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EYES ONLY

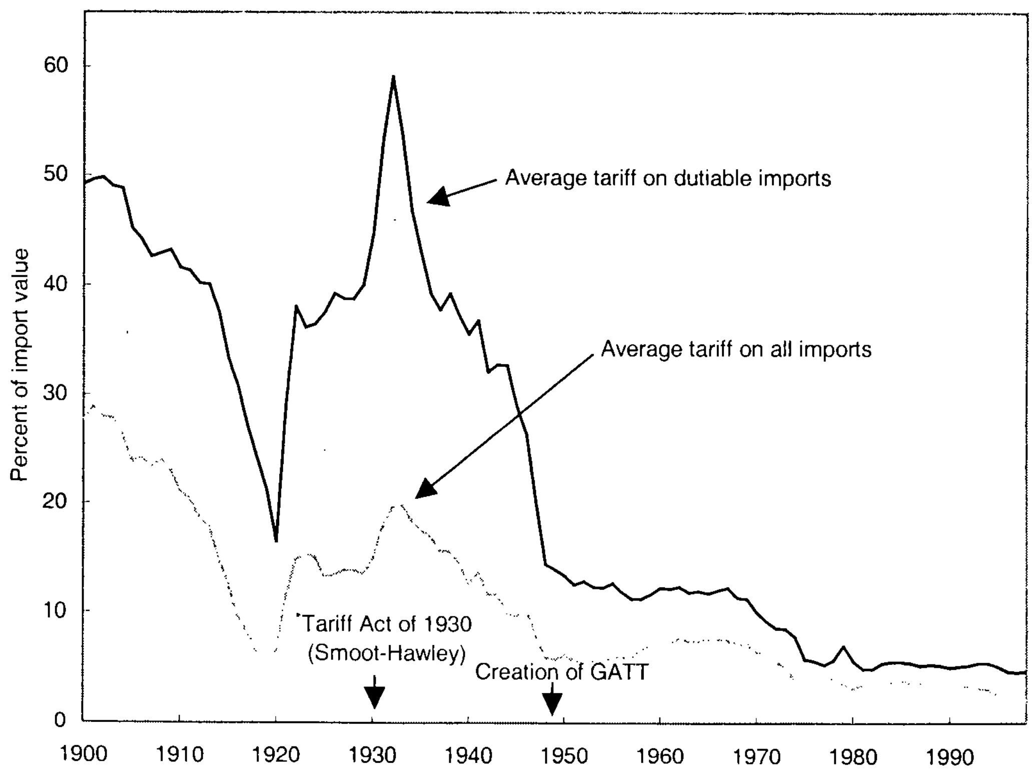
WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

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

November 19, 1999

CHART OF THE WEEK

U.S. Tariff Rates, 1900-1998



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

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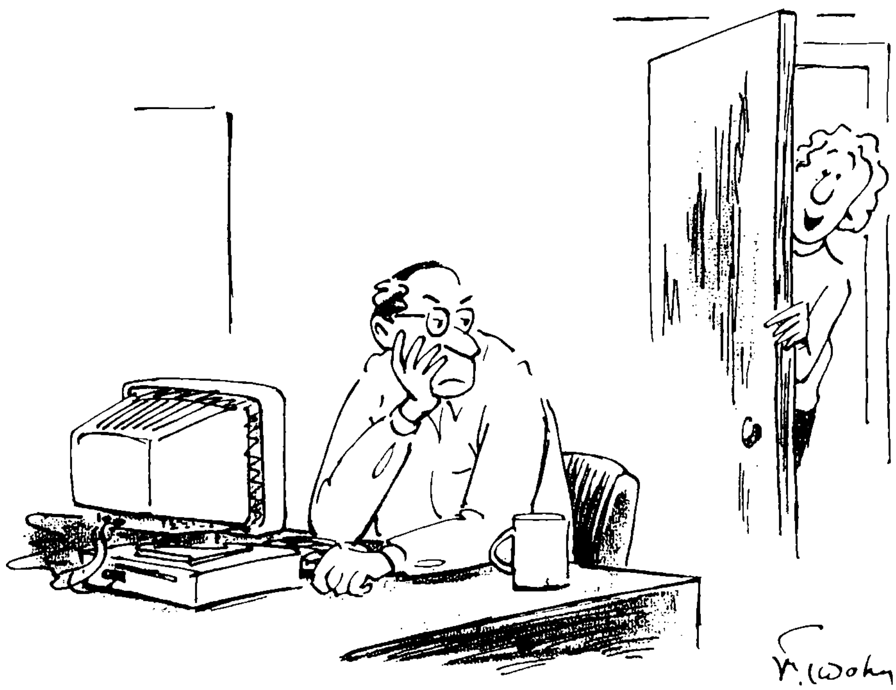
CONTENTS



"Any intellectual property yet, honey?"

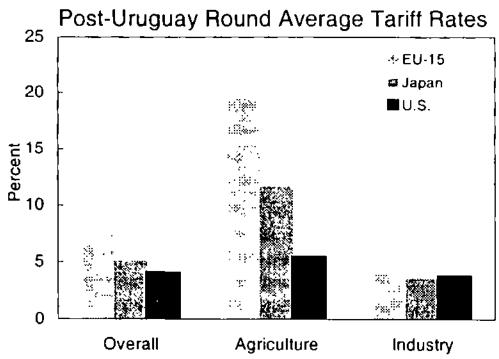
EYES ONLY

SPECIAL ANALYSIS

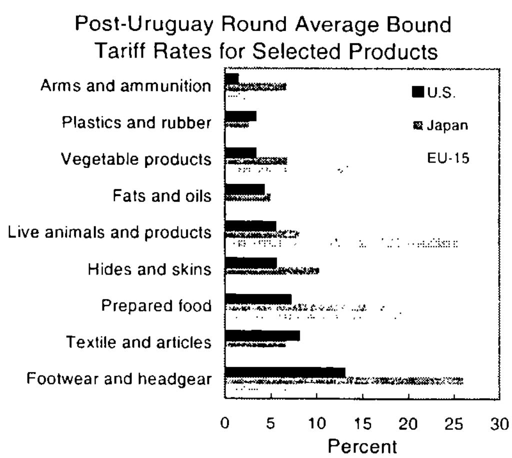
Who Is the Most Open of Them All?

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

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



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



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

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

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

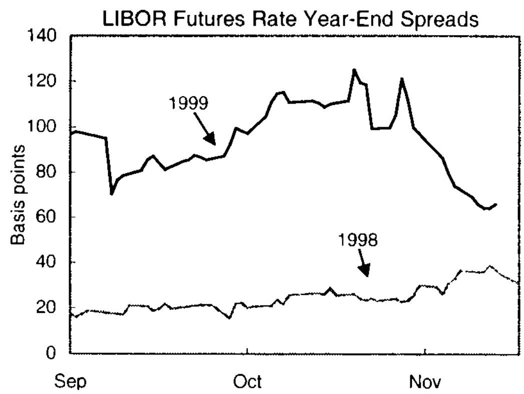
Possible benefits. While economic arguments point to evening out tariff peaks, there may nonetheless be important political reasons for preserving them. Granting high protection to a few politically sensitive sectors may allow more tariff reductions in other sectors, resulting not only in lower overall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

SPECIAL ANALYSIS

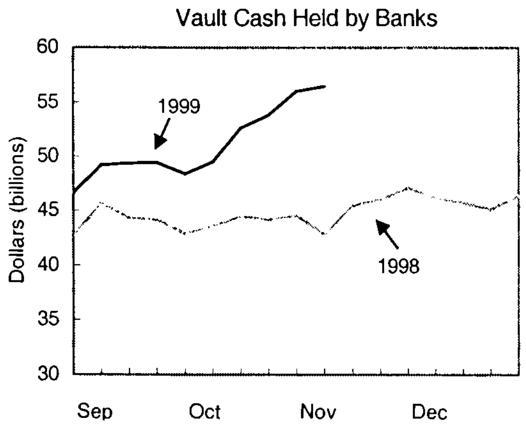
Y2K Effects in Financial Markets

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

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



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



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

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

EYES ONLY

ARTICLE

Patents and Innovation in the On-line World

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

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

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

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

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

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

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

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

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

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

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

INTERNATIONAL ROUNDUP

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

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

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

RELEASES THIS WEEK

U.S. International Trade in Goods and Services

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

Housing Starts

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

Consumer Price Index

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

Industrial Production and Capacity Utilization

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

MAJOR RELEASES NEXT WEEK

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

EYES ONLY

U.S. ECONOMIC STATISTICS

	1970-1993	1998	1999:1	1999:2	1999:3
Percent growth (annual rate)					
Real GDP (chain-type)	3.0	4.6	3.7	1.9	4.8
GDP chain-type price index	5.2	1.1	2.0	1.3	1.0
Nonfarm business (NFB) sector:					
Productivity (chain-type)	**1.7**	3.1	2.7	0.6	4.2
Real compensation per hour:					
Using CPI	**1.0**	3.9	2.8	1.2	2.2
Using NFB deflator	**1.5**	4.7	2.9	2.9	4.4
Shares of Nominal GDP (percent)					
Business fixed investment	11.4	12.5	12.6	12.6	12.8
Residential investment	4.5	4.2	4.4	4.5	4.4
Exports	8.2	11.0	10.7	10.7	10.9
Imports	9.2	12.7	12.9	13.4	13.9
Personal saving	6.6	2.6	2.2	1.8	1.5
Federal surplus	-2.8	0.5	1.1	1.3	N.A.

