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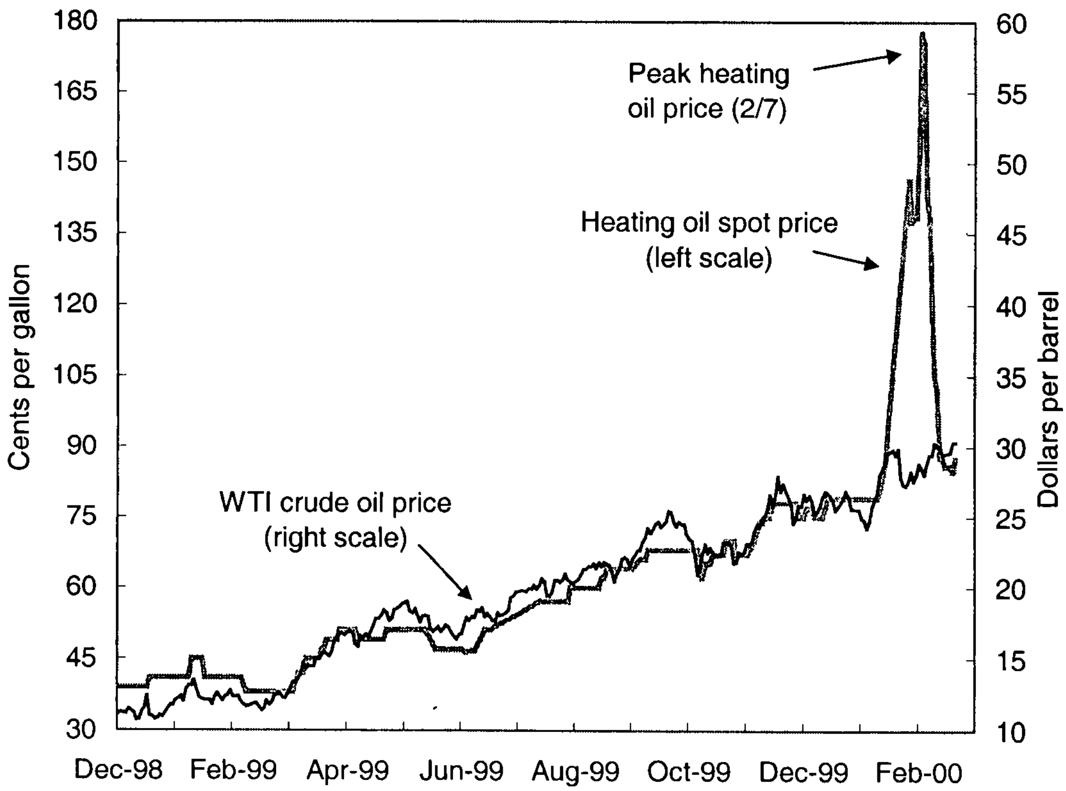
WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

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

February 25, 2000

CHART OF THE WEEK

Heating Oil Prices Fall Back in Line with Oil Prices



The spot price for heating oil (and diesel fuel) skyrocketed in late January and early February, but has since dropped back to a level about 10 percent above that at the end of last year. Except for this short-lived spike, the prices of heating oil and diesel fuel have tended to follow closely the price of West Texas Intermediate crude oil, which has more than doubled during the past year.

EYES ONLY

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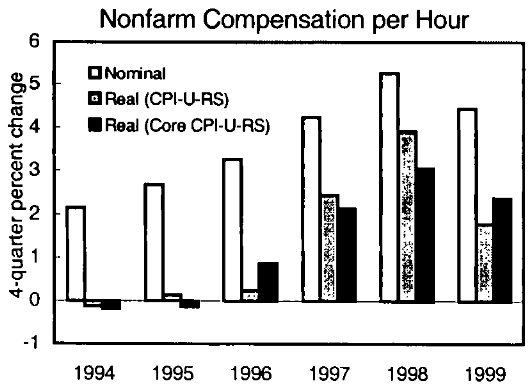
EYES ONLY

CURRENT DEVELOPMENT

What Is Really Happening to Wages?

An article in the *New York Times* this weekend noted that growth in real wages slowed markedly in 1999 and suggested that economists are floundering in their search for an explanation. Much of the mystery is removed, however, once changes in the inflation rate associated with volatility in energy prices are taken into account. Moreover, underlying trends in productivity and inflation augur well for continued solid growth in real wages.

Trends in real compensation. Following a period of acceleration between 1994 and 1998, nominal compensation per hour in the nonfarm business sector slowed somewhat during 1999 (see chart). Because consumer price inflation declined rapidly between 1996 and 1998 and then rose in 1999, the rise and subsequent decline in growth in real hourly compensation (the gray bars in the chart) is more exaggerated than that of nominal compensation. (Growth in average hourly earnings, which exclude nonwage compensation like employer health insurance contributions, shows a similar pattern.)



Analysis. While the CPI is an appropriate deflator for assessing year-to-year changes in the purchasing power of wages, the volatility of energy prices may obscure longer-term trends in inflation, and hence in real wages. This appears to have been the case in 1997-99. When real hourly compensation is computed using the core CPI (which removes the volatile food and energy components), the faster growth in 1998 and abatement in 1999 is much less pronounced (as shown by the black bars in the chart). Over the longer term, real wages tend to track productivity, which has been growing very strongly recently. The Administration forecast foresees continued strong productivity growth, with real hourly compensation increasing about 1.5 percent per year for the next several years.

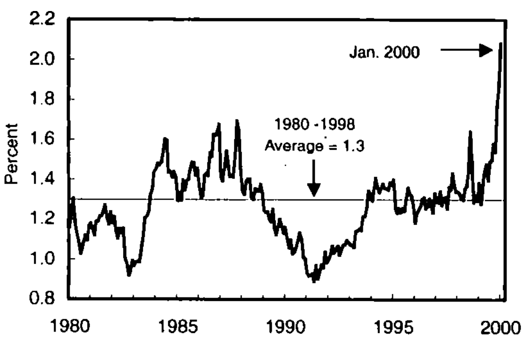
CURRENT DEVELOPMENT

Margin Debt

Margin debt at New York Stock Exchange (NYSE) member firms increased sharply in the last 4 months. Stock speculation has been suggested as a possible explanation for this rise in margin debt, but as yet we lack clear evidence to support this contention.

What is margin debt? Margin debt is money that investors borrow using financial investments for collateral, allowing them to leverage their investments. The Federal Reserve Board sets the maximum portion of the value of investments that investors can borrow, called the margin requirement (currently 50 percent). The industry then sets an additional requirement: if the ratio of the value of the debt to the value of the collateral rises above a specified value, the investor faces a margin call. She must then put up more money or sell her collateral investments to bring down the margin debt so that the ratio of debt to collateral is again below the specified level.

Margin Debt as Percent of Total Market Value



Source: New York Stock Exchange.

Margin mania. During most of the 1980s and 1990s, the total margin debt of NYSE member firms has been a tiny fraction of the total value of NYSE stocks, ranging from about 0.9 to 1.7 percent (see chart). Starting in November 1999, however, investors began borrowing more heavily against their equity holdings, pushing the ratio up to 2.1 percent in January of 2000.

The risks of leveraged stock buying. Some have suggested that the recent spike in margin debt demonstrates the willingness of some investors to use margin debt to purchase stocks that they otherwise could not afford. By leveraging the initial investment, this strategy holds the potential for big gains, but it also entails more risk than the outright purchase of stocks, especially because a margin call could necessitate selling when the market is down. Small investors who are heavily leveraged using margin debt and who lack other lines of credit may suffer significant losses and even have their holdings entirely wiped out. Moreover, if investors start a sell-off in response to margin calls, this could conceivably exacerbate a market downturn.

We just don't know. Stock market speculation is just one possible reason for rising margin debt. Other factors such as relatively low margin interest rates or increased convenience of margin borrowing could be at work. Because of the complexity and potential importance of these issues, the SEC has declared its intention to study and report on the matter.

EYES ONLY

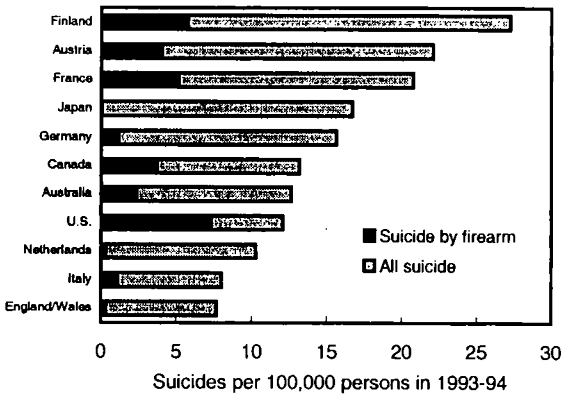
ARTICLE

Guns and Suicide

Although it is well known that the United States has high levels of gun violence and gun homicide, less publicized is the role of guns in suicide. In fact, far more Americans died from gun suicide in 1997 (17,566) than from gun homicide (13,252).

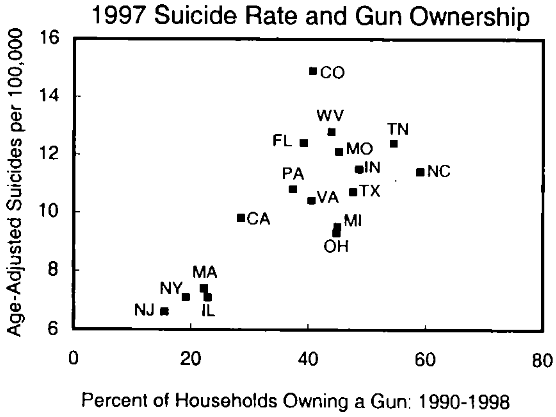
Suicide in the United States and abroad. Suicide is the eighth leading cause of death for all Americans and the third leading cause among young people aged 15 to 24. And while women are twice as likely to report a history of attempted suicide, men composed 80 percent of suicides in 1997. Although the U.S. suicide rate overall is not especially high relative to other industrialized countries, the rate of suicide by firearm is 11 times higher in the United States (see upper chart). Guns were used in 58 percent of U.S. suicides in 1997. Suicide is a growing problem among the young in America: from 1952 to 1995, the incidence of suicide among adolescents and young adults nearly tripled. The suicide rate for children in the United States is twice that of the average in other industrialized countries.

Suicide Rate: Selected Industrialized Countries



More guns, more suicides. The cross-country comparison does not show a strong relationship between the suicide rate and guns, but other evidence supports the conclusion that in the United States suicide is more likely to occur when guns are present, especially among youth. For example, comparisons of suicide attempts with suicide deaths demonstrate that having a gun in the home increases the likelihood of suicide death among adolescents. Similarly, state gun ownership rates in the 1990s are strongly correlated with state suicide rates in 1997 (see lower chart). The fact that overall suicide rates, and not just the incidence of gun suicides, is correlated with gun ownership suggests that guns are not merely another means of committing suicide, but instead contribute to the total incidence of suicides.

1997 Suicide Rate and Gun Ownership



EYES ONLY

Guns are different. A gun is an especially lethal means of suicide. One Canadian study found that 92 percent of suicide attempts using guns resulted in death compared with 78 percent for carbon monoxide and 23 percent for drug overdoses. Considering that an estimated 8 to 25 attempts are made for each suicide, the lethality of gun suicide suggests that the prevalence of guns may increase the rate of suicide death. Furthermore, evidence that suicide attempts are often impulsive, especially for youth, implies that guns may increase the overall suicide rate.

Conclusion. Research indicates that the prevalence of guns may lead to more deaths by suicide than would otherwise be the case. Moreover, with approximately one-third of handguns stored loaded and unlocked, guns present a risk not just to the owner, but to family and friends as well. Not surprisingly, one study finds that the majority of young people attempting suicide with a firearm used a parent's gun. One potential means of reducing such tragedies is to restrict access to firearms through secure storage and "smart gun" technologies.

EYES ONLY

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

Long Work Hours Have Small Effect on Divorce. Many believe that long work hours are a major contributing factor to divorce; however, a study concludes that while long hours do have some effect on the divorce rate, their importance may not be as large as commonly thought. Adding 10 hours to a married man's work week raises the probability of divorce within 2 years by between one-tenth and one-half of 1 percentage point while increasing a wife's hours by the same amount leads to an increase of two-tenths of 1 percentage point, according to a recent study. Income is also a determinant of divorce; an increase in the husband's income decreases the probability of divorce whereas an increase in the wife's income raises the probability of divorce. The author notes, however, that it is often difficult to establish whether long hours are the cause or the effect of a divorce. People who are getting divorced may work long hours for financial reasons, or to avoid their spouse.

States Offer Housing Subsidies in Welfare to Work Programs. In the last 2 years, several states and two counties in California have used Federal TANF or state Maintenance of Effort funds to establish programs providing housing assistance to families attempting to make the transition from welfare to work. Research suggests that affordable housing can be an important component of economic self-sufficiency. Recent studies have shown that families who receive housing subsidies work more hours and have greater earnings than families without such assistance. One possible explanation is that housing subsidies help stabilize the lives of low-income families by preventing repeated moves, thereby improving their ability to secure and retain jobs. Also, housing subsidies allow families to move to areas with greater job opportunities and free up funds for work-related expenses such as child-care, work clothes, and transportation.

Are Oil Shocks Inflationary? A recent study suggests that although changes in oil prices affected overall inflation, they had little effect on core CPI (CPI excluding food and energy) inflation during the 1980s and 1990s. In contrast, oil price changes were found to contribute substantially to core inflation in the 1960s and 1970s. An oil price hike can, in principal, initiate a wage-price spiral as the increase in energy costs causes workers to demand higher wages to protect their standards of living; businesses, facing higher energy and wage costs, are then under pressure to raise prices to preserve profit margins. In the 1970s and early 1980s, the greater prevalence of automatic cost-of-living adjustments (COLAs) indexed to the rate of inflation may have facilitated this process of escalating wage and price increases. In addition, energy used to make up a much larger share of consumer spending then it does today. Another possible explanation for the change in behavior of core inflation is that monetary policy became much less accommodative of oil price shocks during the last two decades. In this view, the Fed reacted quickly to snuff out incipient inflationary pressures resulting from oil price changes. If this pattern continues, this research suggests that the recent rise in oil prices should have little effect on core inflation, even as overall inflation rises for a time.

INTERNATIONAL ROUNDUP

Participatory Democracy Brings High-Quality Growth. To receive the full benefits of a market economy, countries need a supportive institutional framework—one that, among other things, protects property rights, curbs corruption and anti-competitive behavior, and mitigates risks and social conflicts. A recent study examines how developing countries may acquire the appropriate institutions to facilitate market-based development and argues that it is important to recognize the importance of "local knowledge." It argues that strategies for institution-building must not over-emphasize an inflexible best-practice "blueprint" at the expense of experimentation at the local level. Furthermore, the study presents evidence that, compared with other political regimes, participatory democracies are associated with more predictable and stable growth, greater resilience to shocks, and a better income distribution. It concludes that participatory political systems are more effective at incorporating local knowledge, and recommends democracy as a general strategy for building good institutions to support economic development.

UNDP on China's Human Development. The latest China's Human Development Report released by the United Nations Development Program examines how the how the movement toward a market-based economy and the relaxation of state controls have affected people's livelihoods in China. Since reforms began in 1978, individuals have gained increased freedom in their daily lives as well as greater access to goods, services, and information; indicators of life expectancy, health, and literacy have also continued to improve. However, the report notes that despite rapid growth and substantial efforts in rural poverty alleviation, major challenges remain. Urban unemployment and poverty have surged. This development is in part attributable to increasing migration from rural to urban areas and to the reform of state-owned enterprises, which has led to layoffs of millions of state employees. Moreover, the disintegration of the social safety net is a growing cause of concern for the more socially vulnerable groups, including the aged, the ill, and the unemployed.

Agricultural Performance Weak in Africa. Africa was the only region in the developing world where per capita food production declined between 1961 and 1997, putting the food security of a large segment of the population in a precarious position. Growth rates in crop yields over that period lagged behind those of other developing regions, and Africa's market share for traditional export crops fell significantly. A new report by the UN Food and Agriculture Organization (FAO) attributes the declining performance of agriculture in Africa to price distortions, overvalued currencies, and abnormally low investment in infrastructure and institutional development. Agriculture in sub-Saharan Africa accounts for 70 percent of total employment, 40 percent of merchandise exports, and 34 percent of GDP, yet it received less than 10 percent of public expenditures over 1961-97. To increase productivity, the FAO proposes that African governments focus investment on infrastructure such as irrigation, dams, and transportation as well as providing better market information.

EYES ONLY

RELEASES THIS WEEK

Gross Domestic Product

****Embargoed until 8:30 a.m., Friday, February 25, 2000****

According to revised estimates, real gross domestic product grew at an annual rate of 6.9 percent in the fourth quarter of 1999.

Advance Durable Orders

Advance estimates show that new orders for durable goods decreased 1.3 percent in January, following an increase of 6.3 percent in December.

MAJOR RELEASES NEXT WEEK

Consumer Confidence—Conference Board (Tuesday)
NAPM Report on Business (Wednesday)
Leading Indicators (Thursday)
Employment (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	**4.5**	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**	**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	0.2	0.2	0.2
PPI-Finished goods	5.0	3.0	0.2	0.1	0.0

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

New or revised data in **boldface**.
GDP data **embargoed until 8:30 a.m., Friday, February 25, 2000.**

EYES ONLY

FINANCIAL STATISTICS

	1998	1999	December 1999	January 2000	Feb. 24, 2000
Dow-Jones Industrial Average	8626	10465	11246	11281	10093
Interest Rates (percent per annum)					
3-month T-bill	4.78	4.64	5.20	5.32	5.63
10-year T-bond	5.26	5.65	6.28	6.66	6.36
Mortgage rate, 30-year fixed	6.94	7.43	7.91	8.21	8.31
Prime rate	8.35	8.00	8.50	8.50	8.75

INTERNATIONAL STATISTICS

Exchange Rates	**Current level February 24, 2000**	**Percent Change from Week ago**	**Percent Change from Year ago**
Euro (in U.S. dollars)	0.993	0.7	-9.5
Yen (per U.S. dollar)	111.0	0.6	-9.0
Major currencies index (Mar. 1973=100) (trade-weighted value of the U.S. $)	95.52	0.1	0.5

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)	4.0 (Jan)	2.7 (Jan)
Canada	4.2 (Q3)	6.9 (Dec)	2.6 (Dec)
Japan	1.0 (Q3)	4.6 (Nov)	-1.1 (Dec)
France	2.9 (Q3)	10.4 (Dec)	1.3 (Dec)
Germany	2.3 (Q4)	8.8 (Dec)[2/]	1.2 (Dec)
Italy	1.2 (Q3)	12.1 (Apr)	2.1 (Dec)
United Kingdom	1.8 (Q3)	5.9 (Oct)	1.8 (Dec)

U.S. GDP data **embargoed until 8:30 a.m., Friday, February 25, 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.

