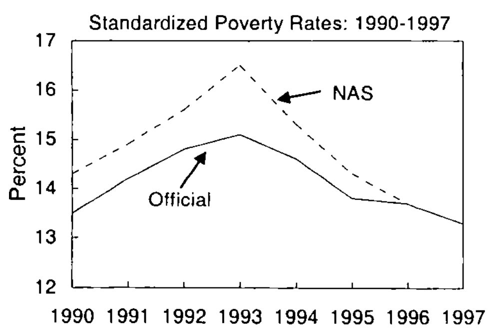
The official measure. Since 1965, poverty has been measured by comparing before-tax cash income with a poverty threshold based on family size, composition, and age. The threshold was originally set at three times the minimum amount required to purchase a balanced diet, because at that time the average family was estimated to allocate one-third of its budget to food. This threshold has been raised each year by the increase in consumer prices.

Why consider alternatives? This official measure has been widely criticized for several weaknesses.

- Outdated threshold. The NAS recommended that thresholds should: cover necessary spending for food, clothing, and shelter (including utilities); reflect regional variation in housing costs; use better adjustments for family size; and be updated regularly using data on consumer spending.

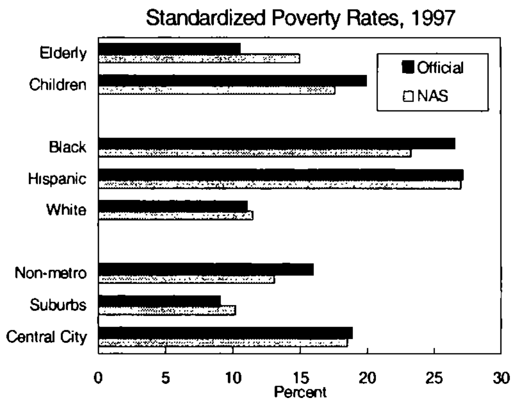
- Omission of taxes and non-cash transfers. The effect of anti-poverty policies such as the Earned Income Tax Credit (EITC), food stamps, school lunches, housing subsidies, and heating assistance are not reflected in official poverty rates.

- Distortions of income adequacy. Medical care and work-related expenses such as transportation and child care are not netted out of income, even though they are not available to pay for food, clothing, and shelter; geographic differences in the cost of living are ignored. Such treatment distorts comparisons of income adequacy for old and young, working and non-working families, and those living in different parts of the country.



Trends in the 1990s. To make comparisons easier, the Census report provides "standardized" estimates of poverty rates, by adjusting the thresholds so that the overall experimental poverty rate and the official rate are identical in 1997. The increase in poverty rates from 1990 to 1992 is similar across all the measures, but the experimental rates declined faster than the official rate from 1993 to 1997 (see chart on previous page). This primarily reflects the effect of the expanded EITC, which is not accounted for in the official poverty measure.

Comparing subgroups. Out-of-pocket medical expenses make a difference to the elderly, who show the largest increase in poverty rates when the standardized NAS measure is used (see chart). Conversely, the poverty rate for children is relatively lower than under the official measure. Female-headed families and black families make up a smaller share of the poor population under the new measures than under the official one, because of the addition of near-cash transfers to income (and because blacks use medical care less than other groups). Largely due to the cost-of-living adjustment, the experimental measures reduce the poverty rate outside metropolitan areas relative to cities and suburbs, and increase poverty rates in the Northeast and West relative to the South and Midwest.



Implications. Although there is wide agreement that the official measure needs revising, there is no consensus yet on exactly how to do this. These new estimates give researchers and policy analysts the information they need to calculate poverty rates with a variety of improved methods, and give policymakers a sense of how the new measures will differ from the old.

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

BadgerCare Begins in Wisconsin. On July 1, Wisconsin began a statewide program of no- or low-cost health insurance designed to fill the gap between Medicaid and private insurance and to help families make the transition from welfare to work. The program, called BadgerCare, provides health insurance for children and parents in uninsured families with income below 185 percent of the poverty line. Once enrolled, families may remain in the program until family income exceeds 200 percent of poverty. Families with income above 150 percent of poverty pay a monthly premium of 3.5 percent of family income. BadgerCare provides identical benefits to Medicaid and was implemented through waivers of Medicaid law and by using flexibility under the Child Health Insurance Program (CHIP). The State's current Medicaid entitlement will be maintained. Wisconsin is among a few states with health insurance programs designed to cover all the members of low-income families.

Quantifying the Benefits of Reduced Gun Violence. A new study estimates that the public would be willing to pay $23.8 billion to reduce gun violence by 30 percent, or $750,000 per injury. The value of a statistical life implied by the studies' results—between $4 and $6.25 million—is consistent with estimates derived using other methods. The new study is based on data from a national survey in which respondents were asked directly how much they would be willing to pay in extra taxes for a program that reduced gun injuries by 30 percent. This methodology differs from most previous studies of the benefits of reducing gun violence that multiplied the annual number of gunshot injuries by some estimate of the cost per injury or that used differences in housing prices (across neighborhoods with different crime rates) to impute the costs of crime.

Estimating the Impact of the Social Security Earnings Test. Eliminating the Social Security earnings test would substantially boost the labor supply of older male workers, according to a recent study. The study uses the "natural experiment" created by three changes in the earnings test rules between 1978 and 1990 to estimate its results. The study finds that working older males bunch in substantial numbers at and just below the earnings exempt amount, and that this bunching reacts directly to the changes in the earnings test rules. Eliminating the test, it estimates, would raise average hours worked by about 5 percent for those currently at or above the exempt amount. Moreover, the short-run fiscal cost associated with workers' taking benefits earlier will be offset in the future because their annual benefits will be lower than if they had waited. The labor supply effects on older men who have withdrawn from the labor force are not addressed in the study.