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

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

New or revised data in **boldface**.

EYES ONLY

FINANCIAL STATISTICS

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

INTERNATIONAL STATISTICS

Exchange Rates	**Current level November 18, 1999**	**Percent Change from Week ago**	**Percent Change from Year ago**
Euro (in U.S. dollars)	1.030	-1.3	N.A.
Yen (per U.S. dollar)	105.9	1.2	-12.8
Major currencies index (Mar. 1973=100) (trade-weighted value of the U.S. $)	93.16	0.6	-0.6

International Comparisons 1/	**Real GDP growth** (percent change last 4 quarters)	**Unemployment rate** (percent)	**CPI inflation** (percent change in index last 12 months)
United States	4.1 (Q3)	4.1 (Oct)	2.6 (Oct)
Canada	3.7 (Q2)	7.5 (Sep)	2.5 (Sep)
Japan	0.9 (Q2)	4.7 (Sep)	-0.2 (Sep)
France	2.1 (Q2)	11.0 (Sep)	0.7 (Sep)
Germany	0.6 (Q2)	9.1 (Sep) 2/	0.6 (Sep)
Italy	0.8 (Q2)	12.1 (Apr)	1.8 (Sep)
United Kingdom	1.8 (Q3)	5.9 (Jul)	1.1 (Sep)

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

EYES ONLY

WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

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

November 12, 1999

CHART OF THE WEEK

Goods and Services Exports as Share of Sector GDP

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

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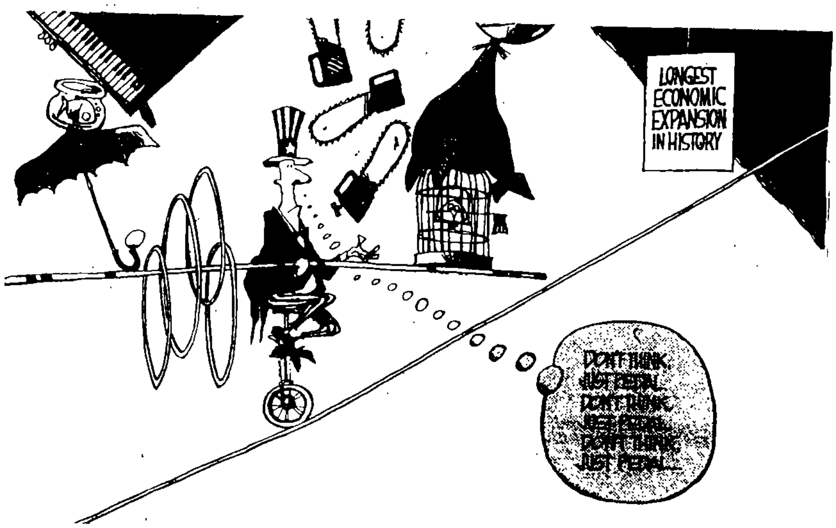

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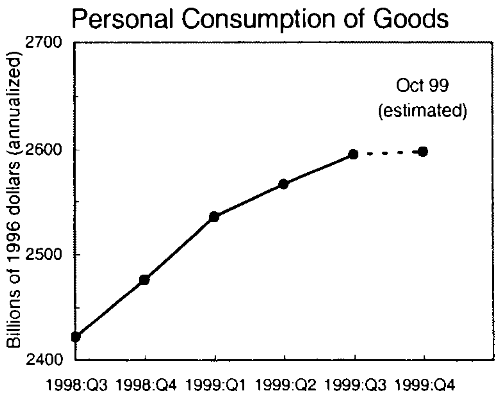
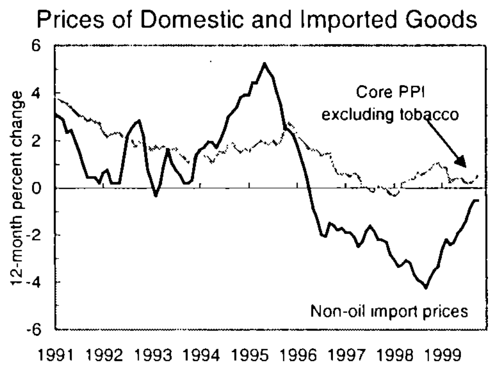
MACROECONOMIC UPDATE

Fourth Quarter Starts Out Strong

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

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





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

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

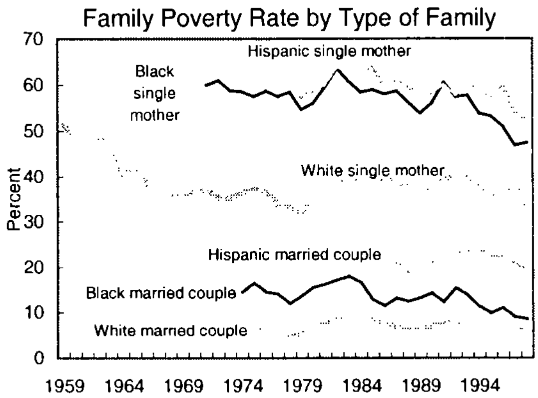
Conclusion. The economy appears to be growing strongly in the fourth quarter. With continued tight labor markets and the change in the import price environment, continued strong productivity growth appears to be the key to keeping inflation tame in the coming year.

SPECIAL ANALYSIS

Poverty and Family Structure

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

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



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

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

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

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

EYES ONLY

ARTICLE

What Comes Next in the Microsoft Case?

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

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

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

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

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

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

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

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

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

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

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

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

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

INTERNATIONAL ROUNDUP

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

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

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

EYES ONLY

RELEASES THIS WEEK

Productivity

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

Retail Sales

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

Producer Price Index

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

MAJOR RELEASES NEXT WEEK

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

EYES ONLY

U.S. ECONOMIC STATISTICS

	1970-1993	1998	1999:1	1999:2	1999:3
Percent growth (annual rate)					
Real GDP (chain-type)	3.0	4.6	3.7	1.9	4.8
GDP chain-type price index	5.2	1.1	2.0	1.3	1.0
Nonfarm business (NFB) sector:					
Productivity (chain-type)	N.A.	**3.1**	**2.7**	**0.6**	**4.2**
Real compensation per hour:					
Using CPI	N.A.	**3.9**	**2.8**	**1.2**	**2.2**
Using NFB deflator	N.A.	**4.7**	**2.9**	**2.9**	**4.4**
Shares of Nominal GDP (percent)					
Business fixed investment	11.4	12.5	12.6	12.6	12.8
Residential investment	4.5	4.2	4.4	4.5	4.4
Exports	8.2	11.0	10.7	10.7	10.9
Imports	9.2	12.7	12.9	13.4	13.9
Personal saving	6.6	2.6	2.2	1.8	1.5
Federal surplus	-2.8	0.5	1.1	1.3	N.A.

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

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

New or revised data in **boldface**.