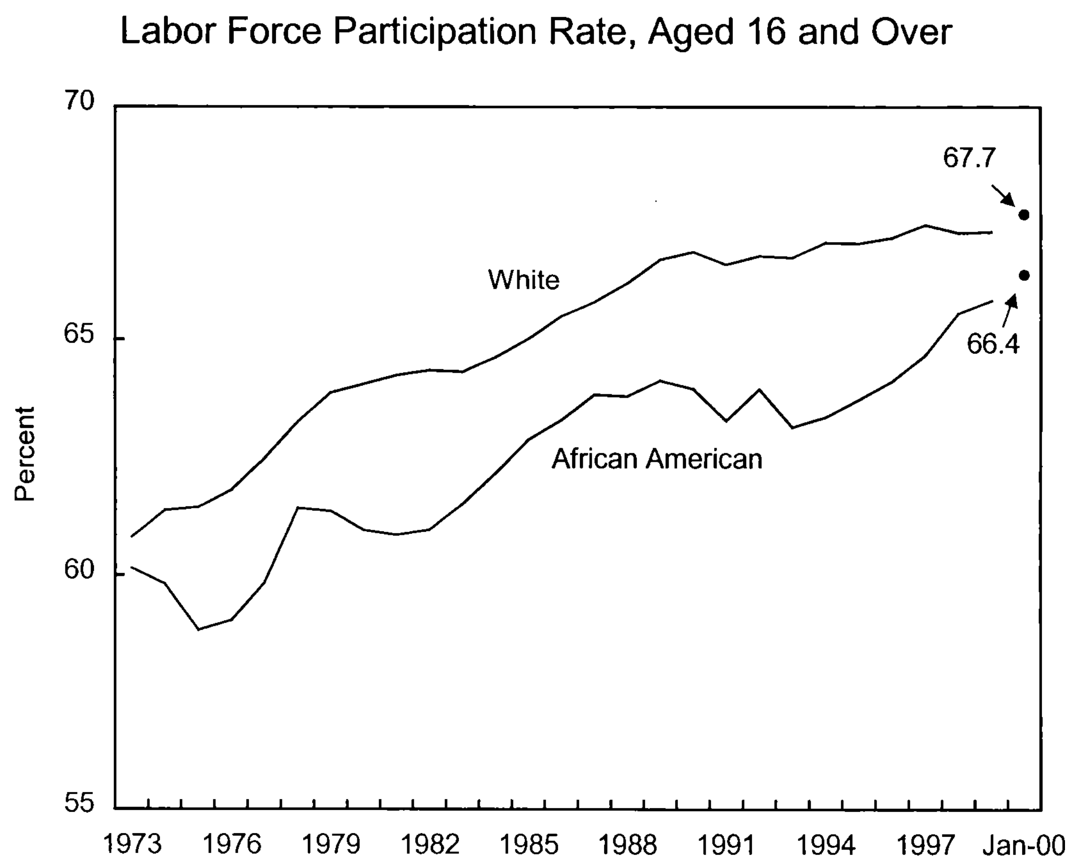
EYES ONLY

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

February 18, 2000

CHART OF THE WEEK



The labor force participation rate of African Americans has been lower than that of whites and has shown greater variability through time. However, gains in African American labor force participation in this expansion have narrowed the gap to the smallest it has been since 1973.

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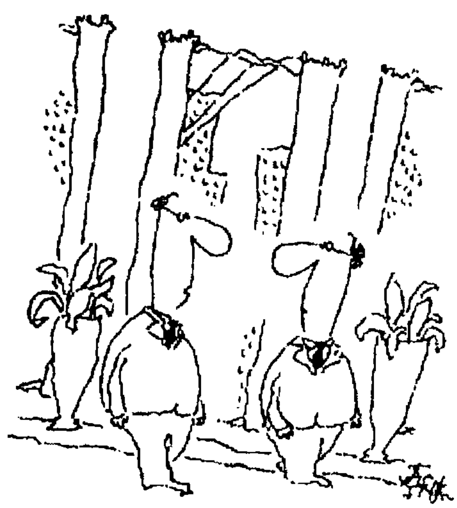
CONTENTS



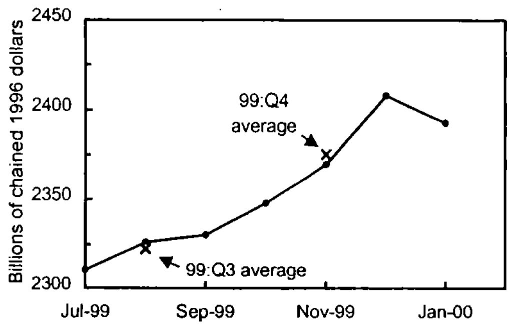
"I'd really like to fire that terrible new advisor, but he keeps advising me not to."

MACROECONOMIC UPDATE

Still Going Strong

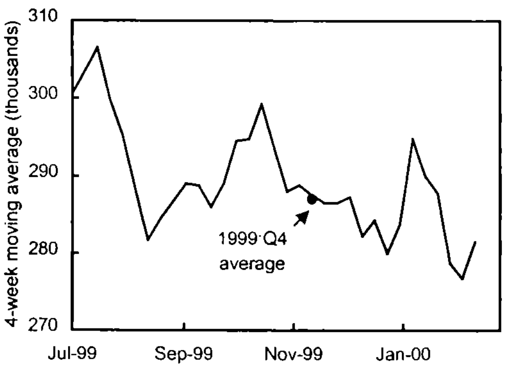
Large gains in industrial production and production-worker hours point to the first quarter being another of solid growth. Y2K effects altered the monthly pattern of activity around the turn of the year but are likely to have limited effects on the quarter. Growth in real GDP in the fourth quarter, estimated at 5.8 percent in the advance report, is likely to be revised up to about 6½ percent at an annual rate.

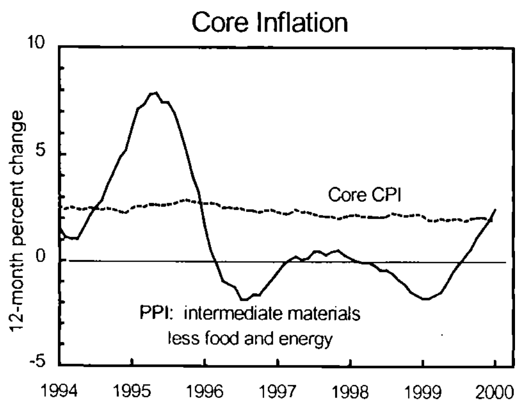
Goods Consumption Less Motor Vehicles



Note: Figures for November, December, and January are adjusted based on latest retail sales reports.

Unemployment Insurance Initial Claims





Note: Core CPI is measured by the core CPI-U-RS

Sales. Y2K effects were clear in retail sales. Real consumption of goods excluding motor vehicles rose sharply in November and December, and then declined in January (see upper chart). The swing was pronounced for sales at grocery, drug, jewelry, and furniture stores. Despite the drop, real sales of non-auto goods in January remained well above the fourth-quarter level.

Y2K and inventories. Inventory accumulation, which added 1.2 percentage points to real GDP growth in the fourth quarter, may have been boosted by the desire to buffer production against Y2K disruptions. No data are yet available for the first quarter, but a drop in stockbuilding is likely.

Other indicators. Indicators that were not obviously affected by Y2K are uniformly strong. Housing starts were up sharply in December and posted a further gain in January. Motor vehicles sold at a strong 17¾ million unit annual rate in January. Payroll employment increased 387,000 in January. And initial claims for unemployment insurance for the 4 weeks ending in mid-February stayed below the fourth-quarter level, indicating continuing strong demand for labor (see middle chart).

EYES ONLY

Inflation. Prices of commodities and intermediate goods (especially petroleum products) have accelerated sharply—likely reflecting the strength of the world economy. But core consumer prices remain low and stable in the face of the price acceleration at the earlier stages of processing (see lower chart on previous page). Labor costs outweigh all other production costs, and these have been contained by the stunning growth of productivity—which now appears to have grown in excess of 5 percent at an annual rate in the second half of 1999.

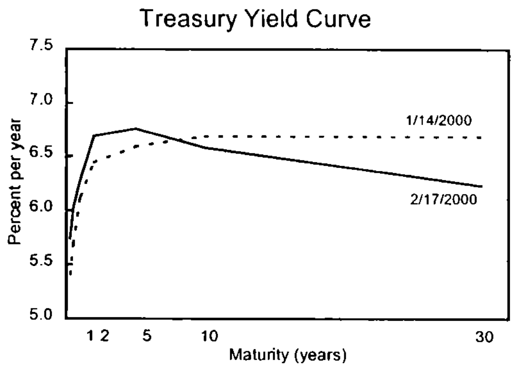
EYES ONLY

SPECIAL ANALYSIS

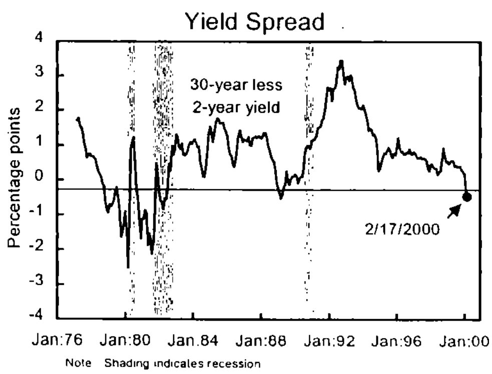
Debt Paydown, the Bond Market, and the Economy

Yields on Treasury bonds have dropped below yields on short- and intermediate-duration Treasury securities. Such an "inversion" of the yield curve usually is associated with a tightening of monetary policy and the possibility of an economic downturn. In this case, however, part of the explanation lies in the market's response to a future of declining public debt, and the macroeconomic impact so far looks to be small.

An inverted yield curve. Since mid-January, yields on 1-to-5-year Treasury securities have increased about 25 basis points, reflecting heightened concerns that the continued strength of the economy would cause the Fed to tighten further. Normally, Fed tightening causes long-term yields to rise, but by less than short-term rates, because the market expects the tightening to be temporary. In fact, however, yields on 30-year Treasury bonds have fallen about 50 basis points. These opposite movements have inverted the usually upward-sloping yield curve (see upper chart). The current inversion is atypical in that much of the action is occurring at the long end of the yield curve rather than the short end, as would be the case if the cause were entirely a tightening of monetary policy.



Supply and demand? Changes in inflationary expectations, monetary policy, and risk factors do not appear to explain fully this sharp downturn in long-term Treasury bond yields. Instead, the decline appears to be related to anticipated reductions in the relative supply of these securities. Recent fiscal projections may have focused investors' attention on the implications for debt management of growing surpluses, and in particular the future reduction in the supply of Treasury notes and bonds. Ongoing volatility in Treasury bond yields suggests that markets are still digesting the implications of reduced debt. While it is unclear whether the downward slope of the yield curve will persist, it is interesting to note that the yield curve in the United Kingdom is likewise inverted—resulting from shifts in supply and institutional demand—and that this condition has persisted for over 6 months.



Does this matter for the economy? Yield-curve inversions occurring because of restrictive monetary policy are often associated with the onset of a recession (see lower chart on previous page). In contrast, the flattening of the yield curve in 1997 resulted from a drop in long-term yields, not a rise in short-term rates, and economic growth continued to be robust in the following 2 years. Although expectations of a policy tightening have contributed to the current inversion of the yield curve, an additional cause has been the sharp decline in long-term yields, suggesting that monetary policy is not so tight as is implied by the slope of the yield curve. The fall in long-term Treasury yields does not look to have much effect on private spending, either. Thus far, there appears to have been little passthrough to private borrowing rates.

Conclusion. Recent declines in long-term Treasury bond yields appear to be related to expected reductions in the supply of these securities in an era of expanding Federal Government surpluses. So far, the macroeconomic implications of the fall in Treasury bond yields appear to be small.

ARTICLE

Recent Changes in Family Finances

As discussed last week, aggregate household debt and debt service payments have been rising faster than disposable personal income in recent years. Recent evidence suggests, however, that for most families assets have been growing even faster than debt.

The SCF. The main source of data on how financial conditions vary among families is the Federal Reserve's Survey of Consumer Finances (SCF), a survey of about 4,300 families that is conducted every 3 years, most recently in 1998. Because wealth is highly concentrated, the SCF oversamples relatively wealthy households in order to get more statistically reliable estimates of the pattern of wealth holdings. However, it explicitly excludes members of the *Forbes* 400 list of the wealthiest Americans as well as a few very famous people.

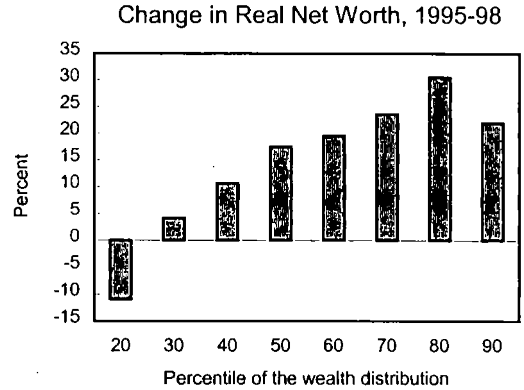
Changes in net worth. A recent Fed analysis of the latest SCF indicates that net worth—the difference between gross assets and liabilities—grew strongly between 1995 and 1998. Real median net worth rose 18 percent, to $71,600. This is 20 percent higher than in 1989, the last full year of the previous economic expansion. Mean net worth, which is more sensitive to the size of the gains in the upper part of the distribution, rose 26 percent between 1995 and 1998, to $282,500. Because some of this gain represented a recovery from a decline in mean net worth between 1989 and 1992, mean net worth in 1998 was also about 20 percent higher than it was in 1989.

Variation by income. The Fed analysis reports that these increases in net worth were broadly shared by different demographic groups, though not by all. In general, older, higher-income, and better-educated families had the largest gains. In terms of levels, 1998 median net worth ranged between $3,600 for families with income below $10,000 and $510,800 for families with incomes of $100,000 or more. Mean net worth was considerably higher in each group. Even in the lowest income category, mean net worth was $40,000—more than 10 times the median, suggesting that even among those with low incomes some proportion of families have substantial net worth relative to their income.

Variation by race. The study reports on just two categories, white non-Hispanics and all others. Levels and changes in the first group closely track those of the population as a whole. For the others, mean net worth increased almost as rapidly as for all families between 1995 and 1998, but the median actually fell slightly. This sharp divergence between the median and the mean suggests considerable variability in the recent changes experienced by non-white and Hispanic families. Since 1989, by contrast, mean and median net worth grew substantially more rapidly for these minorities than for white non-Hispanics. Nevertheless, the median net worth of white, non-Hispanic families was $94,900 in 1998, or almost six times the $16,400 of minority families.

EYES ONLY

The distribution of wealth. Wealth is distributed much more unevenly than income. In 1998, the wealthiest 10 percent of families held more than two-thirds of all wealth, and the top 0.5 percent held more than a quarter. (In the distribution of household income, by contrast, the highest income fifth received about half of aggregate income and the top 5 percent received 21 percent.) Unpublished Fed estimates show a small increase in the Gini measure of wealth inequality between 1995 and 1998, but one that is within the range of sampling error. Nevertheless, these data also show that larger percentage gains in real net worth occurred at the wealthier end of the distribution (see chart). In the wealthiest 10 percent of families, stocks and privately held businesses were the most important sources of gains and debt was relatively unimportant. In the rest of the distribution a variety of assets, including principal residences and stocks, were important. In this group, increases in debt offset about a quarter of the rise in assets.



Conclusion. Survey data on family finances show that recent rapid increases in net worth relative to income have been broadly shared. Nevertheless, the extraordinary gains in the stock market appear to have contributed to larger gains among families that in many cases were already well-off.

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

Teens Respond to Cigarette Price Hikes. An increase in the price of cigarettes has a negative impact on older teenagers' decision to smoke, indicating that raising cigarette taxes may be an effective policy to decrease youth smoking, according to a recent study. Sharp price reductions for cigarettes in the early 1990s were found to account for 30 percent of the increase in youth smoking between 1991 and 1997. Moreover, teens from traditionally socioeconomically disadvantaged groups, such as African Americans and children of less-educated parents, were found to be particularly price sensitive. In contrast, younger teens were not sensitive to price (either in their decision to smoke or in the amount they smoked), indicating that younger teenagers smoke for non-economic reasons such as experimentation or acceptance by peers. Non-price policies were found to have a mixed impact on youth smoking. There is some suggestion that laws which restrict youth access to tobacco products reduce the amount that teens smoke but do not affect their decision to smoke. In addition, the study finds little consistent evidence that clean air regulations matter for youth smoking decisions.

Malpractice Reform Increases Productivity with No Harm to Health. Reforms of medical malpractice liability law designed to reduce the level of compensation to potential claimants improve medical productivity by reducing hospital expenditures without harming patients' health, according to a recent study. Moreover, other policies that reduce non-financial costs to the doctor, such as the time spent and the amount of conflict involved in defending against a claim, may also substantially reduce hospital expenditures. The study found that malpractice pressure leads to highly significant increases in hospital expenditures by encouraging doctors to practice "defensive medicine." A 1 percentage point decrease in a physician's probability of defending against a malpractice claim in a given year results in a 2 to 3 percent decrease in real expenditures. Moreover, these changes in medical practice induced by changes in malpractice pressure do not have systematic or substantial effects on patient health outcomes, at least for the elderly heart-disease patients that were studied.