INTERNATIONAL ROUNDUP

OECD Assesses Employment Protection Legislation. In theory, employment protection legislation (EPL) may help those already working to remain employed but it may discourage employers from making new hires. A new study by the OECD finds that, in practice, EPL does not increase the overall level of unemployment, but it may change the demographic composition of the unemployed as well as the duration of unemployment spells. In countries where EPL is stricter, unemployment tends to be lower for prime-age men (who are mainly the "insiders" EPL is designed to protect) benefit most from EPL), but it may be higher for other groups, especially younger workers. Stricter EPL is also associated with lower turnover in the labor market, with both jobs and unemployment spells tending to last longer. Fewer workers experience unemployment in any given year in countries with stricter EPL, but those becoming unemployed have a greater probability of remaining unemployed for a year or more.

Africa Shows Best Return On Direct Investment. Africa shows the best returns from foreign direct investment (FDI), according to a recent report by the United Nations Conference on Trade and Development (UNCTAD). The report cites data from U.S. transnational corporations showing that their affiliates in Africa have been consistently more profitable than affiliates in most other regions: investments in Africa yielded a 25 percent return in 1997, compared with an average of 14 percent in all developing countries. Yields on FDI in Africa have risen since the early 1980s, both absolutely and relative to all other developing countries. The study acknowledges that these returns are not adjusted for risk, but argues that there is no systematic evidence that FDI in Africa is riskier than in other developing countries. Contrary to popular perception, FDI in Africa is not limited to extraction of natural resources: even in oil-exporting countries like Nigeria, services and manufacturing are key sectors for FDI. Important policy steps have improved the FDI climate, including strengthening of the rule of law, economic stabilization, and improvement of regulatory frameworks for FDI. The report cites seven countries (Botswana, Equatorial Guinea, Ghana, Mozambique, Namibia, Tunisia, and Uganda) as "front-runners" in attracting FDI: active reform has enabled these seven, which account for less than a tenth of the continent's population and GDP, to receive a quarter of FDI.

IMF Moves toward International Financial Architecture Reform. In approving a loosening of conditions under which the Fund may lend to countries in arrears on their debts to private creditors, the Executive Board of the International Monetary Fund last week took a step toward reforming the international financial architecture and tilting the balance of power away from private creditors. Whereas the Fund had previously required that negotiations be underway between a country and its private creditors before it would consider lending into arrears, it now will consider doing so if the member is pursuing appropriate policies and is making a good-faith effort to reach agreement on restructuring with its creditors.

EYES ONLY

RELEASES THIS WEEK

There were no major releases scheduled.

MAJOR RELEASES NEXT WEEK

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

EYES ONLY

U.S. ECONOMIC STATISTICS

	1970-1993	1998	1998:3	1998:4	1999:1
Percent growth (annual rate)					
Real GDP (chain-type)	2.7	4.3	3.7	6.0	4.3
GDP chain-type price index	5.4	0.9	1.0	0.8	1.6
Nonfarm business (NFB) sector:					
Productivity (chain-type)	1.5	2.7	2.5	4.3	3.5
Real compensation per hour:					
Using CPI	0.6	2.6	2.3	2.2	2.6
Using NFB deflator	1.3	3.8	3.4	3.8	2.6
Shares of Nominal GDP (percent)					
Business fixed investment	10.9	11.0	10.9	11.0	11.0
Residential investment	4.5	4.3	4.4	4.5	4.6
Exports	8.2	11.3	11.0	11.3	10.9
Imports	9.2	13.0	12.9	13.1	13.2
Personal saving	5.2	0.3	0.1	-0.0	-0.5
Federal surplus	-2.7	0.9	1.1	0.8	1.4

	1970-1993	1998	April 1999	May 1999	June 1999
Unemployment Rate (percent)	6.7**	4.5**	4.3	4.2	4.3
Payroll employment (thousands)					
increase per month			321	–5	268
increase since Jan. 1993					18895
Inflation (percent per period)					
CPI	5.8	1.6	0.7	0.0	N.A.
PPI-Finished goods	5.0	0.0	0.5	0.2	N.A.

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

EYES ONLY

FINANCIAL STATISTICS

	1997	1998	May 1999	June 1999	July 8, 1999
Dow-Jones Industrial Average	7441	8626	10854	10704	11127
Interest Rates (percent per annum)					
3-month T-bill	5.06	4.78	4.50	4.57	4.55
10-year T-bond	6.35	5.26	5.54	5.90	5.85
Mortgage rate, 30-year fixed	7.60	6.94	7.15	7.55	7.65
Prime rate	8.44	8.35	7.75	7.75	8.00

INTERNATIONAL STATISTICS

Exchange Rates	**Current level**	**Percent Change from**	
	July 8, 1999	**Week ago**	**Year ago**
Euro (in U.S. dollars)	1.020	–0.4	N.A.
Yen (per U.S. dollar)	122.6	1.3	–12.2
Major currencies index (Mar. 1973=100) (trade-weighted value of the U.S. $)	97.66	0.6	–1.6

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	4.0 (Q1)	4.3 (Jun)	2.1 (May)
Canada	3.2 (Q1)	8.1 (May)	1.6 (May)
Japan	0.1 (Q1)	4.7 (May)	-0.4 (May)
France	2.3 (Q1)	11.4 (Apr)	0.5 (Apr)
Germany	0.8 (Q1)	7.2 (Apr) 2/	0.4 (May)
Italy	0.9 (Q1)	12.1 (Apr)	1.6 (May)
United Kingdom	0.7 (Q1)	6.2 (Mar)	1.3 (May)

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 April was 9.1 percent.