EYES ONLY

FINANCIAL STATISTICS

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

INTERNATIONAL STATISTICS

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

International Comparisons [1]	**Real GDP growth** (percent change last 4 quarters)	**Unemployment rate** (percent)	**CPI inflation** (percent change in index last 12 months)
United States	4.1 (Q3)	4.1 (Oct)	2.6 (Sep)
Canada	3.7 (Q2)	7.5 (Sep)	2.5 (Sep)
Japan	0.9 (Q2)	4.7 (Sep)	-0.2 (Sep)
France	2.1 (Q2)	11.0 (Sep)	0.7 (Sep)
Germany	0.6 (Q2)	9.1 (Sep)[2]	0.6 (Sep)
Italy	0.8 (Q2)	12.1 (Apr)	1.8 (Sep)
United Kingdom	1.8 (Q3)	5.9 (Jul)	1.1 (Sep)

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

EYES ONLY

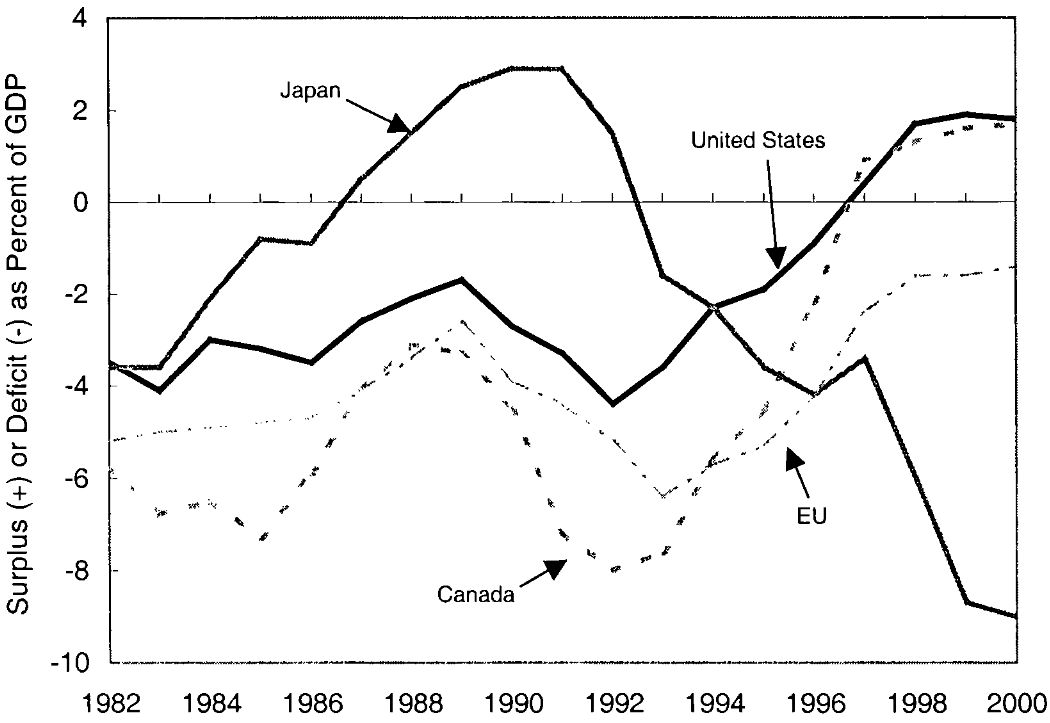
WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

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

November 5, 1999

CHART OF THE WEEK

Fiscal Balances Generally Improving Outside of Japan



Data for 1999 and 2000 are projections

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

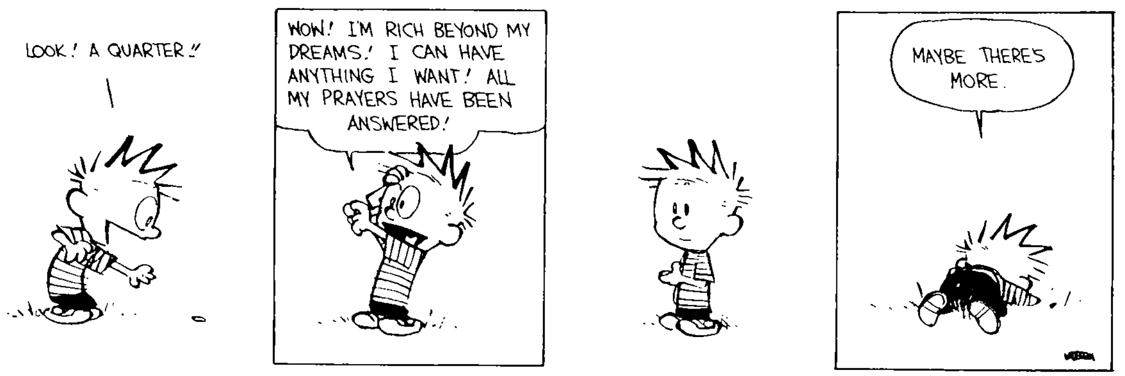
EYES ONLY

CONTENTS

SPECIAL ANALYSES

ARTICLE

DEPARTMENTS



EYES ONLY

SPECIAL ANALYSIS

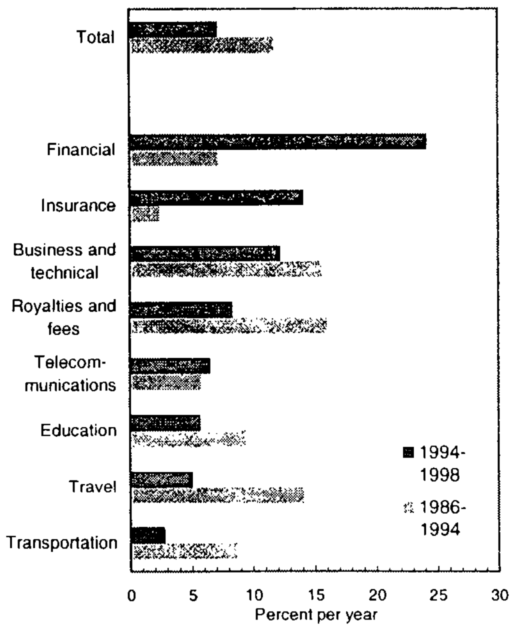
U.S. Service Sector Poised to Gain from New WTO Round

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

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

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

Growth in U.S. Private Service



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

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

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

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

EYES ONLY

SPECIAL ANALYSIS

Gun Industry Innovation and Gun Violence

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

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

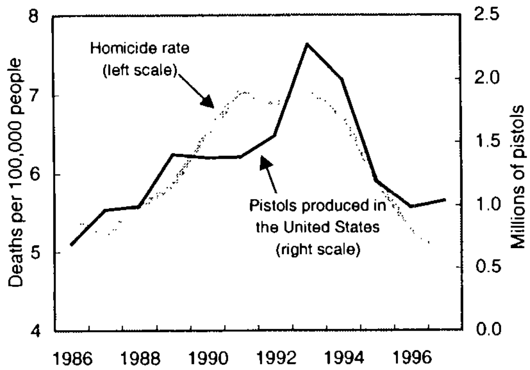
- More handguns. With the declining importance of demand for hunting and sporting guns, in part because of increased levels of urbanization, rifles and shotguns have declined, while handguns have increased as a share of all guns available for sale. The number of hunting licenses issued by states dropped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

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

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

Social costs. The industry's innovations have had important consequences for the social costs of gun violence. In addition to being a factor in increased rates of unintentional death and suicide, handguns are the primary weapon used in homicide. In 1998, over 80 percent of all firearm-related homicides involved a handgun—while handguns represent only about a third of all guns in existence. The increased prevalence of pistols shows up in the crime statistics as well. In 1989-90, only 3 or 4 of the top 10 guns that were used in crimes and traced by the Bureau of Alcohol, Tobacco, and Firearms were pistols, but this number rose to 7 to 9 in 1992-95. Firearm homicide death rates rose into the early 1990s with the increased production of pistols, but both have since declined sharply (see chart). The increasing prevalence of pistols may also account for research findings such as the increase in the average number of wounds per gunshot victim in the late 1980s and the increase in the caliber of bullets recovered in autopsies into the early 1990s.