Trapped in Poor Neighborhoods? A recent study estimates that while over one-third of poor African Americans will live in a high poverty neighborhood for at least 1 year out of 10, most will not stay long. Only 7 percent will live in such a neighborhood for 10 or more consecutive years. Although only a small percentage of those who ever live in a poor neighborhood stay a long time, those who do make up the bulk of residents at any moment in time. In the study, more than three-quarters of residents in high poverty neighborhoods at any given time will likely be there for more than 10 years, and over 50 percent for more than 20 years. Moreover, many of those who do "escape" are likely to return; 40 percent of poor African Americans who leave such neighborhoods will return to one within 5 years, nearly 50 percent within 10 years. This result suggests that, for many poor African Americans, the most difficult part of escaping from high poverty neighborhoods is not moving out at a point in time, but staying out for a long duration.

INTERNATIONAL ROUNDUP

Investment in the Internet for the Developing World. In a major initiative intended to promote the digital economy in the developing world, The World Bank's International Finance Corporation (IFC) has joined with the Japanese Internet company SOFTBANK to invest in Internet businesses in about 100 developing countries. The new venture, called SOFTBANK Emerging Markets (SBEM), will commit $500 million to global Internet development. SBEM will invest seed money in new Internet enterprises and provide an array of technological, legal, and management support to help turn ideas into solid businesses. The initiative will seek to improve Internet access in targeted countries by generating investor interest in emerging markets, which should help lower the price of Internet access and increase the number of subscribers. It will also promote free or subsidized Internet service to schools and other educational institutions.

Development Assistance Rises in the OECD. After more than 5 years of continuous decline, net Official Development Assistance (ODA) by the 21 Development Assistance Committee (DAC) countries of the OECD rose in 1998 by nearly 10 percent in real terms, to $52 billion. Over 60 percent of this increase was accounted for by jumps in bilateral loans and emergency and distress relief. Despite this increase, the ratio of ODA relative to income in the DAC has fallen to 0.25 percent, well below the 0.33 percent average maintained in the 1970s and 1980s. The United States, which gave nearly $9 billion in 1998, was the second largest net donor of ODA; however, it devoted just 0.10 percent of its GNP to ODA, the lowest in the DAC. About half of total ODA in 1998 went toward education, health, and other social and economic infrastructure, with debt relief accounting for 9 percent.

Multinationals Cautiously Optimistic about Investment in Africa. A recent survey of 63 of the world's largest multinational firms by the International Chamber of Commerce and the United Nations Conference on Trade and Development reveals that companies are generally optimistic about investment opportunities in Africa. One-third of firms surveyed expect to increase investment in Africa over the next 3 to 5 years, while more than half expect their investment to remain at present levels. Only 6 percent plan to decrease their investment or pull out of Africa altogether. The growth and size of local markets and the profitability of FDI were the most commonly cited factors influencing investment positively, while the prevalence of bribery was by far the most cited discouraging factor. South Africa was the most attractive country for FDI in Africa, followed by Egypt, Morocco, and Nigeria. Several least developed countries, including Ethiopia, Mozambique, Uganda, and Tanzania, were among the nations expected to make the most progress in creating a business-friendly environment and thus were also seen as attractive destinations for FDI.

EYES ONLY

RELEASES THIS WEEK

U.S. International Trade in Goods and Services

****Embargoed until 8:30 a.m., Friday, February 18, 2000****

The goods and services trade deficit declined to $25.5 billion in December from $27.1 billion in November. For 1999, the goods and services trade deficit was $271.3 billion; for 1998, the deficit was $164.3 billion.

Consumer Price Index

****Embargoed until 8:30 a.m., Friday, February 18, 2000****

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

Producer Price Index

The producer price index for finished goods was unchanged in January. Excluding food and energy, producer prices fell 0.2 percent.

Housing Starts

Housing starts rose 2 percent in January to 1.775 million units at an annual rate.

Industrial Production and Capacity Utilization

The Federal Reserve's index of industrial production increased 1.0 percent in January. Capacity utilization rose 0.5 percentage point to 81.6 percent.

MAJOR RELEASES NEXT WEEK

Advance Durable Shipments and Orders (Thursday)
Gross Domestic Product (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	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	14.1
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	**0.2**	0.2	**0.2**
PPI-Finished goods	5.0	3.0	**0.2**	**0.1**	**0.0**

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

New or revised data in **boldface**.
CPI data **embargoed until 8:30 a.m., Friday, February 18, 2000**.

EYES ONLY

FINANCIAL STATISTICS

	1998	1999	December 1999	January 2000	Feb. 17, 2000
Dow-Jones Industrial Average	8626	10465	11246	11281	10515
Interest Rates (percent per annum)					
3-month T-bill	4.78	4.64	5.20	5.32	5.57
10-year T-bond	5.26	5.65	6.28	6.66	6.58
Mortgage rate, 30-year fixed	6.94	7.43	7.91	8.21	8.38
Prime rate	8.35	8.00	8.50	8.50	8.75

INTERNATIONAL STATISTICS

Exchange Rates	**Current level February 17, 2000**	**Percent Change from**	
		Week ago	**Year ago**
Euro (in U.S. dollars)	0.986	-0.0	-12.2
Yen (per U.S. dollar)	110.3	1.4	-7.4
Major currencies index (Mar. 1973=100) (trade-weighted value of the U.S. $)	95.38	0.4	1.9

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	4.2 (Q4)	4.0 (Jan)	**2.7** (Jan)
Canada	4.2 (Q3)	6.9 (Dec)	2.6 (Dec)
Japan	1.0 (Q3)	4.6 (Nov)	-1.1 (Dec)
France	2.9 (Q3)	10.4 (Dec)	1.3 (Dec)
Germany	1.3 (Q3)	8.8 (Dec)[2]	1.2 (Dec)
Italy	1.2 (Q3)	12.1 (Apr)	2.1 (Dec)
United Kingdom	1.8 (Q3)	5.9 (Oct)	1.8 (Dec)

U.S. CPI data **embargoed until 8:30 a.m., Friday, February 18, 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

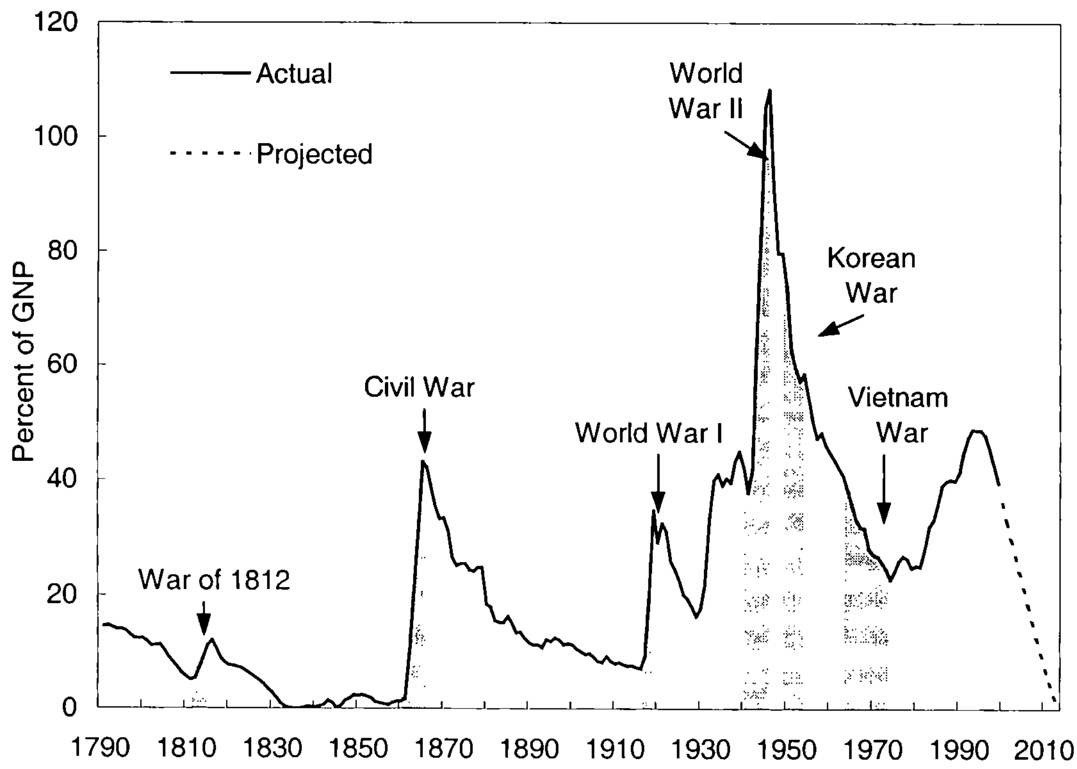
WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

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

February 11, 2000

CHART OF THE WEEK

Federal Debt Held by the Public as a Percent of GNP, 1791-2013



Publicly held Federal debt relative to GNP has generally risen sharply in times of war, and otherwise has tended to decline. Two notable exceptions are the Vietnam War when the debt-GNP ratio fell, and the 1980s and early 1990s, when the debt-GNP ratio rose steadily although the country was mostly at peace. Projections are based on the 2001 Budget. GNP data for 1791-1868 are very rough estimates.

EYES ONLY

CONTENTS

"Go ask your search engine."

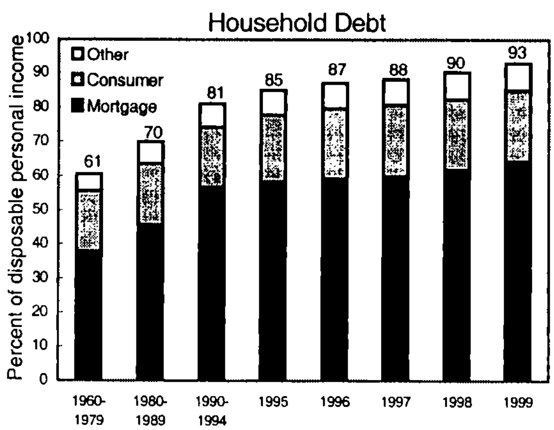
EYES ONLY

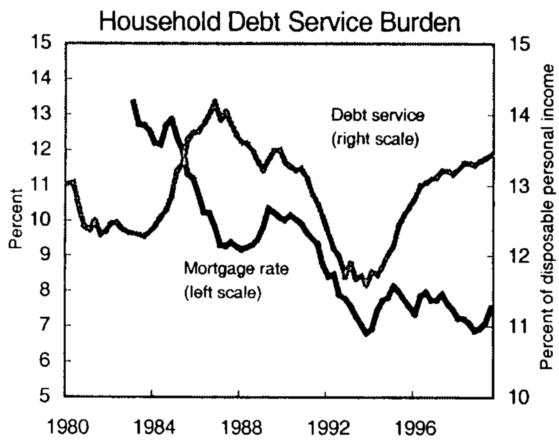
CURRENT DEVELOPMENT

The Financial Condition of Households

Consumer debt increased 7.6 percent in 1999, well above the 5.4 percent increase recorded in 1998. Total household debt (including home mortgages and other debt) increased 9 percent at an annual rate over the first three quarters of 1999 (the latest period for which data are available), up a bit from the rate of increase in 1998. Real estate loan delinquency rates remain low and stable while the number of personal bankruptcies fell for the first time in 4 years.

Trends in household debt. Household debt increased more than 3 percentage points faster than disposable personal income in 1999. Although household debt has been growing faster than disposable income for most of the postwar period, the divergence in these growth rates has been more pronounced over the last 2 years. As a result, the level of household debt reached about 93 percent of disposable personal income in 1999 (upper chart). Growth in non-consumer debt, although strong, is well below the torrid pace witnessed in the mid-1990s. The composition of household debt has shifted over time with mortgages now accounting for nearly 69 percent of household debt, up about 4 percentage points from the 1980s.





Debt service burden. The ratio of debt service to disposable income reached 13.4 percent in the third quarter of 1999, slightly above the 20-year average of 12.9 percent (lower chart). The recent rise in the debt service burden reflects rising debt levels and a pickup in interest rates on car loans and home mortgages. Looking forward, further increases in interest rates would likely push the debt service burden upward.

Indicators of financial distress. The real estate loan delinquency rate remained below 2 percent through the first three quarters of 1999 and has been trending downward since peaking at over 7½ percent in 1991. The delinquency rate for non-mortgage consumer loans remained stable at about 3¾ percent. Based on preliminary data, there were 1.3 million personal bankruptcies in 1999—112,000 fewer than in 1998. This marks a reversal of the trend that saw bankruptcies rise by nearly 80 percent from 1994 to 1998.

Conclusion. Although growth in household debt continues to outstrip that of income, loan delinquency rate has remained stable and personal bankruptcies have fallen sharply. With debt service burdens already high, however, a drop-off in income growth or an increase in interest rates could put pressure on household finances.

EYES ONLY

SPECIAL ANALYSIS

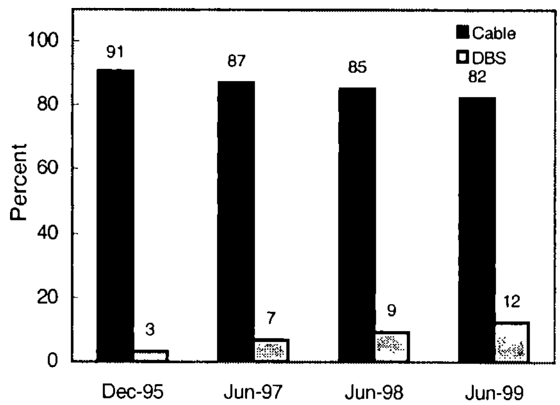
Competition for Cable TV

The Federal Communications Commission recently released its sixth annual report assessing the status of competition in markets for the delivery of video programming. The report finds that competition to cable from direct broadcast satellite (DBS) is growing, and that cable prices are not escalating as rapidly as in the past.

Cable TV and DBS. Cable TV has been the dominant technology for delivering multichannel programming, but the superior quality of DBS technology appears to be eroding cable's market share. Historically, cable systems have been based on analog technology that limits the number of channels available to subscribers. DBS operators use satellites to transmit digital programming to their subscribers' small dishes. This digital technology enables DBS to deliver more channel capacity than many cable systems, digital quality pictures, and specialized programming. In response to this new competitor, cable providers have been investing in upgrading their systems and offering more channels using digital technology. According to cable industry data, while about 64 percent of all cable subscribers are served by systems with 54 or more channels, only about 5 percent of cable subscribers are served by systems with more than 90 channels. By comparison, DBS firms are able to offer packages with more than 100 channels of programming.

Market share shifts. Since 1995, cable's share of the multichannel programming market has declined from 91 percent to 82 percent (see chart). At the same time, DBS technology has grown from just 3 percent to about 12 percent of the market. Although DBS gets a number of customers from areas not served by cable, about 60 percent of its customers have access to cable. The largest DBS operator (DirecTV) has about 9 percent of all multichannel subscribers, which makes it the third largest multichannel programming provider after AT&T and Time Warner.

Cable and DBS Market Shares



Cable prices. Between December 1998 and December 1999, cable prices increased 2.8 percent, far less than the 6.9 percent increase between December 1997 and 1998. Part of these rate increases were driven by higher prices for programming, which increased about 15 percent between 1998 and 1999. Cable firms have also been investing heavily in upgrading their systems, and are expected to have spent nearly $7 billion on system rebuilds and upgrades during 1999.

DBS competition and improved cable service. Direct evidence of competition's effect on reducing cable prices comes from areas where one cable system "overbuilds" another, and then competes head-to-head for the same customers. Examples of overbuilds, however, are comparatively rare. Because DBS is available nationwide, it is difficult to discern the direct effect of DBS competition on cable rates. Nonetheless, competition from DBS. for cable does appear to provide an incentive for cable providers to upgrade their systems to compete with the greater number of channels offered by DBS.

Recent changes brought about by SHVIA. Until recently, one of the principal limitations of DBS service was the inability to offer local broadcast channels via satellite. With the signing of the Satellite Home Viewer Improvement Act (SHVIA) in November 1999, satellite providers can now retransmit local broadcasts into local markets. DBS providers now offer local TV broadcasts in a number of major cities, making further inroads into cable TV's market share likely as competition among multichannel program providers intensifies.

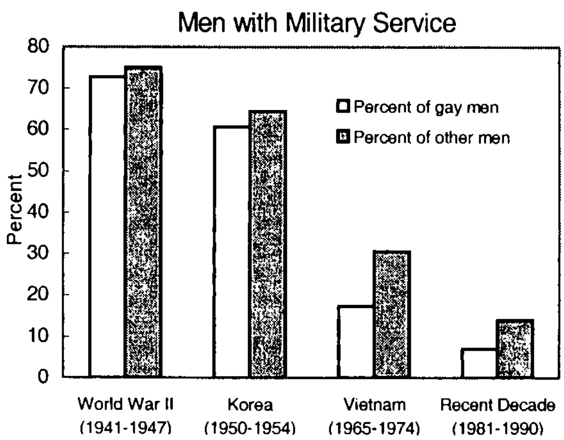
SPECIAL ANALYSIS

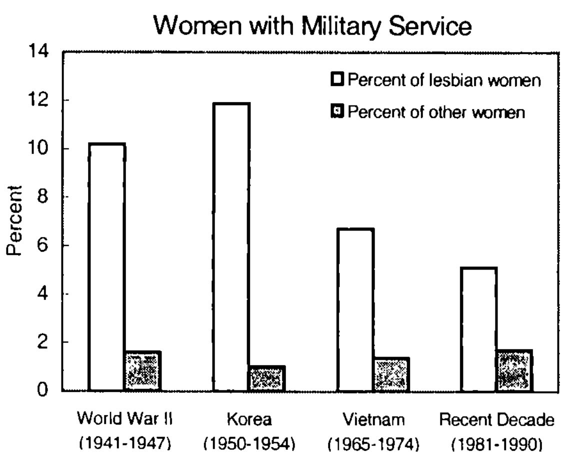
Historical Trends of Gays and Lesbians in the Military

Over the past several decades many gay men and lesbian women have served in the United States military. Until very recently, though, there has been virtually no demographic research to document even basic facts about this record of service.

Rates of military service. In a survey of several thousand adults conducted from 1988 to 1994, about 17 percent of gay men indicated that they had served in the military, compared with 32 percent of heterosexual men. About 8 percent of lesbian women had served in the military, compared with 1.4 percent of heterosexual women. Analysis of same-sex partners in the 1990 Census yields patterns of military service that mirror the survey results (though it is not possible with Census data to examine non-partnered gays and lesbians).

Cohort analysis of military service for men. Cohort analysis of the same-sex partner data from the Census reveals some interesting trends in military service. Gay men who reached draft age (age 18) during the World War II or Korean Conflict eras served in the military in nearly the same proportions as other men. In addition, during these eras the average number of years of service was only slightly lower for gay military men than for other men. The rate of military service has been falling for men in general over the past several decades, and has been falling more rapidly for gay men. Among men turning age 18 from 1981 to 1990 the fraction of gay men with military service was about half as large as for other men, and the length of service was about 1 year shorter.





Cohort analysis of military service for women. Among partnered lesbian women who turned 18 during the World War II and Korean Conflict eras, more than 10 percent served at some time in the military. Among other women in these cohorts, less than 2 percent served at some time. Moreover, lesbian military women accumulated far more years of duty than other women. Among women turning 18 during the Korean Conflict era, for instance, lesbian servicewomen averaged 3.5 years compared with 0.6 years for other women.

Indeed, in the Korean and Vietnam Conflict eras, average years of service for lesbians in the military were similar to the number of years served by men. More recently, there has been a narrowing in the large differences between lesbian women and other women in military service rates, perhaps as a result of changes in military policy that previously barred married women and pregnant women from service.

Conclusion. Best estimates indicate that gays and lesbians make up less than 5 percent of the population. Nonetheless, the service record of this group is of considerable interest. Large numbers of gays and lesbians have served in the U.S. military—many, no doubt, with honor and distinction. Gay men were about as likely as other men to serve in the military during World War II and the Korean Conflict eras, periods when a high percentage of young men were drafted. Lesbian women were more likely to serve than other women during these periods. Indeed, over this span gays and lesbians combined served in the military in higher proportion than heterosexual individuals. However, younger cohorts of gay men are much less likely than other men to have military service, and traditionally high service rates for lesbian women have also declined. Changing social norms about gay "openness" combined with the military policy on sexual orientation and the conversion to an all-volunteer military have likely contributed to these trends.

EYES ONLY

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

BP Amoco/Arco Merger Challenged by FTC. The Federal Trade Commission announced last week that it would challenge the proposed merger between BP Amoco and Arco. The FTC argues that the merger would lessen competition in the exploration and production of Alaskan crude oil and in its sale to West Coast refineries. Some West Coast refineries specialize in processing Alaskan crude oil, and the combined company could use its 75 percent share of Alaskan oil production to raise prices by restricting the supply of Alaskan crude oil. The FTC argues that BP Amoco discriminates in price among these refiners, charging the highest price to refiners that have the least ability to substitute for Alaskan oil while charging lower prices to those with more flexibility. The FTC's next step will be to seek a preliminary injunction in court to stop the merger. A crucial issue for the court will be determining whether the market for Alaskan crude oil on the West Coast is distinct from the world market. If crude oil from the rest of the world can be readily substituted for Alaskan crude, then BP Amoco would be unable to use its control of Alaskan oil to raise prices without encouraging imports from other sources.

Welfare-to-Work May Not Be Enough. According to a study which has received much attention recently (but has not yet been published in full), welfare reform's goal of improving child outcomes is unlikely to succeed unless several factors are addressed. Despite evidence that high-quality child care can improve early learning, the quality of child care used by the study's sample of current and former welfare mothers was generally quite low. In center-based care, educational materials were often scarce and little reading or storytelling was observed. In home-based care, where most children were placed, there were even fewer educational materials, and much greater use of television and videos. In addition, these children's early learning and development may be limited by uneven parenting practices and high rates of maternal depression. Although the authors acknowledge that they cannot draw causal links between welfare reform and poor child development outcomes, they argue that welfare-to-work alone may not improve children's well-being without addressing these deeper issues.

Why Don't Households Save? Vast differences exist in the wealth holdings of American households with a large percentage arriving close to retirement with little or no wealth, according to a recent study using data from the Health and Retirement Survey. One quarter of households where the respondent was between 50 and 61 years of age had less than $30,000 in net worth, and one-tenth had a net worth of $850 or less. Moreover, savings are often invested in low-return assets: nearly one-half of these households do not own any stocks, bonds, or real estate. Planning for retirement appears to be one predictor of wealth: households who plan accumulate significantly more wealth by retirement age. Unfortunately, about one-third of households nearing retirement have done little or no planning for retirement. Factors that tend to raise the likelihood of retirement planning include education level, being married, and having a sibling older than 62.

EYES ONLY

INTERNATIONAL ROUNDUP

Oil Prices in 2000 May be Higher than Previously Expected. The U.S. Energy Information Administration (EIA) recently raised its average crude oil price forecast for 2000 by $2 per barrel, assuming continued decline in world petroleum inventories and greater compliance by OPEC to targeted cuts. Prices in the futures market showed a similar pattern. The EIA still expects that OPEC production will increase substantially in 2000, although more slowly than previously projected. If OPEC production does expand as assumed, crude oil prices should gradually recede in the second half of 2000 after remaining relatively high for the first half of the year. The average cost per barrel of crude oil imported into the United States (a broad gauge of international oil costs) is projected to fall from around $25 per barrel this January to about $22.50 per barrel by January 2001, and continue to fall the rest of that year. On average, world demand will still exceed production this year, so a net withdrawal from inventories worldwide is expected. However, year-over-year declines in stocks are expected to end during the second half of 2000.

Japan's Economy Continues to Struggle. Japan's Economic Planning Agency said this week that the economy is likely to have contracted during the fourth quarter of 1999. This follows on the heels of the third quarter's 4 percent (annual rate) decline in real GDP. Recent high-profile job cuts, lower year-end bonuses, and falling wages are thought to have contributed to a sharp drop-off in December household spending, making 1999 the seventh straight year of decline. On a more positive note, industrial production rose in the fourth quarter of last year, and data released yesterday showed a larger-than-expected gain in private industrial machinery orders in December 1999, boosting hopes that higher private capital investment will bolster the economy.

FDI Flows Rose Sharply in 1999. Worldwide flows of foreign direct investment (FDI) rose 25 percent in 1999 to a record $827 billion, according to preliminary estimates by United Nations Conference on Trade and Development. This increase follows a 41 percent jump in 1998, and marks a more than doubling of FDI flows over the last 3 years. In the industrialized countries cross-border mergers and acquisitions have become the primary mode of entry into foreign markets, and are growing in importance in developing countries. In 1999, the United Kingdom overtook the United States as the largest outward investor for the first time since 1988, while the United States likely remained the world's largest recipient of foreign direct investment. FDI flows to developing countries rose last year by 15 percent after stagnating in 1998, with China the largest recipient at $40 billion.

EYES ONLY

RELEASES THIS WEEK

Retail Sales

****Embargoed until 8:30 a.m., Friday, February 11, 2000****

Advance estimates show that retail sales rose 0.3 percent in January following an increase of 1.7 percent in December. Excluding sales in the automotive group, retail sales declined 0.3 percent following an increase of 1.9 percent.

Productivity

Nonfarm business productivity rose 5.0 percent at an annual rate in the fourth quarter of 1999. Manufacturing productivity rose 10.7 percent.

MAJOR RELEASES NEXT WEEK

Industrial Production and Capacity Utilization (Tuesday)
Housing Starts (Wednesday)
Producer Prices (Thursday)
Consumer Prices (Friday)
U.S. International Trade in Goods and Services (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	**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	14.1
Personal saving	6.6	1.7	1.8	1.5	1.4
Federal surplus	-2.8	N.A.	1.3	1.4	N.A.

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Unemployment Rate (percent)	6.7**	4.2**	4.1	4.1	4.0
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increase per month			257	316	387
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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**.

EYES ONLY

FINANCIAL STATISTICS

	1998	1999	December 1999	January 2000	Feb. 10, 2000
Dow-Jones Industrial Average	8626	10465	11246	11281	10644
Interest Rates (percent per annum)					
3-month T-bill	4.78	4.64	5.20	5.32	5.50
10-year T-bond	5.26	5.65	6.28	6.66	N.A.
Mortgage rate, 30-year fixed	6.94	7.43	7.91	8.21	8.36
Prime rate	8.35	8.00	8.50	8.50	8.75

INTERNATIONAL STATISTICS

Exchange Rates	Current level February 10, 2000	Percent Change from Week ago	Year ago
Euro (in U.S. dollars)	0.987	-0.2	-12.9
Yen (per U.S. dollar)	108.7	0.8	-5.0
Major currencies index (Mar. 1973=100) (trade-weighted value of the U.S. $)	94.99	0.4	2.9

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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2/ Rate for unified Germany.

EYES ONLY

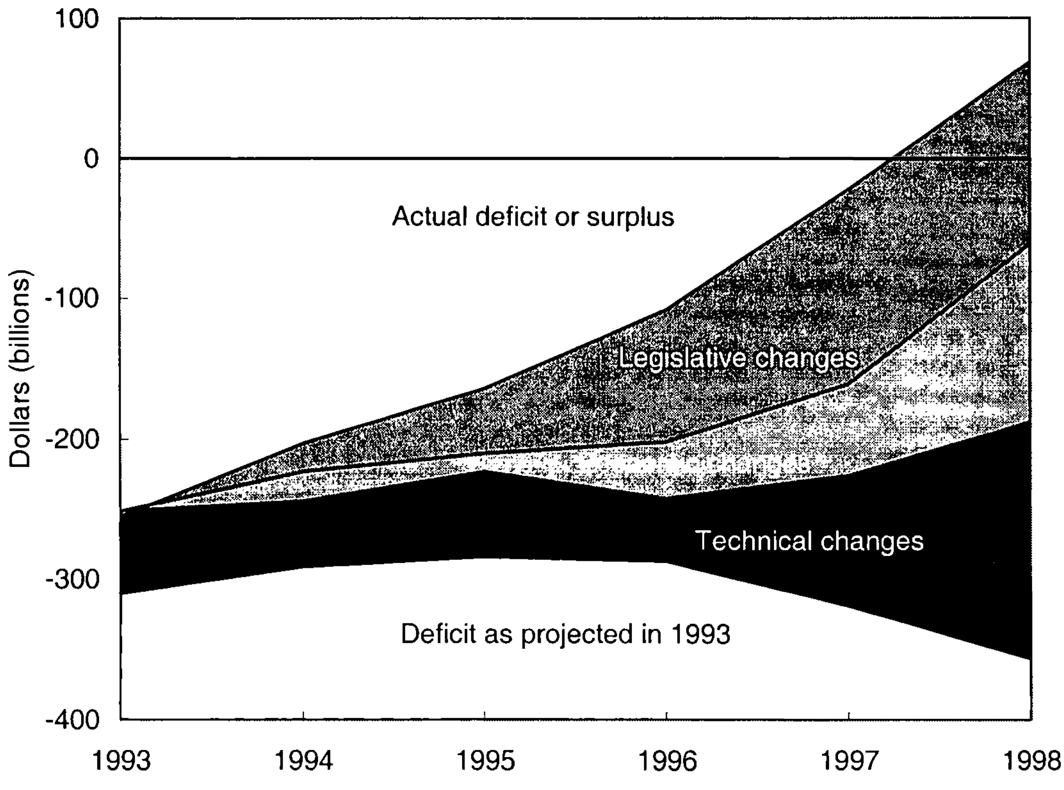
WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

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

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).

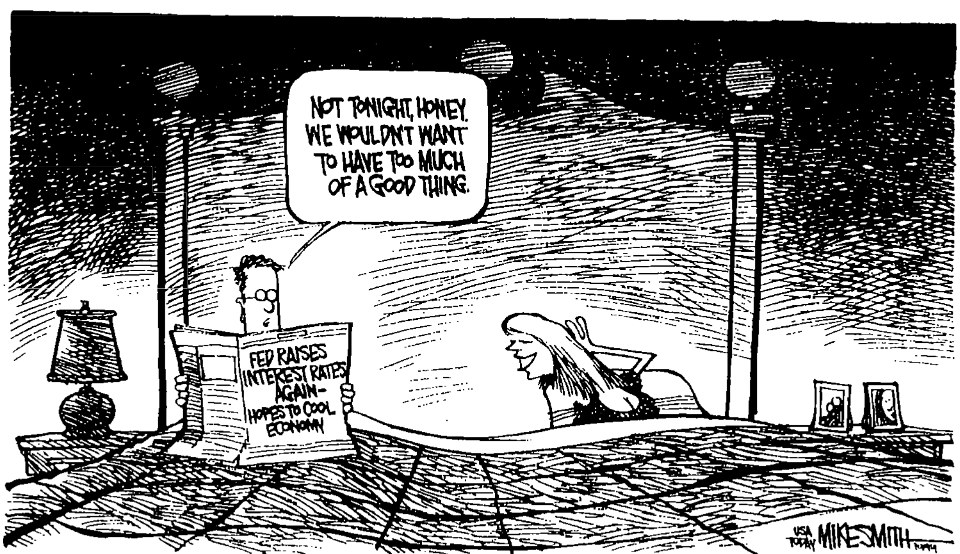
CONTENTS

EYES ONLY

CURRENT DEVELOPMENT

ARTICLE

DEPARTMENTS



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

EYES ONLY

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.

EYES ONLY

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.

EYES ONLY

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.

EYES ONLY

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.

EYES ONLY

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.

EYES ONLY

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.

EYES ONLY

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.

EYES ONLY

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

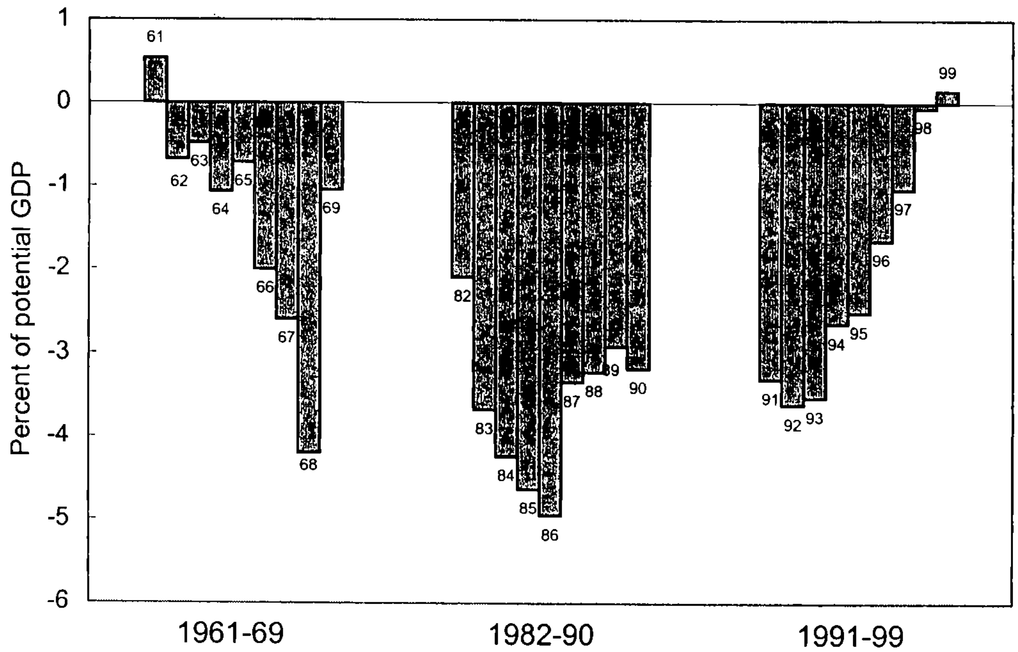
WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

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

January 14, 2000

CHART OF THE WEEK

The Structural Budget Balance in Three Long Expansions



The structural budget balance has moved steadily from deficit to surplus over the last 7 years of this expansion. In the 1961-69 expansion, by contrast, the structural deficit grew larger until the 1968 tax increase; and the structural deficit was large throughout the 1982-90 expansion. (The structural deficit reflects adjustments to the deficit to remove cyclical and temporary factors; it measures what the deficit would be at full employment.) A Special Analysis in this Briefing discusses other indicators of fiscal restraint in this expansion.

EYES ONLY

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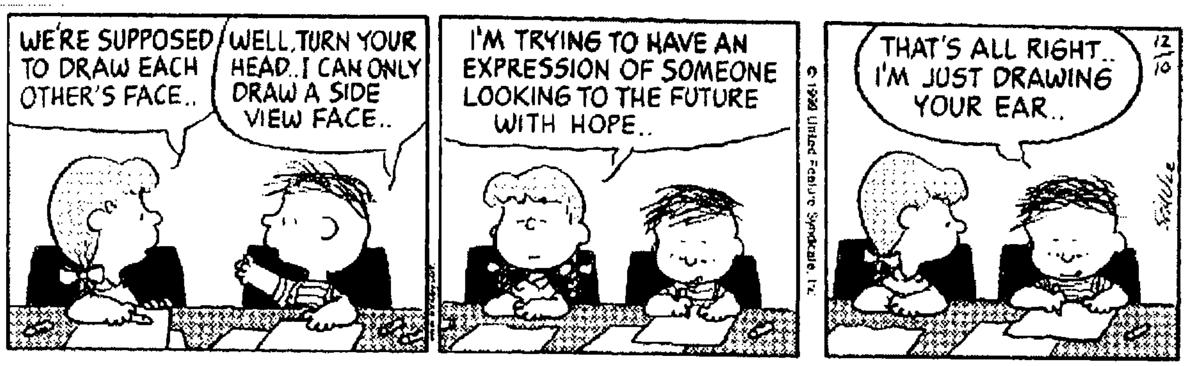
DEPARTMENTS



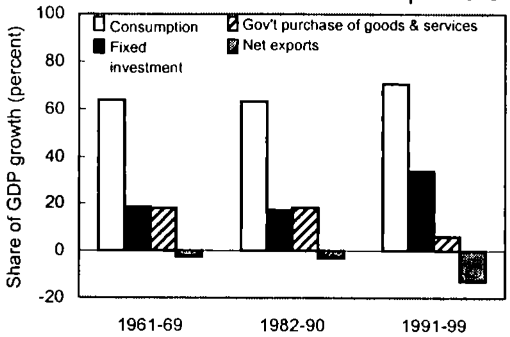
SPECIAL ANALYSIS

Fiscal Discipline and Economic Growth

As shown in the Chart of the Week, the decline in the structural budget deficit in this expansion has been unusual compared with what happened in the other two long expansions. This reflects an unusual decline in federal expenditures relative to GDP.