Firearm Homicide Deaths and Pistol Production



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

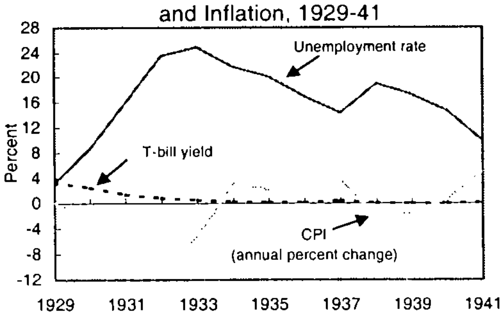
ARTICLE

The "Liquidity Trap" and Monetary Policy

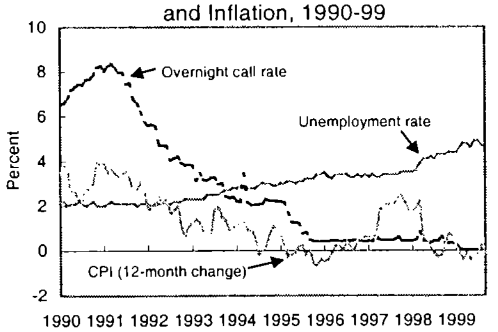
Monetary policy primarily affects the economy through the control of short-term interest rates. But what if an economy were in a recession and interest rates were already near zero? Monetary policy would be unable to push interest rates below zero—and thereby stimulate the economy—because people can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

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

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



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



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

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

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

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

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

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

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

EYES ONLY

INTERNATIONAL ROUNDUP

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

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

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

EYES ONLY

RELEASES THIS WEEK

Employment and Unemployment

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

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

Leading Indicators

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

NAPM Report on Business

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

MAJOR RELEASES NEXT WEEK

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

EYES ONLY

U.S. ECONOMIC STATISTICS

	1970-1993	1998	1999:1	1999:2	1999:3
Percent growth (annual rate)					
Real GDP (chain-type)	3.0	4.6	3.7	1.9	4.8
GDP chain-type price index	5.2	1.1	2.0	1.3	1.0
Nonfarm business (NFB) sector:					
Productivity (chain-type)	1.5	2.6	3.6	0.6	N.A.
Real compensation per hour:					
Using CPI	0.6	2.5	2.9	1.5	N.A.
Using NFB deflator	1.3	3.7	3.0	3.7	N.A.
Shares of Nominal GDP (percent)					
Business fixed investment	**11.4**	12.5	12.6	12.6	12.8
Residential investment	**4.5**	4.2	4.4	4.5	4.4
Exports	8.2	11.0	10.7	10.7	10.9
Imports	9.2	12.7	12.9	13.4	13.9
Personal saving	**6.6**	2.6	2.2	1.8	1.5
Federal surplus	**-2.8**	0.5	1.1	1.3	N.A.

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

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

New or revised data in **boldface**.
Employment and unemployment data **embargoed until 8:30 a.m., Friday, November 5, 1999**.

EYES ONLY

U.S. ECONOMIC STATISTICS

	1970-1993	1998	1999:1	1999:2	1999:3
Percent growth (annual rate)					
Real GDP (chain-type)	3.0	4.6	3.7	1.9	4.8
GDP chain-type price index	5.2	1.1	2.0	1.3	1.0
Nonfarm business (NFB) sector:					
Productivity (chain-type)	1.5	2.6	3.6	0.6	N.A.
Real compensation per hour:					
Using CPI	0.6	2.5	2.9	1.5	N.A.
Using NFB deflator	1.3	3.7	3.0	3.7	N.A.
Shares of Nominal GDP (percent)					
Business fixed investment	**11.4**	12.5	12.6	12.6	12.8
Residential investment	**4.5**	4.2	4.4	4.5	4.4
Exports	8.2	11.0	10.7	10.7	10.9
Imports	9.2	12.7	12.9	13.4	13.9
Personal saving	**6.6**	2.6	2.2	1.8	1.5
Federal surplus	**-2.8**	0.5	1.1	1.3	N.A.

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

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

New or revised data in **boldface**.
Employment and unemployment data **embargoed until 8:30 a.m., Friday, November 5, 1999**.

EYES ONLY

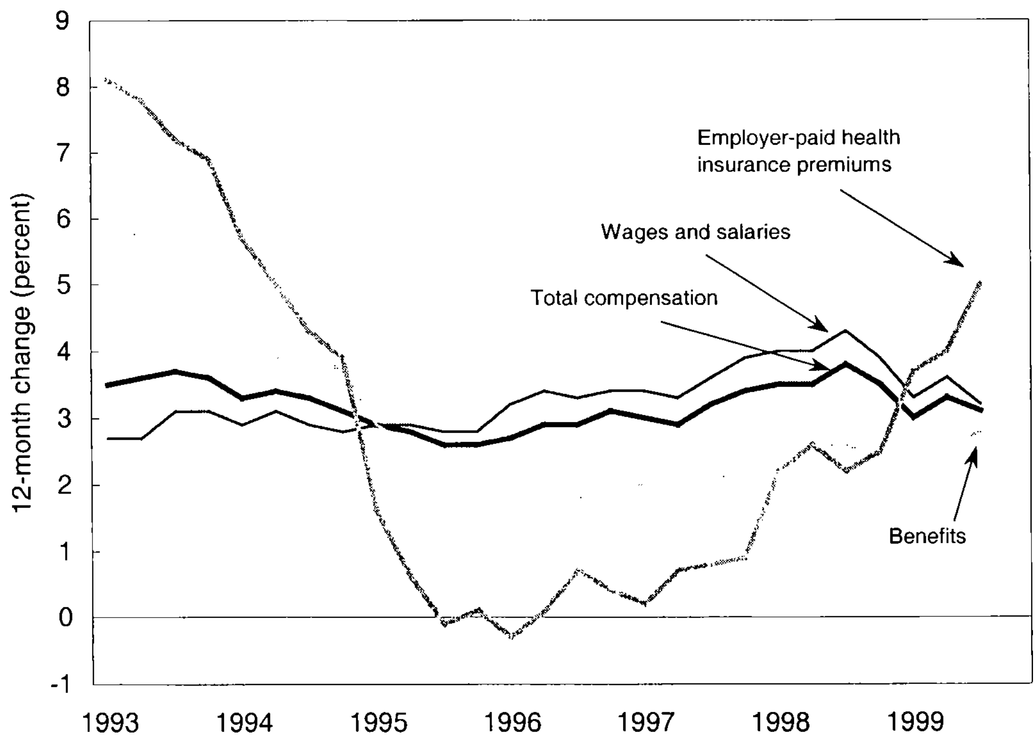
WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

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

October 29, 1999

CHART OF THE WEEK

Employment Cost Index for Private Industry



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

CONTENTS

EYES ONLY

CURRENT DEVELOPMENT

SPECIAL ANALYSIS

ARTICLE

DEPARTMENTS

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

EYES ONLY

CURRENT DEVELOPMENT

GDP Scorecard: Third Quarter 1999

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

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

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

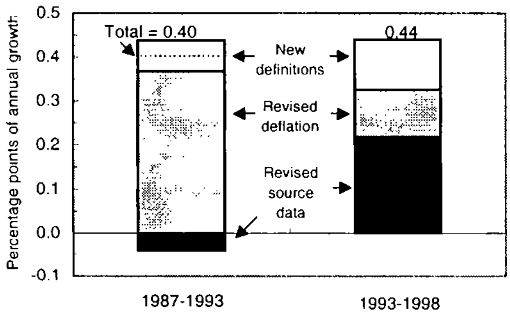
EYES ONLY

SPECIAL ANALYSIS

Revisions Show Higher GDP Growth

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

Sources of Revision to Real GDP Growth*



* CEA estimates

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

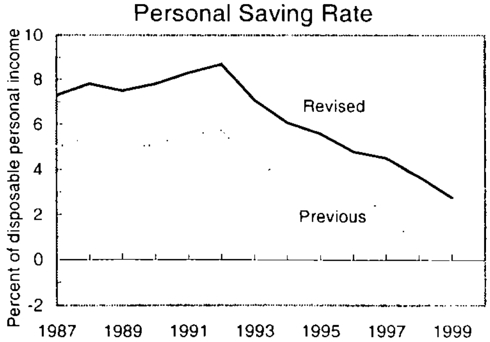
The revisions fall into three main categories (see upper chart):

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

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

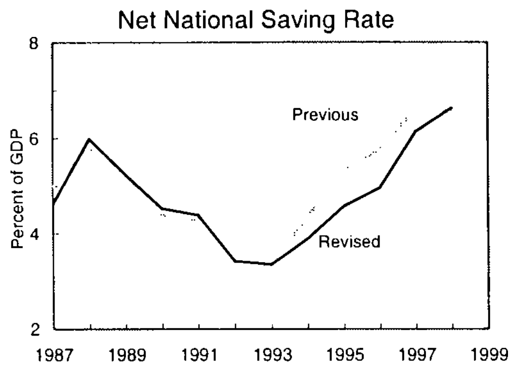
- New definitions. The most significant new definition is the inclusion of the purchase and development of computer software as investment, raising the *level* of GDP by about 1.9 percent by 1998. This change raises the *growth rate* of real GDP by an average of 0.1 percentage point per year.

Personal Saving Rate

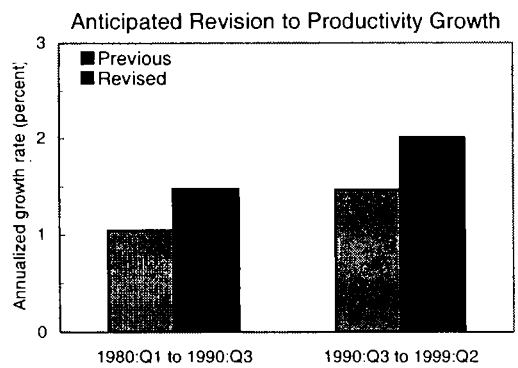


Note: 1999 data based on first half

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



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



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

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

EYES ONLY

ARTICLE

Evaluating the Evidence on Job Stability

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

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

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

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

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

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

EYES ONLY

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

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

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

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

EYES ONLY

INTERNATIONAL ROUNDUP

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

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

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

EYES ONLY

RELEASES THIS WEEK

Gross Domestic Product

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

Employment Cost Index

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

Advance Durable Orders

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

Consumer Confidence

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

MAJOR RELEASES NEXT WEEK

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

EYES ONLY

U.S. ECONOMIC STATISTICS

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

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

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

New or revised data in **boldface**.

EYES ONLY

FINANCIAL STATISTICS

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

INTERNATIONAL STATISTICS

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

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

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

EYES ONLY

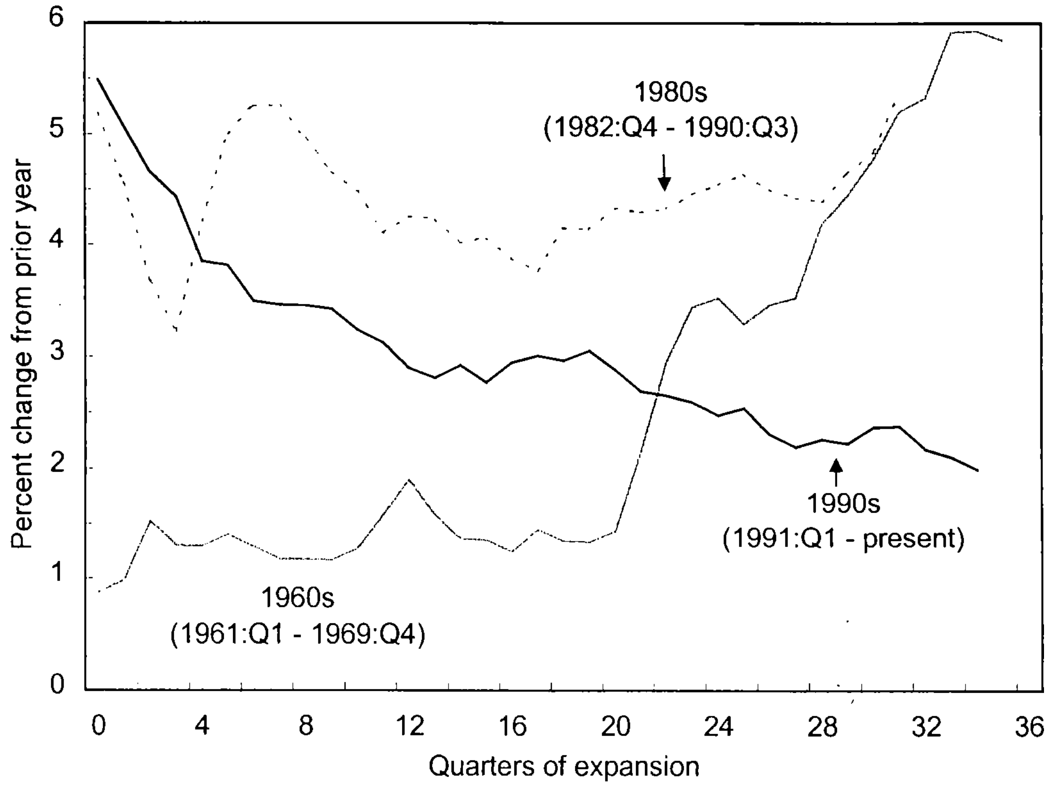
WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

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

October 22, 1999

CHART OF THE WEEK

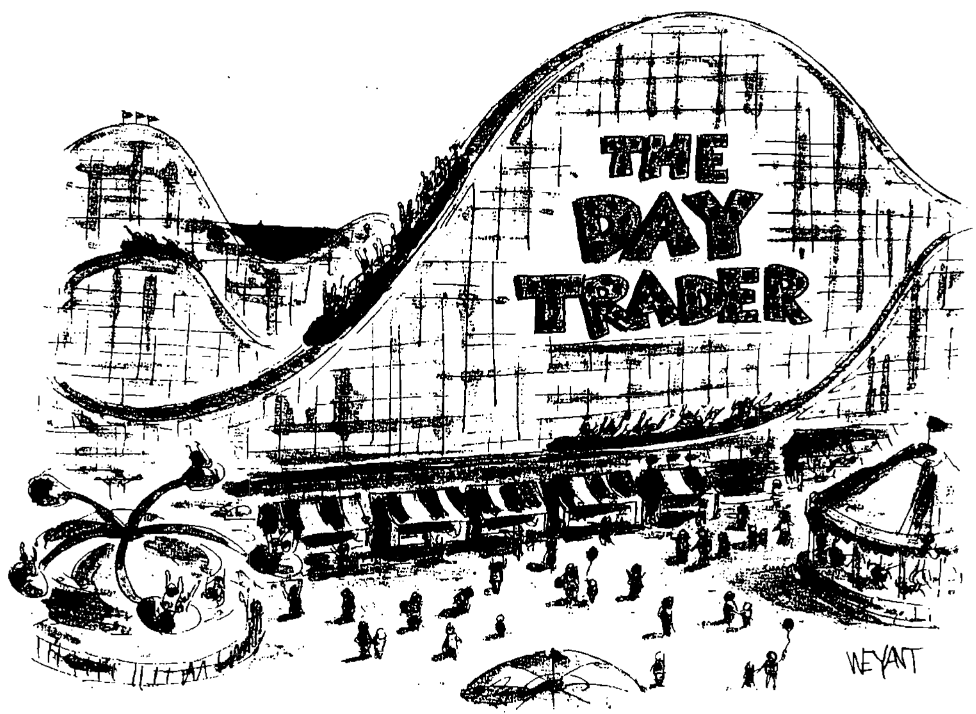
Core Inflation in Three Long Expansions



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

EYES ONLY

CONTENTS



EYES ONLY

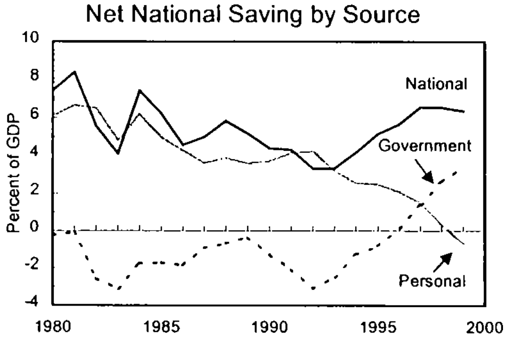
TREND

Have Americans Stopped Saving?