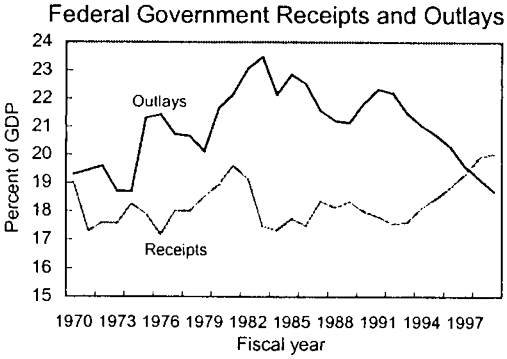
Contributions to growth. Growth in GDP can be disaggregated into the contributions of the major demand components: consumption, investment, government purchases, and net exports. In this expansion, the proportion of growth represented by consumption (the largest component of GDP) has been a little higher than in the other long expansions and the negative contribution of net exports has been larger (see upper chart). The difference that reflects fiscal discipline, however, is the relatively small contribution from government and the relatively large contribution from private fixed investment. Moreover, the modest contribution of government is entirely accounted for by growth in state and local spending: federal purchases of goods and services were smaller in 1999 than they were in 1991 after adjusting for inflation.

Contributions to Economic Growth in Expansions



Federal expenditures and revenues. Total federal expenditures, which include Social Security and other transfers in addition to purchases of goods and services, fell from 22.3 percent of GDP in 1991 to 19.0 percent in 1999 (see lower chart). This decline of 3.3 percentage points is more than twice the decline of 1.3 percentage points during the 1982-90 expansion. Moreover, the decline in spending in the 1980s was associated with a decline in revenues (as a share of GDP), whereas the decline in the current expansion occurred during a period of rising revenues. This contradicts the view that increases in government revenue simply invite a corresponding increase in spending.

Federal Government Receipts and Outlays



Analysis. Budget deficits can be useful in stimulating the economy when private demand is weak. And arguably they served that role in the early stages of the 1960s and 1980s expansions. However, fiscal restraint was applied too late to prevent a sharp rise in inflation later in the 1960s expansion. It was never a feature of the 1980s expansion, and the combination of loose fiscal policy and tight monetary policy was associated with relatively high real interest rates and declining saving and investment. In the current expansion, by contrast, fiscal discipline has allowed monetary policy to accommodate strong growth with low inflation. Interest rates have been lower than they would have been without fiscal discipline, and investment has flourished.

EYES ONLY

SPECIAL ANALYSIS

Bugs Bunny Online: Not a Mickey Mouse Merger

America Online (AOL) and Time Warner agreed to merge this week in a stock deal that combines an older media franchise with one of the better known players in the new world of the Internet. In this "merger of equals," AOL is far smaller than Time Warner in terms of revenue ($1.5 billion versus $6.7 billion in the third quarter of 1999). Nevertheless, with its higher market value, AOL was able to offer to buy out Time Warner shareholders while leaving AOL shareholders with 55 percent of the shares in the new AOL Time Warner.

AOL's dilemma. AOL is an Internet service provider (ISP) that also supplies its own content to more than 20 million members of its America Online service. Most AOL customers dial in on an ordinary phone line to receive relatively slow "narrowband" access. Broadband access that increases the speed at which consumers can download their favorite news, music, and movie clips from the Web is now becoming available in two ways: through the local cable company's wire using a cable modem, and through the local phone company's wire using a digital subscriber line (DSL) service. AOL had been seeking at Federal, state, and local levels "open access" to provide its content over a broadband pipe, but it had been notably unsuccessful in persuading the largest cable company–AT&T–to open up its lines on terms acceptable to AOL.

Enter Time Warner. Time Warner is a multimedia company that is involved in many different ventures, including publishing, music and film production, and TV production for various cable networks such as its subsidiaries CNN and HBO. Time Warner also operates a number of cable systems throughout the country that serve approximately 13 million subscribers. Time Warner has upgraded about 85 percent of its systems to offer high speed broadband Internet access, but it still has relatively few broadband customers.

The plan. By merging, the combined company expects to realize synergies between the two operations. With its large customer base and expertise in marketing Internet services, AOL should be able to expand the number of Time Warner cable customers who purchase broadband access. The new company will also benefit from marketing Time Warner content to existing AOL subscribers.

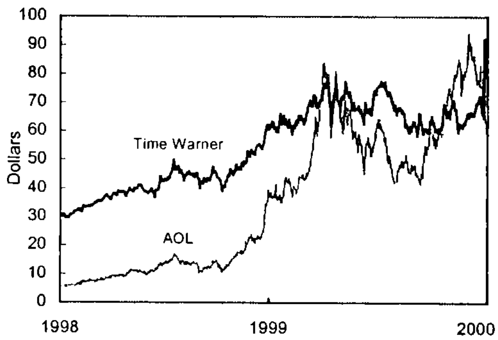
Competition and Internet access issues. The merger will not solve all of AOL's broadband access issues, since Time Warner's systems still represent only a fraction of the nation's total cable consumers. Thus, it is not surprising that the two companies have said that they are "committed to ensuring consumer choice of ISPs and content," because AOL will still need broadband access for customers not served by Time Warner. It is far from clear, however, whether AOL Time Warner will actively push for legislation in this area.

Despite its large size, the new company will still face competition. In its existing dial-in business, AOL faces competition from many other national and regional Internet service providers, and there are a number of other providers of broadband access through wires owned by other cable and phone companies. With respect to content, Time Warner will still have to compete with other providers of news, information, music, and movies as it does today, and the companies have said nothing to suggest that they intend to restrict the sales of that content to a single distribution provider like AOL.

The proposed merger will be reviewed by the antitrust authorities, but there appear at first blush to be relatively few markets where the merger might substantially reduce competition under traditional antitrust guidelines. The FCC may review the merger under the Telecommunications Act of 1996. And incumbent phone companies may have an increased desire to seek relief or revisit the Act.

Stock market valuations. Over the past 2 years, both companies' stock prices have risen sharply, but the percentage gain has been much larger for AOL stock (see chart). In part at least, this difference reflects investor expectations that AOL's business has much more potential for earnings growth than Time Warner's. The terms of the merger call for AOL to pay a large premium to Time Warner's shareholders relative to its pre-merger value. For this deal to benefit AOL shareholders as well, the synergies from combining the two companies would have to be substantial. However, the historical results from previous mergers suggest that shareholders in acquiring firms tend not to benefit from mergers. And the initial market reaction to the AOL Time Warner deal was a 13 percent decline in the value of AOL stock during the two trading days following the announcement.

Stock Prices of AOL and Time Warner



Future expectations. After the announcement of this merger, other Internet and media companies have seen their stock prices rise in anticipation of further mergers, but the shape of any future deals is less clear. AOL's leading role as both an ISP and a content provider is unusual in the online world, and other media and Internet companies may need to find a different model to use before attempting to blend traditional media with the Internet.

ARTICLE

Fishery Business

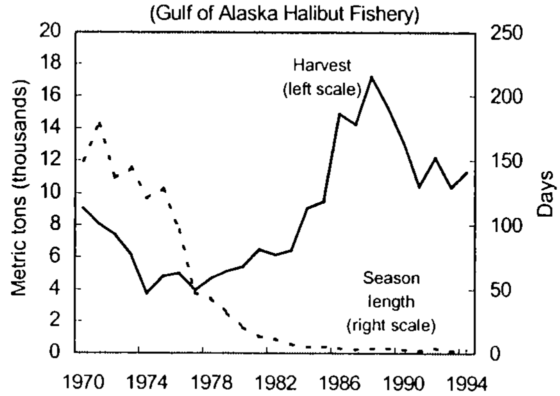
Over-fishing continues to be a problem for most fisheries in the United States, according to a recent report from the National Research Council (NRC). The report, which was requested in the Sustainable Fisheries Act of 1996, confirms the efficacy of individual quotas for some fisheries as a tool for addressing this problem, and it recommends lifting the moratorium on introducing new quota programs that was imposed by the Act.

The over-fishing problem. Fisheries are a common property resource, and without effective management over-fishing is likely to occur. This is because individual fishers' decisions about how intensively to fish are unlikely to take into account the full costs of these decisions in depleting the fish stock and possibly even killing off a species.

Traditional management strategies. Some fishery managers have tried to prevent over-fishing by imposing an annual limit on the catch. This limit, called the total allowable catch (TAC), is set at a level designed to guarantee the sustainability of the fishery, and the season usually ends once this limit is reached. This creates an additional problem, however, as each fishing crew tries to beat the rest of the fleet and capture as large a fraction of the TAC as possible. The "derbies" that result can be quite wasteful; fishers over-invest in gear and purchase ever-larger boats, making the derbies even more frenetic.

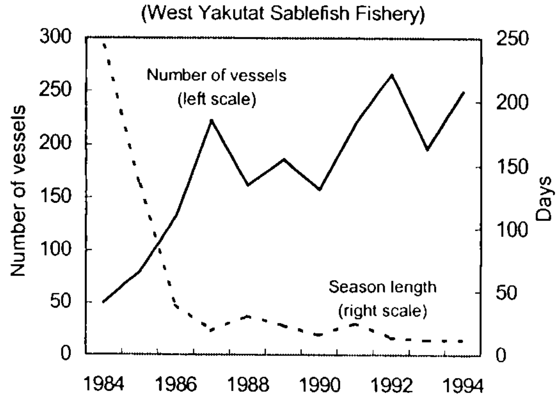
Harvest and Season Length

(Gulf of Alaska Halibut Fishery)



Number of Vessels and Season Length

(West Yakutat Sablefish Fishery)



Inefficiency. When this process significantly shortens the fishing season, consumers' access to certain species of fresh fish is restricted and fishers' work efforts are concentrated in a short, intense season. In the central Gulf of Alaska halibut fishery, for example, the season collapsed from a high of over 170 days in 1971 to 2 days in 1991, while the total catch more than quadrupled from 1974 to 1988 (see upper chart). In the West Yakutat sablefish fishery, the number of vessels increased almost fourfold in only 4 years in the mid-1980s as the number of days fell sharply (see bottom chart). Shorter seasons have also been associated with higher accident rates, because, with a season of only a few days, the decision to sit out bad weather is often tantamount to sitting out the season.

A possible solution. A potentially more efficient approach for some fisheries is to allocate shares of the TAC through individual quotas and allow fishers to trade these quotas in an open market. Under a quota system, each fisher has a right to a specified share of the TAC in each year, and each can catch this share in the cheapest manner possible without having to worry about the behavior of competitors. The incentives to concentrate production in the early portion of the season and to over-invest in capital disappear. Overall efficiency is improved further when the quotas are transferable, because less efficient fishers have an incentive to sell their rights to more efficient fishers.

Experience with individual quotas. The NRC report finds that individual quotas have been used extensively around the world, with very promising results. New Zealand first introduced a program in 1986 and at least 7 other countries now employ individual quotas. The creation of each of the four U.S. programs underway before the moratorium was imposed arose, in part, out of a concern over the build-up of fishing capital. In two of these (the surf clam/ocean quahog fishery and the wreckfish fishery) over-harvesting has ceased, and there is evidence that the total quantity of capital has subsequently fallen. In the Alaskan halibut and sablefish fisheries, the annual harvest did not exceed the target in the first 2 years of the quota program, after doing so by an average of 6 percent over the previous 17 years.

Conclusion. The moratorium on new individual quota programs imposed by the Sustainable Fisheries Act of 1996 runs through October 1, 2000. In recommending that the Congress lift this moratorium and allow regional fisheries to use individual quotas, the NRC report emphasizes that the quotas are not a panacea applicable to all fisheries. But it also concludes that past experience has repeatedly demonstrated the effectiveness of individual quotas in matching harvesting and processing capacities to the resource, slowing the race to fish, providing consumers with a better product, and reducing wasteful and dangerous fishing.

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

The Gender Pay Gap in Top Corporate Jobs. Between 1992 and 1997, about 2.5 percent of high-level executives in U.S. corporations were women. According to a recent study, these women earned about 45 percent less than their male counterparts. As much as three quarters of this gender gap can be explained by the fact that women tend to manage smaller companies and are less likely to be CEOs, chairs, or company presidents. Taking into account that female executives also tend to be younger and have less seniority than males reduces the unexplained gender gap to just 5 percent. While the absence of a significant conditional gender gap implies that women and men who hold similar jobs in firms of similar size receive fairly equal compensation, it does not rule out the possibility of discrimination in terms of gender segregation or promotion.

Children's Life Prospects Diverge. The number of children under age 6 with particularly bright futures and the number with particularly dim futures both rose between 1976 and 1996, according to a recent study. Looking at both "risk factors" and "opportunity factors" in young children's environments that are associated with negative and positive adult outcomes, the study found that the share of young children with particularly good prospects rose from 9 percent to 26 percent. Most of this growth resulted from having mothers who are now more educated and more likely to delay childbearing. The proportion of children with poor prospects—having a teen or unmarried mother, having a mother without a high school degree or living in poverty—rose from 8 percent to 12 percent. Applying this analysis to children in cities and suburbs, the study found increases in both good and bad prospects in both cities and suburbs. But it also found that in 1996 half of all children with poor prospects lived in central cities, while two-thirds of all children with good prospects lived in suburbs.

Manufacturing Increasingly Relies on Temporary Workers. The manufacturing sector increased its use of temporary help workers in the 1990s, according to a recent study. The study argues that because the official BLS data count these temporary workers as service sector not manufacturing employees, the number of jobs generated in manufacturing has been underestimated, manufacturing productivity has been overstated, and the decline in manufacturing hours has been overestimated. Not counting these workers in manufacturing explains, in part, the apparent flatness of manufacturing employment in the 1990s. While official data suggest that the expansionary period between 1992 and 1997 generated only 550,000 manufacturing jobs, accounting for the temporary workers implies that, in fact, as many as 1,060,000 new jobs were created. The decline in manufacturing hours between 1989 and 1997 also disappears once temporary help workers are taken into account. The study finds that excluding temporary help workers raises manufacturing productivity (and lowers service sector productivity), but it does not account for much of the gap between the high rate of growth in manufacturing productivity and the low rate in services. Nor does it change the rate of growth of productivity for the nonfarm sector as a whole.

INTERNATIONAL ROUNDUP

European Commission to Create Food Safety Authority. In a White Paper published this week, the European Commission unveiled plans to create an independent European Food Authority, with the aim of restoring public confidence in European food policy after a series of food alerts and crises in recent years. The intention is that the Authority will be guided by the best science and work closely with national scientific bodies. It will be independent of industrial and political interests and open to public scrutiny. Its main tasks will be disseminating independent scientific information on all aspects of food safety, operating a rapid alert system, and communicating with consumers on issues of food safety and health. The White Paper envisions the Authority beginning operations in 2002, once the necessary legislation is adopted.

China to Shut Down Steel Plants. China has announced plans to close its small steel plants, which may result in the loss of thousands of jobs. Small smelters and mills with annual production capacities below 100,000 tons are to be closed, affecting more than 2,500 plants. Plants that rely on small and backward steel blast furnaces and converters will also be closed. According to the *China Daily*, most of the plants in question are low-technology operations that waste resources and generate serious pollution. The plan will allow the government to obtain better control of steel output. China's goal is to achieve a 10 percent reduction of steel output this year in order to alleviate a current steel market glut. The plant closures will be enforced with strict measures, including denying designated plants raw materials, power supplies, credit, environmental licenses, and markets for their steel.

Russia's Health Crisis. Russia is in the midst of a health crisis, with deaths currently exceeding births by about 700,000 a year. Some experts estimate that without immediate policy measures, Russia's population is on track to drop to 80 million in 50 years from about 150 million today. Drug-resistant tuberculosis, AIDS, and cardiovascular disease are rampant. Some estimate that over 10 million Russians will be infected with HIV by 2005. The death rate from cardiovascular disease in Russia is higher than the death rate in the United States from all causes combined. Alcohol abuse poses additional concerns. In 1996, over 35,000 Russians died from unintentional alcohol poisoning; the comparable U.S. figure is 300. The experiences of countries like Thailand and Uganda in successfully lowering HIV infection rates show the positive impact when diverse government ministries, NGOs, and grassroots community groups join forces to raise local awareness. However, it has been argued that Russia's leadership has done little to promote "healthy lifestyles" domestically.

EYES ONLY

RELEASES THIS WEEK

Industrial Production and Capacity Utilization

****Embargoed until 9:15 a.m., Friday, January 14, 2000****

The Federal Reserve's index of industrial production increased 0.4 percent in December. Capacity utilization rose 0.1 percentage point to 81.3 percent.

Consumer Price Index

****Embargoed until 8:30 a.m., Friday, January 14, 2000****

The consumer price index rose 0.2 percent in December. Excluding food and energy, consumer prices rose 0.1 percent. For the 12-month period ending in December, consumer prices rose 2.7 percent; excluding food and energy, consumer prices rose 1.9 percent.

Retail Sales

Advance estimates show that retail sales increased 1.2 percent in December following an increase of 1.1 percent in November. Excluding sales in the automotive group, retail sales rose 1.4 percent following an increase of 0.7 percent.

Producer Price Index

The producer price index for finished goods rose 0.3 percent in December. Excluding food and energy, producer prices rose 0.1 percent. For the 12-month period ending in December, producer prices rose 3.0 percent; excluding food and energy, producer prices rose 0.9 percent.

MAJOR RELEASES NEXT WEEK

Housing Starts (Wednesday)
U.S. International Trade in Goods and Services (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	5.7
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	12.7
Residential investment	4.5	4.2	4.4	4.5	4.4
Exports	8.2	11.0	10.7	10.7	10.8
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	**1999**	**October 1999**	**November 1999**	**December 1999**
Unemployment Rate (percent)	6.7**	4.2**	4.1	4.1	4.1
Payroll employment (thousands)					
increase per month			284	222	315
increase since Jan. 1993					20367
Inflation (percent per period)					
CPI	5.8	**2.7**	0.2	0.1	**0.2**
PPI-Finished goods	5.0	**3.0**	-0.1	0.2	**0.3**

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

New or revised data in **boldface**.
CPI data **embargoed until 8:30 a.m., Friday, January 14, 2000**.

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FINANCIAL STATISTICS

	1998	1999	November 1999	December 1999	Jan. 13, 2000
Dow-Jones Industrial Average	8626	10465	10810	11246	11582
Interest Rates (percent per annum)					
3-month T-bill	4.78	4.64	5.07	5.20	5.25
10-year T-bond	5.26	5.65	6.03	6.28	6.63
Mortgage rate, 30-year fixed	6.94	7.43	7.74	7.91	8.18
Prime rate	8.35	8.00	8.37	8.50	8.50

INTERNATIONAL STATISTICS

Exchange Rates	**Current level January 13, 2000**	**Percent Change from Week ago**	**Percent Change from Year ago**
Euro (in U.S. dollars)	1.027	-0.5	-12.2
Yen (per U.S. dollar)	106.1	0.9	-6.5
Major currencies index (Mar. 1973=100) (trade-weighted value of the U.S. $)	92.80	0.2	1.2

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	4.3 (Q3)	4.1 (Dec)	**2.7** (Dec)
Canada	4.2 (Q3)	6.9 (Nov)	2.1 (Nov)
Japan	1.0 (Q3)	4.6 (Nov)	-1.2 (Nov)
France	2.9 (Q3)	10.7 (Nov)	0.9 (Nov)
Germany	1.3 (Q3)	9.0 (Nov)[2]	1.0 (Nov)
Italy	1.2 (Q3)	12.1 (Apr)	2.0 (Nov)
United Kingdom	1.8 (Q3)	5.9 (Sep)	1.4 (Nov)

U.S. CPI data **embargoed until 8:30 a.m., Friday, January 14, 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

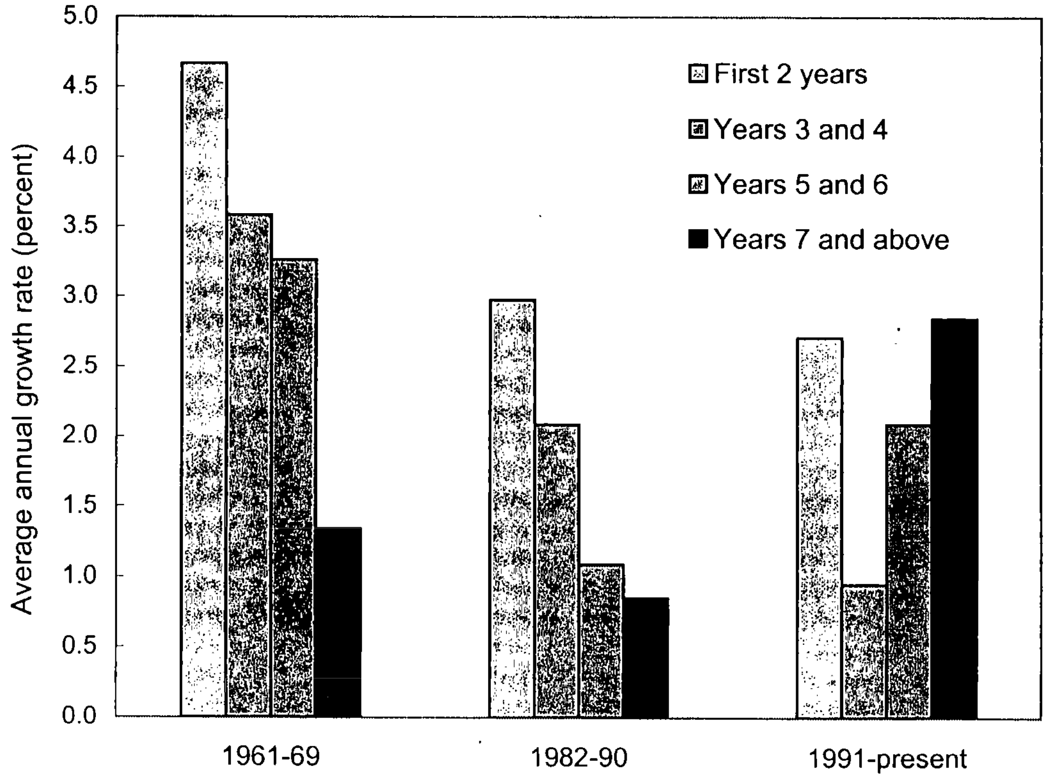
WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

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

January 7, 2000

CHART OF THE WEEK

Growth in Nonfarm Output per Hour During Expansions



Productivity growth tends to be strong in the early stages of an expansion as idle resources are put back to work. But the rate of growth of productivity tends to fall as the expansion matures. While this was true of the other two long postwar expansions, it has not been true in the current expansion, with nonfarm productivity growth strongest in the later years. A Special Analysis in this Briefing examines possible reasons for this acceleration.

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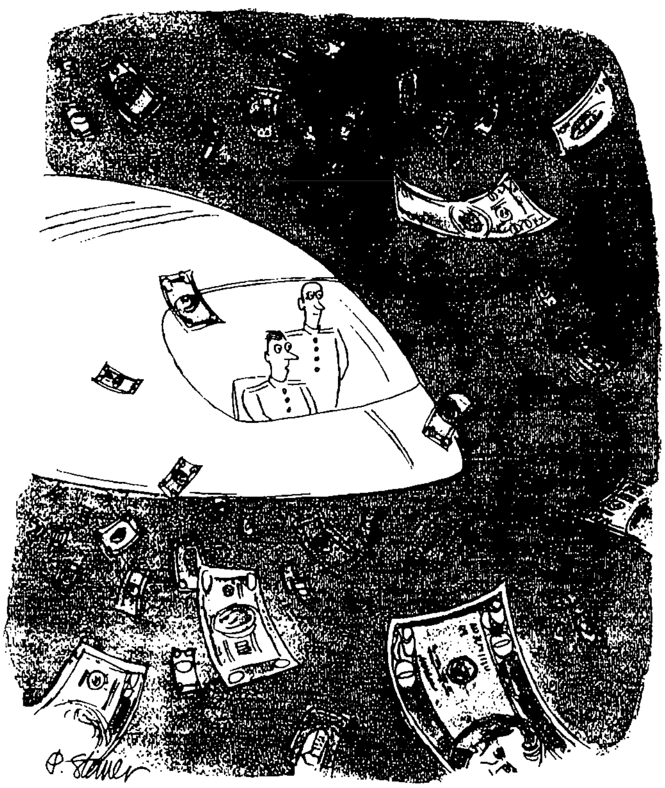


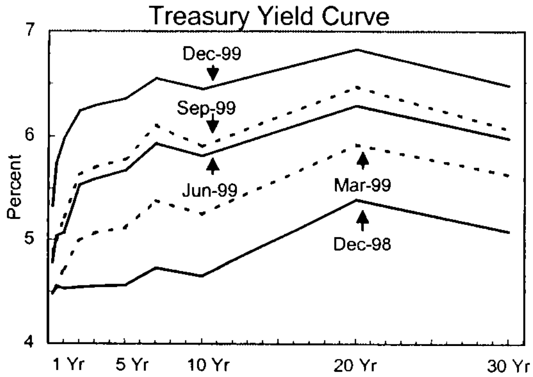
"Captain, it looks like we've entered cyberspace."

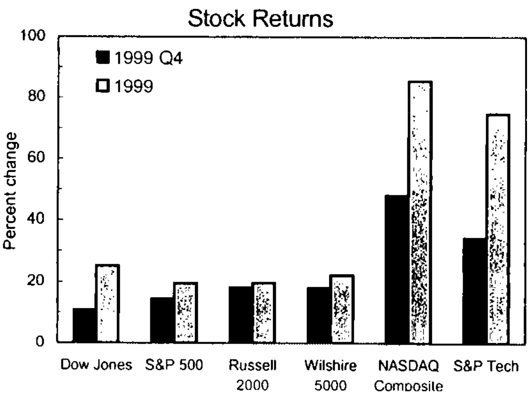
FINANCIAL MARKET UPDATE

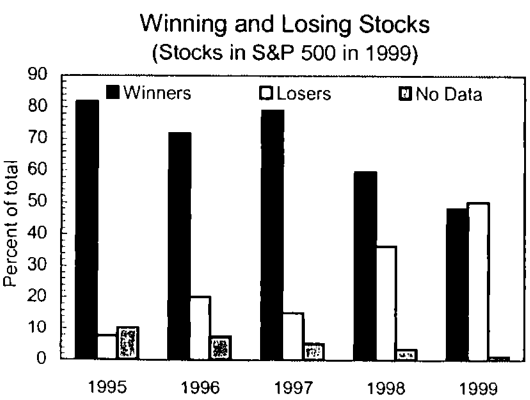
Fourth Quarter 1999

Stock prices soared in the last quarter of 1999, led by technology companies. All major indexes closed out 1999 at record highs. The Federal Reserve raised its target lending rate in November but made no further move in December. Market concerns about future rate hikes have kept yields on long-term Treasuries near 2-year highs.

Interest Rates. Treasury rates increased over the past 3 months at all maturities (see top chart). In November, when the Federal Reserve raised its federal funds target rate 25 basis points to 5½ percent, it cited the shrinking pool of available workers and the potential inability of production to keep pace with demand. Signaling a commitment to help smooth the year-2000 transition, the Fed made no further move in December despite continued concerns about increasing inflationary pressures. However, federal funds futures rates rose at the end of December, indicating that the market expects the Fed to raise rates again in February.







Stock prices. The Standard and Poor's 500 index grew a robust 15 percent in the fourth quarter, but technology-based indexes performed even better, illustrating the strength of the technology sector relative to the market as a whole (see middle chart). In particular, the NASDAQ significantly out-performed other major indexes, gaining 48 percent in the fourth quarter alone and 86 percent for 1999.

Concentrated gains. Although the broad indexes showed strong growth, gains were more concentrated than in previous years. For example, in 1999 the S&P 500 grew about 20 percent, yet fewer than half of all stocks in the index realized any gains (see bottom chart). In contrast, over 70 percent of these stocks saw price increases in 1996, even though the index as a whole grew at about the same rate as in 1999.

EYES ONLY

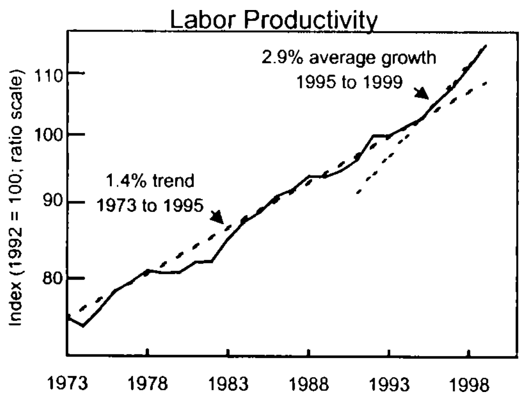
Happy New Year? Stock prices have been volatile this week. After falling sharply in the first few days, the Dow recouped some its losses and the S&P 500 stabilized. Technology stocks were particularly hard hit, however, with the NASDAQ falling over 8 percent through Thursday.

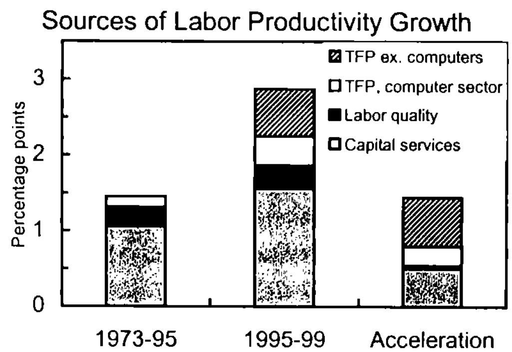
EYES ONLY

SPECIAL ANALYSIS

Accounting for the Surge in Productivity Growth

Labor productivity trended upward at an average annual rate of 1.4 percent from 1973 to 1995, but it has since accelerated to a 2.9 percent annual clip over the past 4 years (see upper chart). CEA analysis finds that half of this acceleration is accounted for by an increase in capital—especially computer capital—and by productivity growth in the computer-producing sector.





More capital per worker. Labor productivity increases when workers have more capital to work with. Partly because business investment as a share of GDP has been above its long-term average since 1995, capital services per hour have grown faster since 1995 as well. Analysis of preliminary data indicates that this capital deepening accounted for 1.5 percentage points of annual labor productivity growth during the 1995-99 period, up from 1.1 percentage points during the 1973-95 period (see lower chart). Thus, the increase in capital services per hour accounts for about a third of the 1.5 percentage point increase in annual productivity growth. Most of this gain from capital deepening is accounted for by investment in computers and software.

Computer quality. Besides their role in capital deepening, computers enter GDP directly as a flow of new investment. Hence, productivity growth in the production of computers contributes directly to overall productivity growth. Productivity growth has been particularly rapid in the computer-producing sector, as reflected in the rapid decline in computer prices. Price declines for computers, which had been running at a 15 percent average annual rate before 1995, fell at a 27 percent annual rate thereafter, indicating an acceleration in computer quality after 1995. Improved computer quality added an estimated 0.25 percentage point to the post-1995 productivity acceleration.

Work force quality. The American work force has become better educated, and, since about 1980, the average worker has had more work experience. However, nothing dramatically new happened to the index of labor composition after 1995, and the estimated contribution of work force quality to productivity growth of 0.3 percentage point per year since 1995 is only slightly above the pre-1995 pace.

Total factor productivity. According to these estimates, the combined effects of capital deepening, changing labor composition, and rising computer quality account for about half of the post-1995 acceleration in productivity. The residual, called total factor productivity (TFP), reflects all the other factors that affect productivity growth. These may include cyclical influences and new efficiencies from the use of the Internet, especially for business-to-business transactions.

Outlook. Can the factors that account for the more rapid pace of labor productivity growth since 1995 be sustained? Of course we cannot know for sure, but current trends are positive and Administration policies are supportive.

- Capital deepening. The growth rate of capital services per hour increased in 4 of the past 5 years, reaching 5.4 percent in 1999—a rate that implies a 1.8-percentage-point per year contribution of capital deepening to labor productivity growth. For 2000, the pace of capital deepening is likely to increase further, because the level of investment is already very high. Projections over the longer run are more speculative, but the level of nominal investment is expected to remain high relative to nominal output. Pursuing a budget policy of debt reduction also promotes investment.

- Computers. The pace of computer price declines has been particularly rapid over the past 4 years and may not be sustainable. However, the contribution of computers to productivity growth would still be important even if the rate of price declines slowed to the longer term rate of about 20 percent per year.

- Work force quality. The trend toward a more educated work force seems likely to continue with the Administration's policy of promoting human capital investment, and the average age of the work force will continue to rise through at least 2008, when the leading edge of the baby-boom generation retires. But these factors are not expected to accelerate, and the contribution of labor composition to productivity is not likely to change much from its historical average of 0.3 percentage point per year.

- Total factor productivity. This is the most difficult factor to forecast since it is a residual reflecting a wide variety of factors.

EYES ONLY

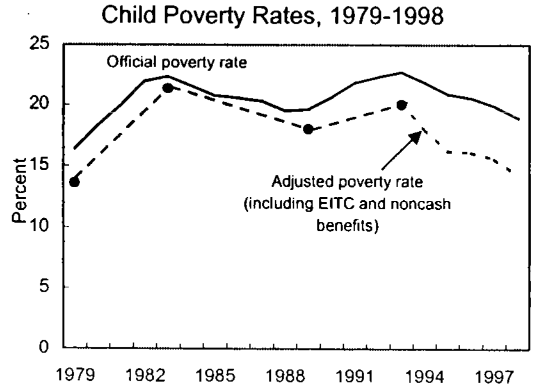
SPECIAL ANALYSIS

Recent Changes in the Safety Net and Child Poverty

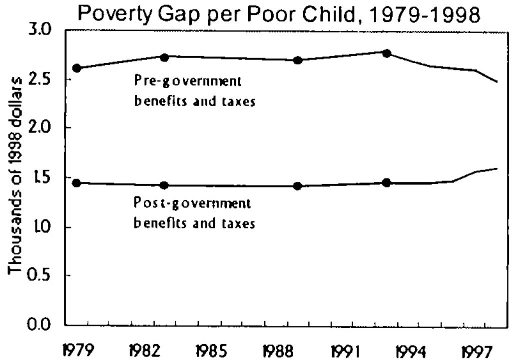
Since 1993, the number of poor children has fallen by 2.3 million. However, a new study from the Center on Budget and Policy Priorities finds that the average poor child in 1998 was worse off than the average poor child in 1994. The study attributes this result to sharp declines in the number of poor children receiving cash assistance and food stamps. This conclusion must be interpreted cautiously, however, in light of the changing composition of the families who remain poor.

Trends in the child poverty rates. The official child poverty rate, which is based on a measure of income that includes earnings and cash assistance but excludes other benefits such as the EITC and food stamps, has declined sharply, from 22.7 percent in 1993 to 18.9 percent in 1998 (see upper chart). This is the lowest rate since 1980. The study finds that the decline is even sharper using a broader income measure that includes the EITC and noncash benefits such as food stamps.

Child Poverty Rates, 1979-1998



Poverty Gap per Poor Child, 1979-1998



The child poverty gap. To examine trends in the depths of poverty, the study focuses on a different statistic, the "child poverty gap," which measures the *amount* by which poor children's family income falls short of the poverty threshold. The study finds that, in 1998, the per child gap before taking into account government benefits and taxes was $2,489—the lowest it has been since 1979 (see lower chart). The net effect of taxes and transfers is to shrink the gap. However, the study finds that the post-tax-and-transfer gap per child has risen in recent years and, at $1,604 in 1998, was the largest on record and $149 higher than it was in 1994.

Together, these results imply that many low-income families with children boosted their earnings, taking advantage of the strong economy and welfare reform—but that these earnings gains have not been large enough to offset reductions in net transfers from government.

Analysis. This plausible but pessimistic interpretation is the one emphasized in the study. It notes that in both 1993 and 1995, 57 percent of poor children (before counting benefits based on income) received AFDC, while by 1998, only 41 percent of poor children received TANF. Child participation in the food stamp program also shows a downward trend: between 1995 and 1998, the number of children receiving food stamps declined by almost 27 percent while the number of poor children fell 10 percent.