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

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

Net National Saving by Source



Note: 1999 data based on first half

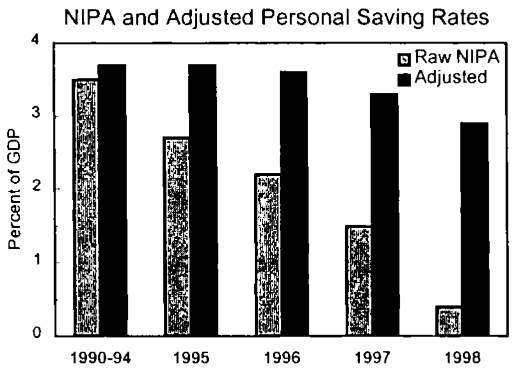
Measuring personal saving. In general, saving may be thought of as the part of current income that is laid aside for future use. The recent study suggests that some adjustments to the NIPA measure of personal saving might bring it more in line with this economic concept of saving. Among the most important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

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

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

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

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



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

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

SPECIAL ANALYSIS

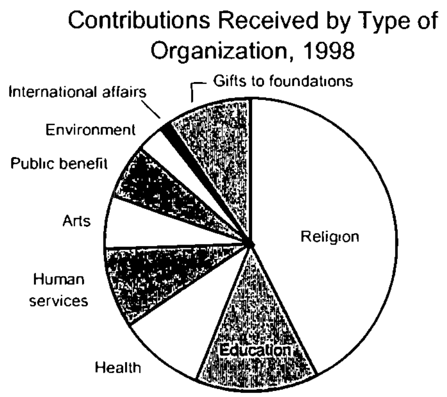
Recent Trends in Philanthropy

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

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

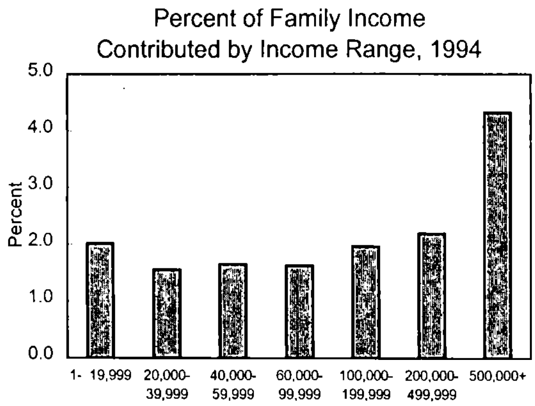
Who gives? Individuals accounted for an estimated 85 percent of all contributions in 1998 (77 percent of all giving was from living individuals and another 8 percent was from bequests). Other giving came from foundations (10 percent) and corporations (5 percent). About 70 percent of households contributed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

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



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

EYES ONLY



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

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

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

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

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ARTICLE

Reviving Russia: What Is to Be Done?

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

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

Average Labor Productivity by Sector, Russia 1997

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

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

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

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

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

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

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

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

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

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

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

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

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

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

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

EYES ONLY

INTERNATIONAL ROUNDUP

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

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

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

EYES ONLY

RELEASES THIS WEEK

U.S. International Trade in Goods and Services

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

Housing Starts

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

Consumer Price Index

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

MAJOR RELEASES NEXT WEEK

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

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U.S. ECONOMIC STATISTICS

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

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

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

New or revised data in **boldface**.

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FINANCIAL STATISTICS

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

INTERNATIONAL STATISTICS

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

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

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

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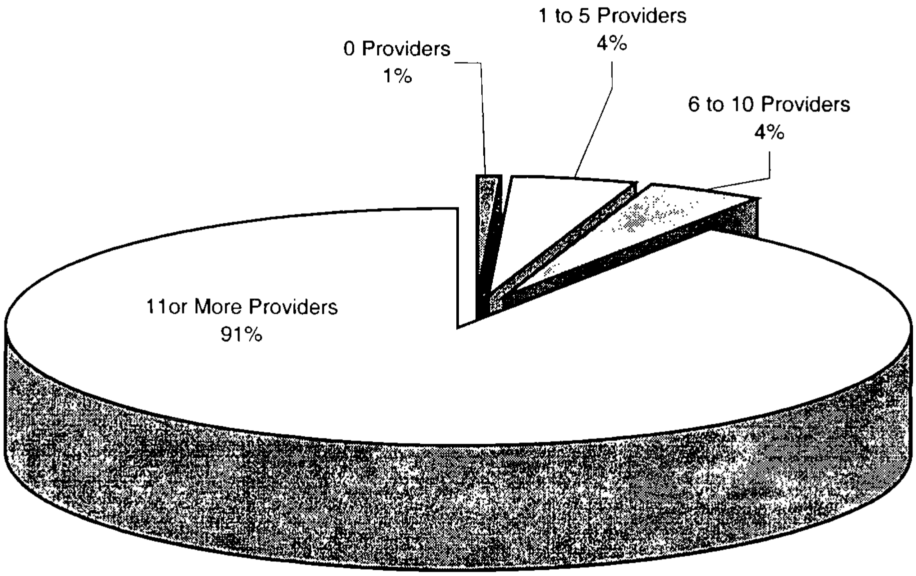
WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

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

October 15, 1999

CHART OF THE WEEK

Percent of Population with Local Internet Access



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

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CONTENTS

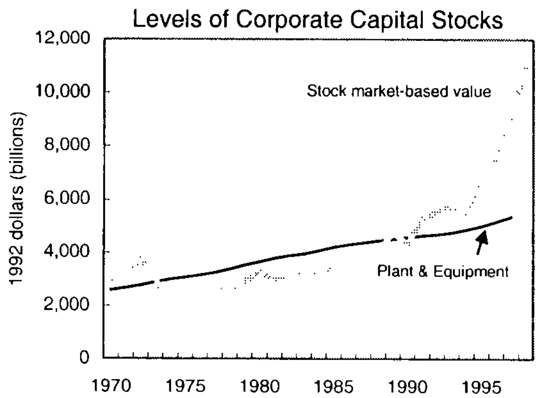
"I've consolidated all our bills into one missed payment."

SPECIAL ANALYSIS

Intangible Capital and the Stock Market

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

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



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

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

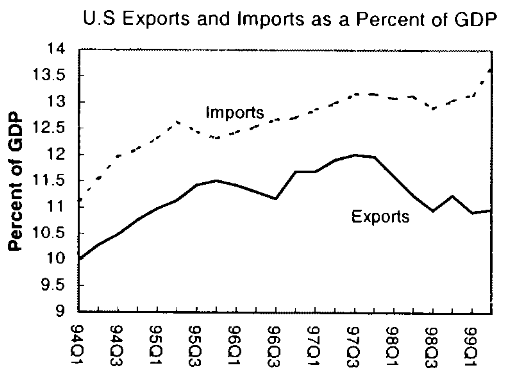
EYES ONLY

SPECIAL ANALYSIS

Recent Patterns of Trade and Growth

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

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



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

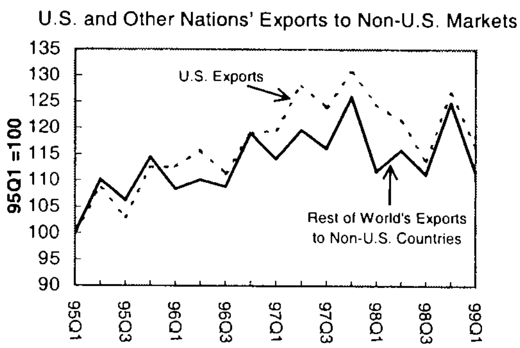
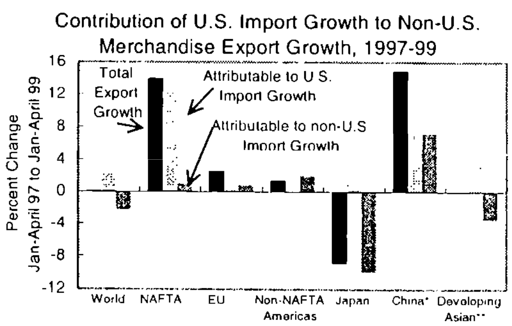


Chart derived from import data

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



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

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

EYES ONLY

ARTICLE

From Learning to Earning

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

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

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

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

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

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

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

EYES ONLY

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

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

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

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

INTERNATIONAL ROUNDUP

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

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

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

EYES ONLY

RELEASES THIS WEEK

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Industrial Production and Capacity Utilization
****Embargoed until 9:15 a.m., Friday, October 15, 1999****

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

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

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

Retail Sales

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

MAJOR RELEASES NEXT WEEK

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

EYES ONLY

U.S. ECONOMIC STATISTICS

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

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

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

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

EYES ONLY

FINANCIAL STATISTICS

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

INTERNATIONAL STATISTICS

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

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

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

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

EYES ONLY

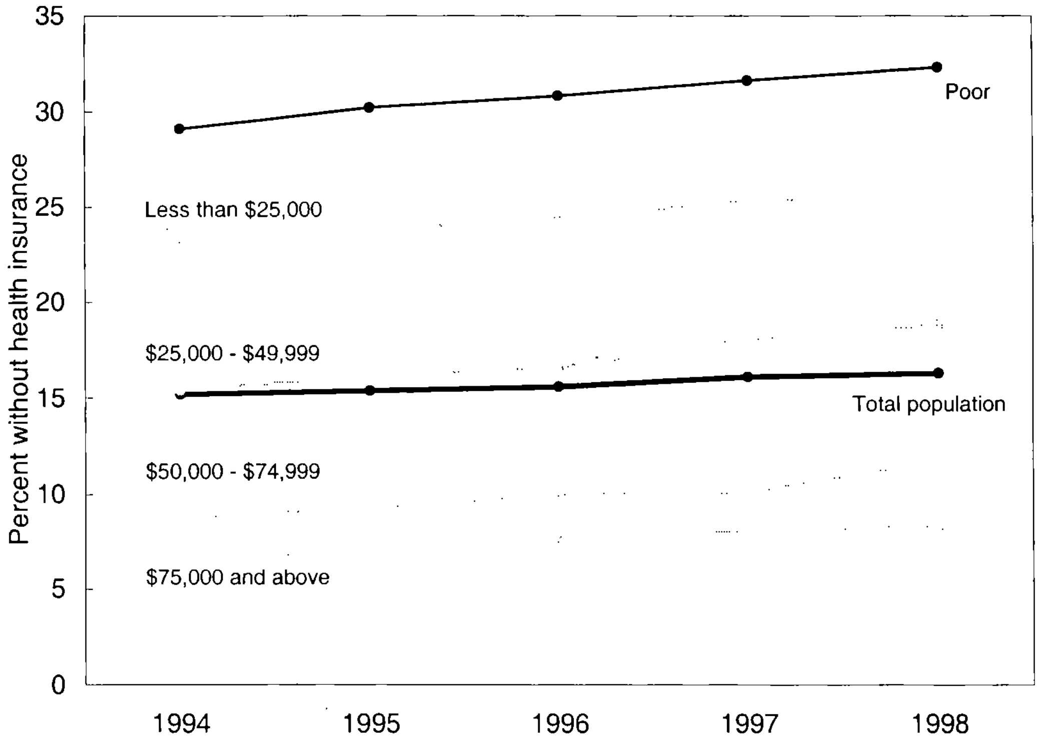
WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

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

October 8, 1999

CHART OF THE WEEK

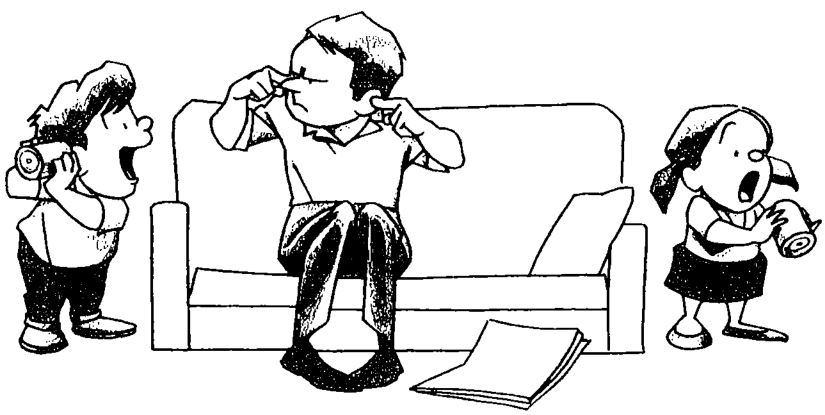
Lack of Health Insurance Coverage by Income Group



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

EYES ONLY

CONTENTS



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

EYES ONLY

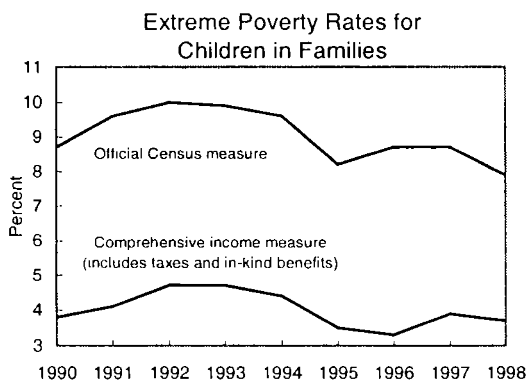
TREND

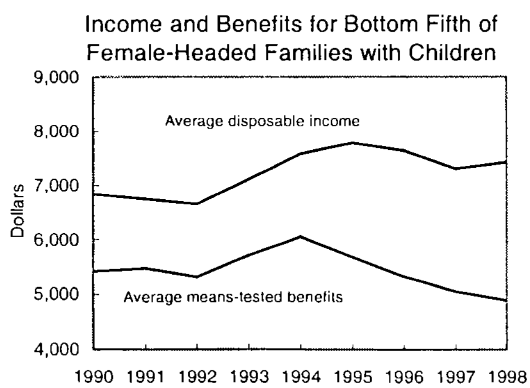
Extreme Child Poverty and the Income of Single Mothers

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

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

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





Female-headed households. The trend toward lower disposable income for the poorest fifth of female-headed households with children reported by the CBPP was also halted in 1998. The HHS analysis shows that the average means-tested benefits received by this group continued to decline in 1998 (see lower chart on previous page). However, earnings and other income increased by more than enough to offset the decline in benefits, leading to an increase in average disposable income (the comprehensive definition of income). As a result, the comprehensive measure of the poverty rate for female-headed families declined slightly between 1997 and 1998.

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

SPECIAL ANALYSIS

An Alternative to Stricter Medicaid Asset Limits

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

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

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

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

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

Early indicators are encouraging. Preliminary evaluations suggest that partnership programs have successfully attracted middle-income-and-asset households—exactly those who might otherwise transfer their assets in order to qualify for Medicaid. In New York, partnership insurance accounts for 20 percent of all long-term care policies active in the state. In addition, partnership policies may represent a more affordable long-term care option for some people. In Connecticut, for example, it is only necessary to purchase an amount of insurance equal to the amount of assets an individual wishes to protect. These early indicators suggest that partnership policies may present a viable way to address the transfer problem.

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

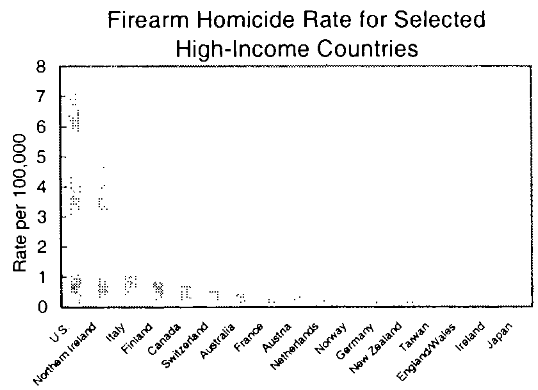
Conclusion. The Administration has proposed a major initiative to address the Nation's long-term care needs. Some version of partnership programs may offer additional encouragement for using private long-term care insurance rather than simply transferring assets to qualify for Medicaid.