While the data clearly show that the average child poverty gap has widened (based on the comprehensive, post-tax-and-transfer-income measure), the interpretation of this finding is difficult because the composition of the poor population has changed. The data do not track individuals over time, and the strong economy and policy initiatives such as EITC and minimum wage have been successful in helping many families escape poverty since 1993. To the extent that those who have escaped poverty had incomes closer to the poverty threshold to begin with than those left behind, the per child gap could have increased with no individual families becoming worse off. However, the narrowing of the pre-tax-and-transfer gap suggests that remaining poor families may in fact have both increased their earnings and experienced some decline in benefits.

Conclusion. Further research is required to learn more about how much of the change in the child poverty gap reported in the study reflects compositional effects and how much reflects changes in receipt of government benefits. Even so, the study highlights the plight of families where parents face the greatest barriers to employment, such as limited work experience, a disability, or difficulty in finding child care. This points to the importance in fighting poverty of continued efforts to ensure that low-income families receive the benefits for which they are eligible, and for finding innovative ways to reduce child poverty.

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

Children without Health Insurance Are Enrolled in Other Programs. Almost three-quarters of all low-income children without health insurance live in families that participate in other government programs, such as the National School Lunch, WIC, Food Stamp and Unemployment Compensation Programs. This finding by the Urban Institute suggests a new possibility for identifying uninsured children and encouraging their families to enroll them for Medicaid or CHIP coverage. Several localities are building outreach efforts around the National School Lunch Program, which serves the families of an estimated 60 percent of all low-income uninsured children. Programs already in existence include sending informational flyers to parents and positioning trained volunteers at schools to answer questions and help complete applications. Concerns such as the need to protect the privacy of lunch program applicants and the fact that Medicaid and CHIP programs require more information than the National School Lunch Program, still need to be addressed.

Enrollment of Foreign Students in U.S. Colleges Nears Half a Million. The number of foreign students attending colleges and universities in the United States increased 2 percent in the last school year to a record total of nearly 491,000, according to a recent study. China supplied the most students (10.4 percent), followed by Japan and Korea. Although foreign students compose only 3 percent of America's total higher education population, they contribute more than $13 billion dollars to the U.S. economy in money spent on tuition, living expenses, and related costs. With over three-quarters of that funded by overseas sources, higher education now ranks as the country's fifth largest service sector export, according to the study.

Survey Finds Grandparents Play Active Role in Families. Most grandparents regularly interact with their grandchildren, according to a survey of over 800 grandparents aged 50 and over. The survey, sponsored by the American Association of Retired Persons, found that more than 8 in 10 grandparents had talked with a grandchild on the telephone or had seen a grandchild in person in the previous month. It also found that 11 percent of grandparents are caregivers: 3 percent are raising a child and 8 percent provide day care on a regular basis. Roughly a third of the African American grandparents surveyed are caregivers—compared with roughly a fifth of the white grandparents. Grandparents spent a median of $489 per year for gifts, clothes, outings, tuition, and other purchases for their grandchildren. Among activities engaged in with grandchildren in the past month, the most frequently reported were eating together at home (72 percent) or eating out (65 percent). Other activities with responses in roughly the 40 to 55 percent range included watching a television comedy, having grandchildren stay overnight, shopping for clothes, engaging in exercise or sports, watching educational television, and going to religious services. Asked to rate their relationship with a grandchild on a scale of 0 to 10 (excellent), the mean answer was 8.7.

EYES ONLY

INTERNATIONAL ROUNDUP

International Mergers Increase as Regulation Becomes More Complex. Last year was a record year for mergers and acquisitions, with more than $1.7 trillion in announced deals recorded in the United States, $1.2 trillion in Europe, and $162 billion in Asia. However, at the same time that mergers, particularly cross-border mergers, are rapidly increasing, merger control laws are becoming more numerous and complex. A survey of 99 international jurisdictions found that 28 countries and the European Union have substantially revised and strengthened existing competition laws in the past 3 years, and that 41 countries have instituted new merger control regulations in the past decade. The proliferation of regimes means that obtaining clearance for mergers and acquisitions worldwide is becoming increasingly complex, as companies must comply with merger notification requirements in different jurisdictions, each with its own rules, time frames, thresholds, and policy aims.

EU and Mexico Reach Trade Agreement. At the end of November 1999, Mexico and the European Union agreed on the terms of a free trade area (FTA) between the two regions, although both partners must still approve the agreement. The agreement will include an FTA covering industrial and agricultural goods, a preferential agreement in services, an agreement covering investments, rules on competition and intellectual property, and an effective dispute settlement system. The agreement may help bolster the share of Mexico's imports coming from the EU. (This share had declined from an average of 14 percent in 1990-92 to 9 percent in 1998.) At the same time, the agreement may allow Mexico to decrease its dependence on U.S. markets, currently the destination for roughly 80 percent of Mexican merchandise exports. Anecdotal evidence suggests that the proposed free trade agreement is already stimulating foreign direct investment in Mexico. For instance, the Nissan-Renault automobile alliance recently announced a joint venture of $400 million in Mexico over the next 7 years.

Debt-for-Health Swap for Sub-Saharan Africa. Of the estimated 34 million people living with HIV/AIDS in the world today, 23 million live in sub-Saharan Africa. Infection rates approach a quarter of the adult population in several countries in the region and top 10 percent in many others. A shortage of funds hinders efforts to slow the spread of the epidemic and reduce its impact. Recent international debt relief programs, such as the Cologne Debt Initiative, may free up resources to address social problems, and a recent study argues that HIV/AIDS prevention should be placed at the top of the agenda for sub-Saharan Africa. The study reviews various debt-for-development swap programs since 1987 and recommends using the debt relief savings to establish a "counterpart fund" in debtor countries, with a top priority of implementing HIV/AIDS prevention programs. The study states that even with a modest amount of funding, the effect on HIV/AIDS prevention could be significant. For example, Uganda launched a national campaign against HIV/AIDS with less funding than what could be available to most other sub-Saharan countries through debt relief, and it has successfully reduced the HIV/AIDS prevalence rate among Uganda's teenagers from 28 percent in 1992 to 10 percent in 1996.

EYES ONLY

RELEASES THIS WEEK

Employment and Unemployment
****Embargoed until 8:30 a.m., Friday, January 7, 2000****

In December, the unemployment rate was unchanged from November at 4.1 percent. Nonfarm payroll employment rose by 315,000.

NAPM Report on Business

The Purchasing Managers' Index fell 0.7 percentage point to 55.5 percent in December. (A reading above 50 percent indicates that the manufacturing economy is generally expanding.)

MAJOR RELEASES NEXT WEEK

Producer Prices (Thursday)
Retail Sales (Thursday)
Industrial Production and Capacity Utilization (Friday)
Consumer Prices (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	5.7
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	12.7
Residential investment	4.5	4.2	4.4	4.5	4.4
Exports	8.2	11.0	10.7	10.7	10.8
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	1999	October 1999	November 1999	December 1999
Unemployment Rate (percent)	6.7**	**4.2****	**4.1**	**4.1**	**4.1**
Payroll employment (thousands)					
increase per month			**284**	**222**	**315**
increase since Jan. 1993					**20367**
Inflation (percent per period)					
CPI	5.8	N.A.	0.2	0.1	N.A.
PPI-Finished goods	5.0	N.A.	-0.1	0.2	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, January 7, 2000**.

EYES ONLY

FINANCIAL STATISTICS

	1998	1999	November 1999	December 1999	Jan. 6, 2000
Dow-Jones Industrial Average	8626	10465	10810	11246	11253
Interest Rates (percent per annum)					
3-month T-bill	4.78	4.64	5.07	5.20	5.25
10-year T-bond	5.26	5.65	6.03	6.28	6.57
Mortgage rate, 30-year fixed	6.94	7.43	7.74	7.91	8.15
Prime rate	8.35	8.00	8.37	8.50	8.50

INTERNATIONAL STATISTICS

Exchange Rates	**Current level January 6, 2000**	**Percent Change from**	
		Week ago	**Year ago**
Euro (in U.S. dollars)	1.032	3.0	-11.3
Yen (per U.S. dollar)	105.2	2.8	-6.7
Major currencies index (Mar. 1973=100) (trade-weighted value of the U.S. $)	92.62	-0.5	1.3

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	4.3 (Q3)	**4.1** (Dec)	2.6 (Nov)
Canada	4.2 (Q3)	7.2 (Oct)	2.1 (Nov)
Japan	1.0 (Q3)	4.7 (Oct)	-1.2 (Nov)
France	3.0 (Q3)	11.0 (Sep)	0.9 (Nov)
Germany	1.3 (Q3)	9.0 (Oct)[2/]	1.0 (Nov)
Italy	1.2 (Q3)	12.1 (Apr)	2.0 (Nov)
United Kingdom	1.8 (Q3)	5.9 (Aug)	1.4 (Nov)

U.S. unemployment data **embargoed until 8:30 a.m., Friday, January 7, 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

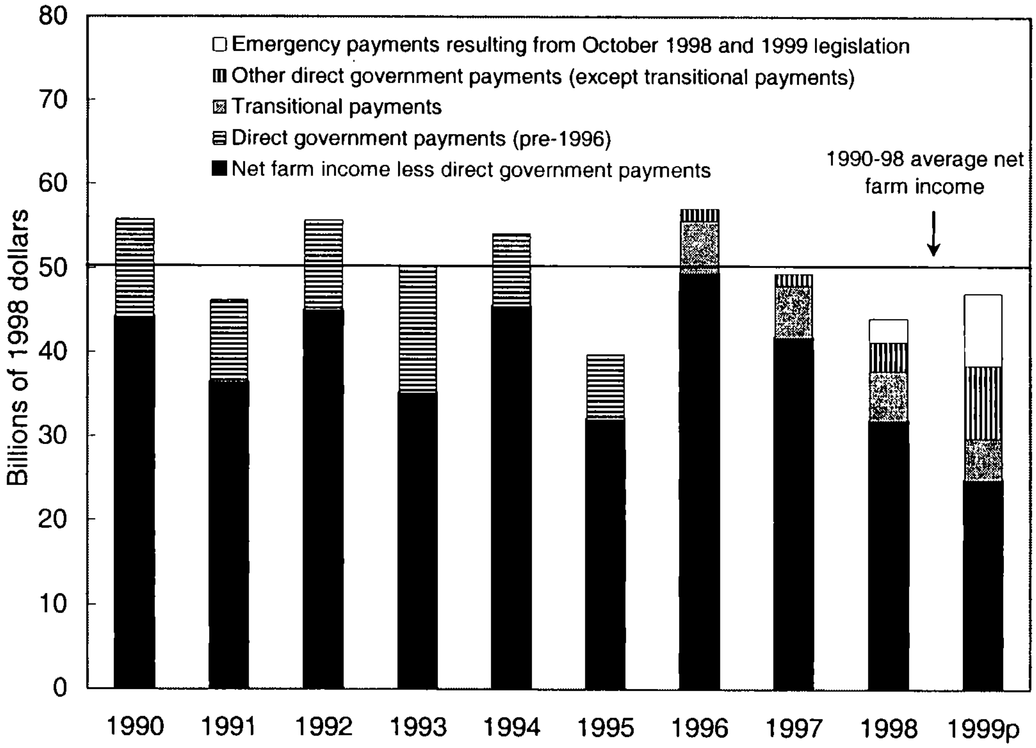
WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

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

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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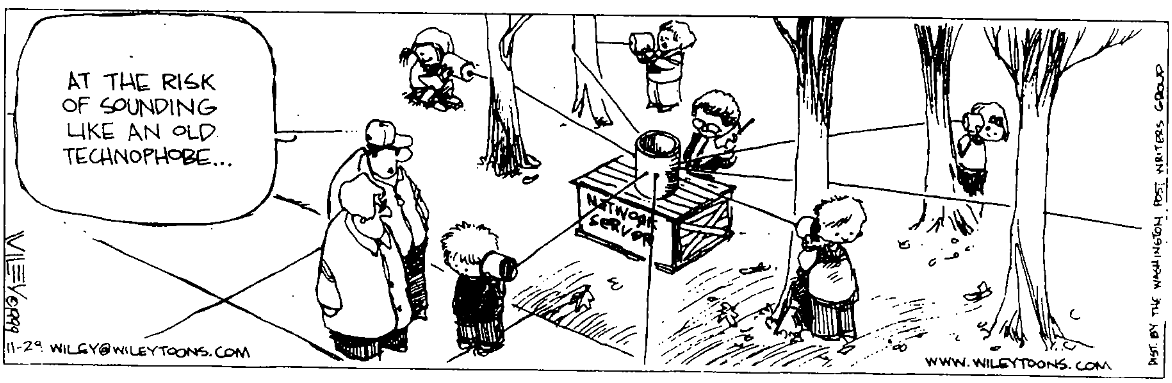


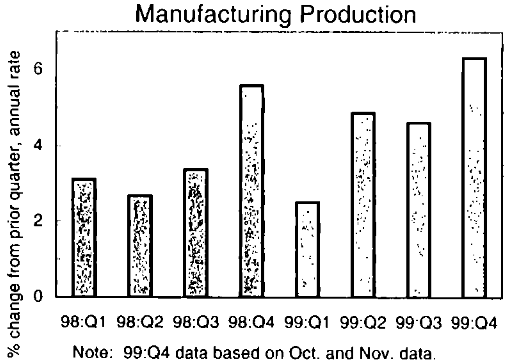
EYES ONLY

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.

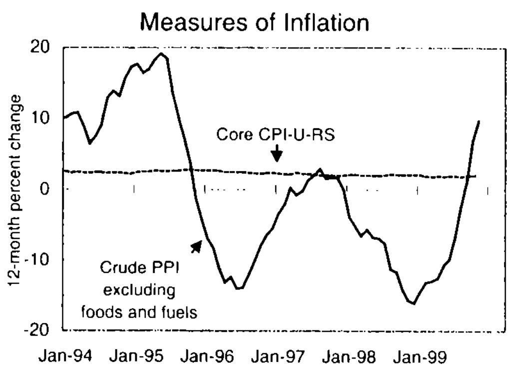
The labor market. Payroll employment grew by an average of 250,000 per month in October and November, and total hours of production workers have increased at a 2½ percent annual pace thus far in the fourth quarter. Adding trend growth in productivity (probably around 2¼ percent at an annual rate), these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



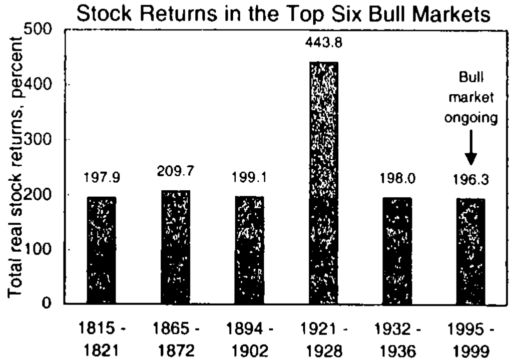
EYES ONLY

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.

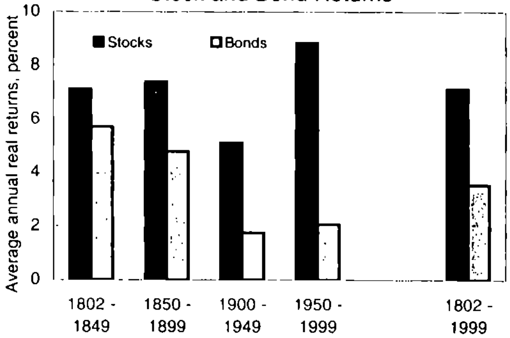
Stock Returns in the Top Six Bull Markets



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.

Stock and Bond Returns



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.

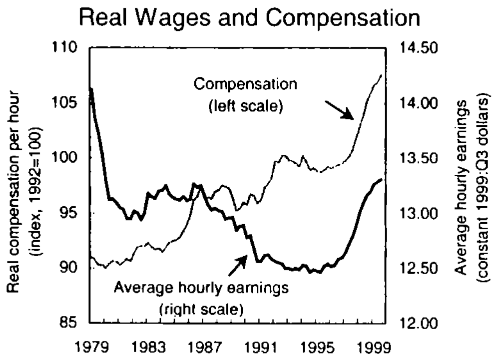
EYES ONLY

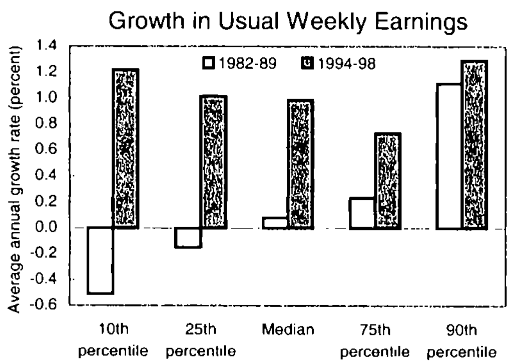
ARTICLE

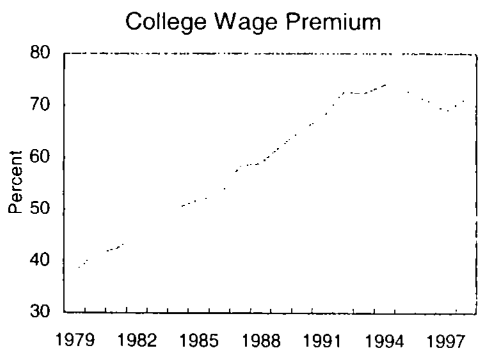
Inequality in the 1990s: Is the Gini Back in the Bottle?

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 labor's share. 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).

Income and earnings inequality. 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).

The college wage premium. 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.

- <u>The trends themselves may have been brought to a halt by offsetting microeconomic forces</u>. 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.

EYES ONLY

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)

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	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**.

EYES ONLY

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**	**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.

EYES ONLY

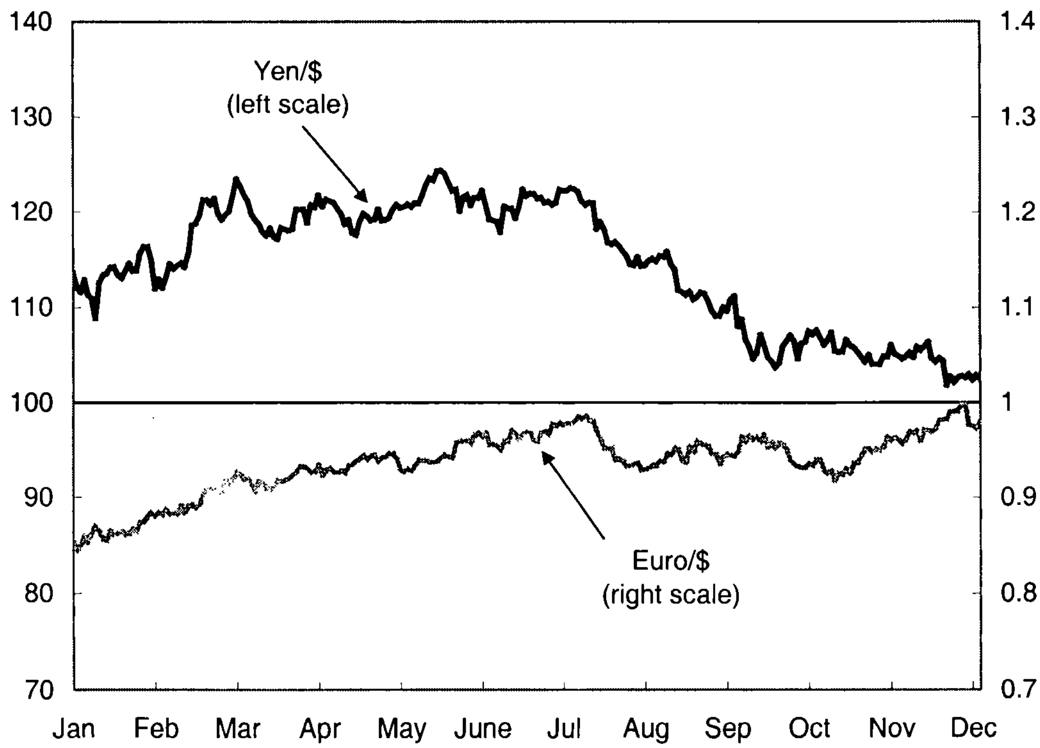
WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

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

December 10, 1999

CHART OF THE WEEK

Convergence of Exchange Rates in 1999



The euro is nearly at parity with the dollar while the yen is nearly at parity with the penny.

EYES ONLY

CONTENTS

CURRENT DEVELOPMENT

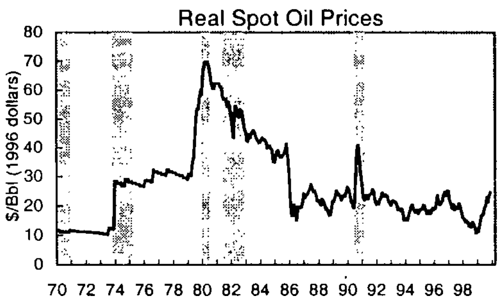
Have Oil Prices Reached their Peak?

At the end of last year, real oil prices hit their lowest point in over 25 years. Since then, rising demand and falling supply have pushed crude oil prices back up. As of yesterday, the price stood at $26 per barrel for West Texas Intermediate crude oil. Prices of refined products, like gasoline, have followed the same general trend. A key issue for the United States economy in the next year is whether oil prices have peaked or whether further increases are expected.

Supply. One of the reasons for the increase in oil prices is a reduction in supply. After oil prices fell below $12 a barrel at the end of last year, the major OPEC countries agreed to production targets to limit the supply of oil and thereby increase the price. Analysts generally believe that the major OPEC countries have stuck to the agreed upon limits. In addition, Iraq cut off oil exports in November, reportedly to protest a shortening of the renewal period of the "Oil-for-Food" program from 6 months to 2 weeks.

Demand. Shifts in demand have also influenced oil prices. The Asian crisis and slow world growth dampened demand for oil last year. Since then, economic recoveries in Asia and in parts of Europe have combined with the booming U.S. economy to push up world oil demand this year. In addition, there is some anecdotal evidence of stock building of oil and refined products in preparation for possible Y2K-related disruptions. Demand is expected to remain strong next year.

Outlook. Futures prices for oil imply that markets expect oil prices will fall next year. Two factors support this view. First, most Administration experts agree that the New Year will not generate widespread disruptions in the flow of oil. Moreover, Mexico, Venezuela, and Saudi Arabia recently announced that they would make up any Y2K-related shortfalls. Second, there are reasons to suspect that OPEC desires lower prices than those seen today. High oil prices encourage non-OPEC high-cost suppliers to increase production, cutting into OPEC's profits. In addition, high prices threaten the integrity of the cartel by making production in excess of agreed upon targets more profitable.



Notes: Price is West Texas Intermediate.
The gray bars represent U.S. recessions.
October-December 1999 data are estimates.

Interestingly, none of the Blue Chip forecasters expect that rising oil prices will seriously threaten the current economic expansion, despite the experiences of the 1970s and early 1990s when oil price hikes were associated with economic downturns (see chart). This view seems justified because, relative to overall prices, the price of oil is much lower today than the peaks reached in the 1970s and the early 1990s. Unlike past oil price increases, this one was preceded by a decline in oil prices. Moreover, the energy intensity of the economy has fallen steadily for the last 50 years, suggesting that the U.S. economy may be less vulnerable to oil price shocks. Arguably, only a precipitous spike in oil prices would pose a significant risk to the economy.

EYES ONLY

ARTICLE

A Closer Look at Skill-Biased Technical Change

One common explanation for the increase in wage inequality in the United States from 1979 to the early 1990s is technical progress that has shifted labor demand toward more highly skilled workers relative to the less skilled–so called "skill-biased technical change." Research is beginning to provide insights into how information technology (IT) affects the workplace and the demand for skills.

Findings. Case studies of individual firms have shown how companies use IT to change the way they conduct business. These studies find that successful IT investment is often coupled with changes in business strategy and organizational structure. A recent study provides broad supporting evidence based on survey data on about 400 large U.S. firms during the mid-1980s to the mid-1990s. The two key findings are:

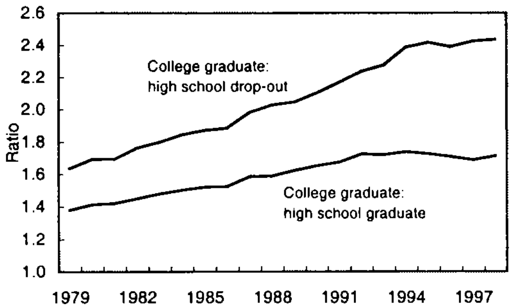
- IT interacts with organizational structure and worker skills. Controlling for industry and firm size, firms that invest more in computer equipment also tend to have a decentralized workplace organization (including broader job responsibilities for line workers, more decentralized decisionmaking, or more self-managing teams) and employ higher-skilled or more educated workers. One reason for combining IT and a decentralized workplace may be that IT can put greater information in the hands of front-line workers who may be better able to make day-to-day decisions than upper-level managers. This increased role for front-line workers in turn may raise the importance of skills and education for job performance.

- These interactions affect productivity. Firms with high levels of IT investment, workplace decentralization, and more highly skilled workers tend to have higher productivity than those with lower levels. Moreover, firms that use IT intensively without instituting organizational changes often experience little if any productivity gains. This helps explain the apparent lag (during the 1980s and early 1990s) in the effect of IT on productivity in the United States, since it has taken time for firms to redesign their organizations to take advantage of their IT investments.

Other evidence. Trends in the economy over the last 25 years dovetail with the case-study and firm-level evidence. Impressive advances in the underlying science and engineering of IT have increased the capabilities and reduced the costs of this technology. As a result, real investments in IT have grown at double-digit rates for several decades. Meanwhile, decentralized workplaces appear to have become more common. The skill levels of the work force have also been rising, at least according to measures such as the proportion of college graduates in the work force. Until 1994, the demand for more educated workers outpaced supply, raising the wages of more-skilled workers relative to less-skilled workers (see chart). Earnings growth since 1994 has been much more evenly distributed.

Implications and conclusion. Based on evidence from large firms, IT and IT-enabled organizational change appear to be important factors in raising the demand for skilled workers. Of course, IT can reduce the demand for skills in some cases. For example, computer-assisted scanning devices for final sales or inventory control may require lower average skills by retail clerks, and an automated teller machine may completely replace a bank teller. Nonetheless, it seems apparent that new technology and organizational change are making the acquisition of education and skills increasingly important for getting and keeping well-paying jobs. This highlights the importance of ensuring that students learn the basic skills needed in the information economy: higher-level math, reading, and writing skills, personal skills such as the ability to work effectively in groups, and a knowledge of computers.

Ratio of Full-Time Year-Round Weekly Median Earnings by Educational Attainment



ARTICLE

Saving the Planet while Cutting Taxes

The Administration has proposed a domestic greenhouse gas tradable permit program for 2008 to 2012 subject to the ratification of the Kyoto Protocol. Recent analysis indicates that how the program is implemented will affect energy company shareholders and taxpayers, and could also affect the costs to society of achieving the Kyoto target.

Effects of the tradable permit program on energy prices. Implementing a tradable permit program would require industries covered by the program to restrict their greenhouse gas emissions to comply with the Kyoto Protocol emissions target. Abating greenhouse gas emissions involves costs associated with investing in new technologies, fuel-switching, and other ways to reduce emissions. As the energy sector becomes more competitive over the next decade, the costs of controlling emissions will be reflected in consumer prices. For example, the Administration's economic analysis of the Kyoto Protocol found that a tradable permit price of $23 per ton of carbon would increase energy prices to consumers by about 5 percent in 2010, but this increase could be largely offset through the implementation of the Administration's electricity restructuring proposal.

To "grandfather" or to auction? A key question in implementing a tradable permit system is the allocation of permits. For example, the government could give away permits to firms ("grandfathering"); alternatively, the government could sell permits to firms through auctions. Importantly, the price of energy paid by consumers is likely to be the same in either case. Permits will be scarce, and the price of energy will reflect the cost of buying a permit or taking abatement measures regardless of how the permits were originally distributed. Producers who receive free permits will be like owners of particularly low-cost oil wells when oil prices go up: they will sell at the market price and reap windfall profits. In contrast, an auction allows the government to capture the value of the permits, because competition should lead companies to bid away almost the full value of any potential windfall profits from owning the permits.

Grandfathering would result in the giving away of permits valued in the tens to hundreds of billions of dollars annually. Because these firms can pass on most of the cost of reducing emissions to consumers, the grandfathering of permits would provide these firms with significant windfall profits, and allow them to enjoy higher profits under climate policy than without climate policy. However, if the government sells permits it would receive revenues in the tens to hundreds of billions of dollars annually. While energy firms would have lower profits under an auction, the permit revenues could be recycled back into the economy through tax cuts. Recent research has found that such revenue recycling could reduce the costs to society resulting from the use of greenhouse gas permits by up to 80 percent.

Effects of permit allocation on energy industries. One paper evaluated the effects of grandfathering and auctioning on energy industries. Giving away permits to energy industries would significantly increase equity values while selling permits would lower equity values. An alternative is to follow a hybrid approach that combines elements of grandfathering and auctions. It is estimated that grandfathering 5 to 15 percent of the permits to energy firms while auctioning the remaining permits would be sufficient to ensure that these firms' equity values would be the same under climate policy as they would be without climate policy. Furthermore, since most of the permits would be auctioned, such an approach would still provide significant revenues to the government.

Conclusion. The type of permit allocation does not affect energy prices. It can however, significantly influence the impact of climate policies on energy industries as well as the costs to society. A hybrid system of grandfathering and auctioning permits could preserve energy industries' profits and equity values while providing sufficient government revenues to finance tax cuts or for other purposes.

EYES ONLY

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

Midwest Feels the Heat of a Strong Economy. After suffering from a weak labor market during the 1970s to early 1990s, labor market conditions in the Midwest have improved significantly. In fact, the Midwest's unemployment rate (3.4 percent in October of this year) has been the lowest among the four regions for every month since April 1991. As a result, business executives in the Midwest report that their most difficult problem is "finding good help at current wage offers." A recent study by the Federal Reserve Bank of Chicago suggests that the region's tight labor market will continue. One reason the study cites is slow work force growth caused by continued net-migration out of the Midwest. Another reason is the region's strong economy, which has propelled growth in labor demand, particularly for workers with high levels of education and skills. The study mentions possible public policy responses including encouraging migration to the region, improving education and training, continued welfare-to-work efforts, improving access to transportation and information about jobs for inner-city residents, and encouraging businesses to move to the central cities, where labor markets are typically not as tight.

The Gains from Telecommuting. In May 1997, more than 21 million Americans did some work at home as part of their primary job, according to a recent report. Lower prices and expanding access to mobile phones, laptops, e-mail, and the Internet have made it easier for people to work at home. The report finds that telecommuting provides benefits both to employees and businesses. Workplace flexibility reduces time spent commuting and may help workers balance work and family responsibilities. Not surprisingly, working parents take advantage of telecommuting more than childless workers; in fact, married women with children under the age of 6 had the highest home work rate at nearly 24 percent. Evidently, employers find that offering the option of telecommuting is a way to attract and retain employees and reduce absenteeism. In a 1998 study of large companies, 33 percent allowed employees to work off-site on a regular basis and another 14 percent said they were considering it.

Beige Book Reports Continued Growth. Reports from most Federal Reserve Districts indicated continued moderate to strong economic growth in October and November. Consumer spending picked up over the Thanksgiving weekend, after being hampered by warm weather earlier in November. Manufacturing activity continued to advance in most Districts. Commercial real estate markets remained strong in most parts of the country. Home sales have slipped. Agricultural conditions were mixed, and low prices persist for grains and some other commodities. Oil and gas drilling has increased. Bank lending has declined for residential mortgages but risen for consumer loans. Labor markets remain tight in all Districts. The pace of wage and salary increases did not appear to be accelerating generally, although there were some reports of larger recent salary increases in some industries and regions. Prices appear to be mostly steady at the retail level. Although prices of industrial goods were reported to be mostly steady in a majority of Districts, prices of some goods have been on the rise.

INTERNATIONAL ROUNDUP

€1 = $1 = ¥100? Last week, the yen soared to its strongest level against the dollar in 4 years despite interventions by the Japanese government, while the euro tumbled to its weakest level since its introduction at the beginning of the year, briefly dropping below parity with the dollar. Economic statistics released this week may help curb these trends in the yen and the euro. After growing soundly in the first half of the year, the Japanese economy contracted at an annual rate of nearly 4 percent in the third quarter, according to data released on Monday. Indicators suggest that the outlook for the fourth quarter is similarly dismal, which should dampen upward pressure on the yen. Turning to the euro, unemployment and other indicators released this week indicated improved economic prospects in Germany, suggesting a brighter outlook for the Euro-region. The euro has climbed back above parity and is currently at around $1.02.

New Alliance to Produce Global Framework for E-business. The United Nations and the world's leading computer and software companies have joined together to unify technical standards for the exchange of electronic business information, a move that may revolutionize business on the Web. Currently, most Web documents are stored and transmitted in a computer language known as HTML (Hypertext Markup Language). HTML is easy to learn and is adequate for simple data display, but it limits the types of information that can be represented. A new, more sophisticated language known as XML (Extensible Markup Language) holds the promise of broadening how the Internet can be used. For example, standardized XML specifications would allow an emergency room physician to transfer a wider variety of patient records from distant hospitals into a local database. The public-private alliance aims to create a single global XML standard so that firms in different industries can exchange electronic business data, thereby lowering the barrier of entry to electronic business, particularly with respect to small and medium-size enterprises and developing countries.

Better Ways to Cut Pollution. Developing countries are cutting industrial pollution by combining the power of local communities, markets, and the media to police discharges from private companies, according to a recent World Bank report. The report argues that controlling pollution through traditional regulations entails high enforcement costs and often yields disappointing results. The report presents evidence suggesting that market incentives and public information may provide much better outcomes. Seven highly populated regions in Colombia, for example, instituted a system that charges a flat levy for every ton of specified pollutants discharged into the nation's waterways. In the first 6 months of the plan, discharges of biochemical oxygen demand (BOD) into the Rio Negro River fell 52 percent, and discharges of total suspended solids fell 16 percent. The Indonesian PROPER program, in which regulators publish ratings of plants based on their environmental performance, provides an example of the power of public information disclosure. In an 18-month period, PROPER induced the pilot group of factories to reduce their water pollution by 40 percent.

EYES ONLY

RELEASES THIS WEEK

Producer Price Index

****Embargoed until 8:30 a.m., Friday, December 10, 1999****

The producer price index for finished goods rose 0.2 percent in November. Excluding food and energy, producer prices were unchanged.

Productivity

Nonfarm business productivity rose 4.9 percent at an annual rate in the third quarter. Manufacturing productivity rose 3.9 percent.

MAJOR RELEASES NEXT WEEK

Consumer Prices (Tuesday)
Retail Sales (Tuesday)
Industrial Production and Capacity Utilization (Wednesday)
U.S. International Trade in Goods and Services (Thursday)
Housing Starts (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	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)					
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Imports	9.2	12.7	12.9	13.4	13.8
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Federal surplus	-2.8	0.5	1.1	1.3	1.4

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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	N.A.
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**.
PPI data **embargoed until 8:30 a.m., Friday, December 10, 1999**.

EYES ONLY

FINANCIAL STATISTICS

	1997	1998	October 1999	November 1999	Dec. 9, 1999
Dow-Jones Industrial Average	7441	8626	10397	10810	11135
Interest Rates (percent per annum)					
3-month T-bill	5.06	4.78	4.86	5.07	5.10
10-year T-bond	6.35	5.26	6.11	6.03	6.14
Mortgage rate, 30-year fixed	7.60	6.94	7.85	7.74	7.84
Prime rate	8.44	8.35	8.25	8.37	8.50

INTERNATIONAL STATISTICS

Exchange Rates	**Current level December 9, 1999**	**Percent Change from**	
		Week ago	**Year ago**
Euro (in U.S. dollars)	1.016	1.4	N.A.
Yen (per U.S. dollar)	102.6	-0.1	-13.1
Major currencies index (Mar. 1973=100) (trade-weighted value of the U.S. $)	93.05	-0.8	0.1

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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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.