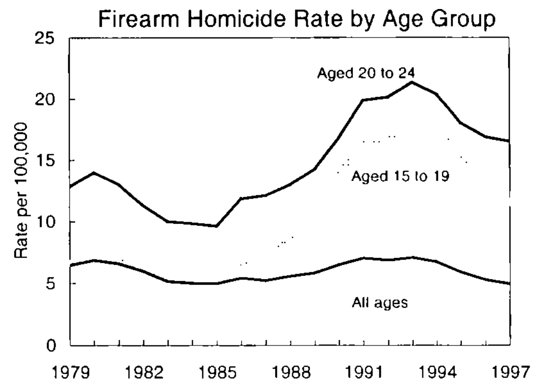
EYES ONLY

ARTICLE

The Costs of Gun Violence

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





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

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

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

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

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

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

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

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

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

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

INTERNATIONAL ROUNDUP

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

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

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

EYES ONLY

RELEASES THIS WEEK

Employment and Unemployment

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

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

Leading Indicators

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

MAJOR RELEASES NEXT WEEK

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

EYES ONLY

U.S. ECONOMIC STATISTICS

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

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

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

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

EYES ONLY

FINANCIAL STATISTICS

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

INTERNATIONAL STATISTICS

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

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

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

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

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

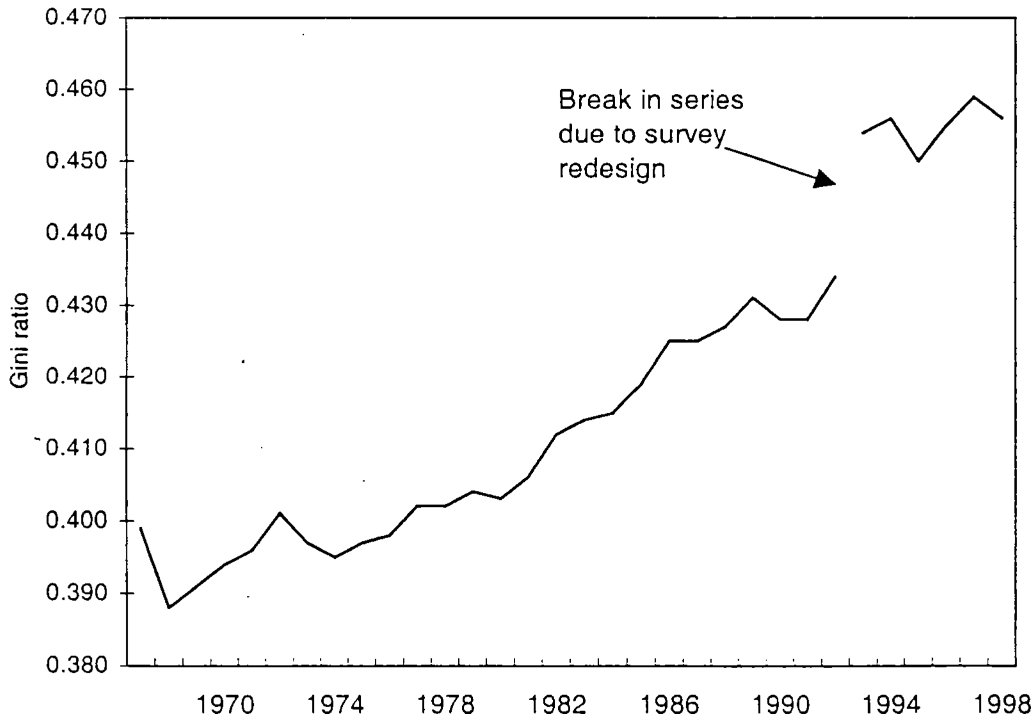
WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

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

October 1, 1999

CHART OF THE WEEK

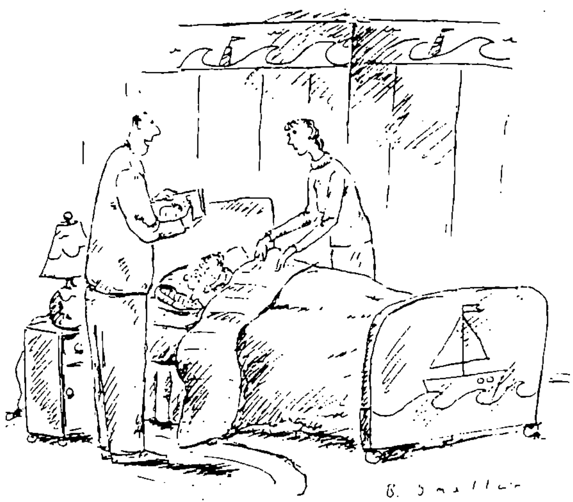
Income Inequality Has Stopped Increasing



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

EYES ONLY

CONTENTS



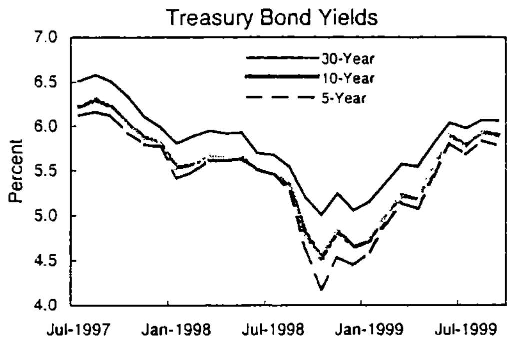
"Of course he looks peaceful—he's lived his entire life in a bull market."

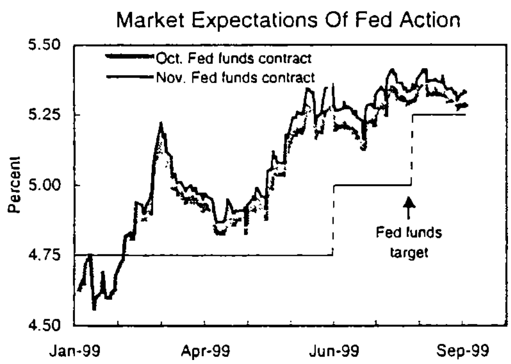
EYES ONLY

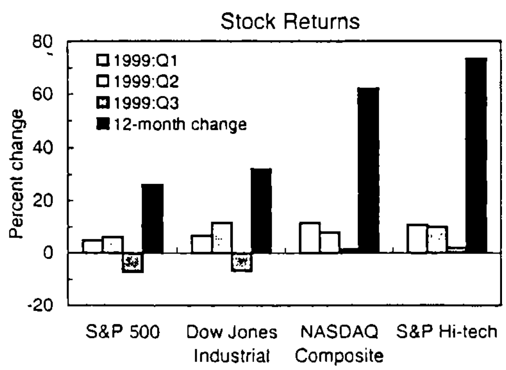
FINANCIAL MARKET UPDATE

Third Quarter, 1999

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







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

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

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

EYES ONLY

CURRENT DEVELOPMENT

Y2K Inventory Building Could Make GDP More Volatile

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

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

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

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

EYES ONLY

SPECIAL ANALYSIS

E-Commerce (Re)discovers the Distribution System

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

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

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

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

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

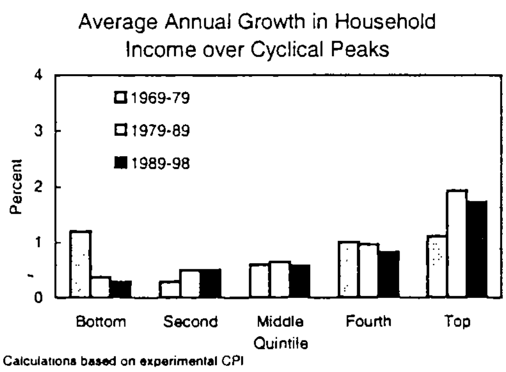
ARTICLE

Measuring Income and Poverty

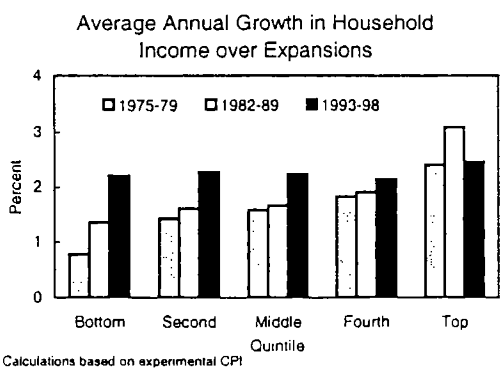
The latest statistics on income and poverty show excellent progress since 1993. Median family income adjusted for inflation is at an all-time high and the poverty rate is lower than it has been at any time since 1979. In some ways, the gains would be even more impressive if the official measures better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

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

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

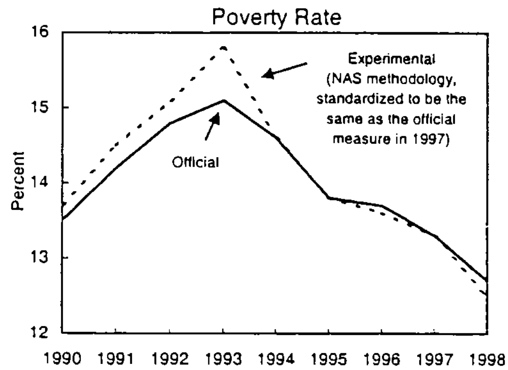


A hopeful sign that the stagnation of median income and the rise in inequality that characterized the 1973-93 period may be over can be seen in the growth of income since 1993. In each fifth of the distribution, growth in real income exceeded 2 percent per year (using the experimental CPI) and growth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



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

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



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

EYES ONLY

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

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

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

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

EYES ONLY

INTERNATIONAL ROUNDUP

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

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

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

EYES ONLY

RELEASES THIS WEEK

NAPM Report on Business

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

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

Gross Domestic Product

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

Advance Durable Orders

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

Consumer Confidence

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

MAJOR RELEASES NEXT WEEK

Leading Indicators (Tuesday)
Employment (Friday)

EYES ONLY

U.S. ECONOMIC STATISTICS

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

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

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

New or revised data in **boldface**.

EYES ONLY

FINANCIAL STATISTICS

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

INTERNATIONAL STATISTICS

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

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

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