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EYES ONLY

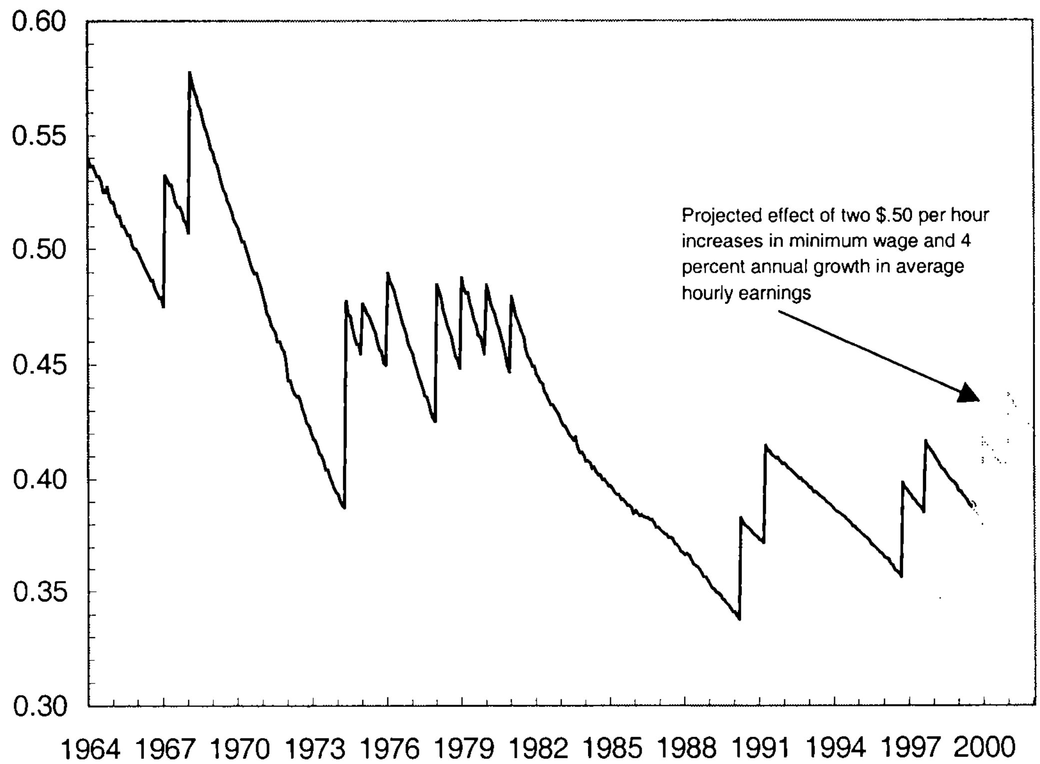
WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

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

September 24, 1999

CHART OF THE WEEK

Ratio of the Minimum Wage to Average Hourly Earnings



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

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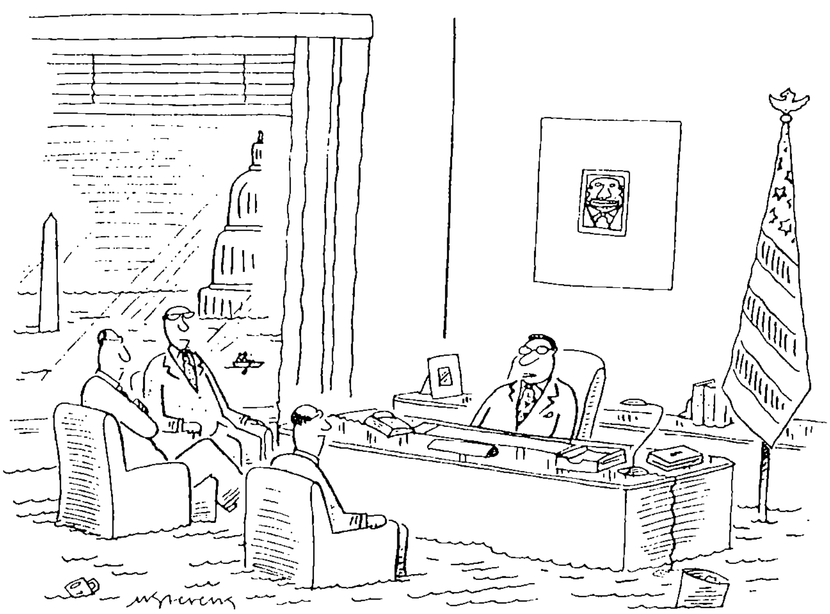


"Gentlemen, it's time we gave some serious thought to the effects of global warming."

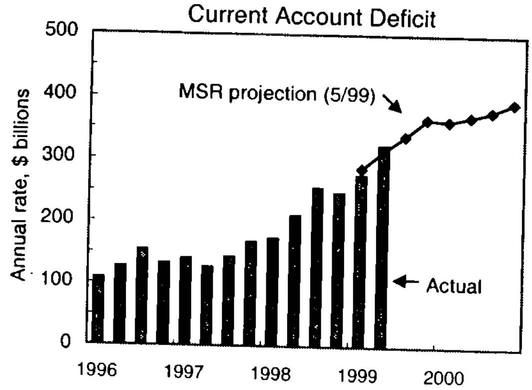
EYES ONLY

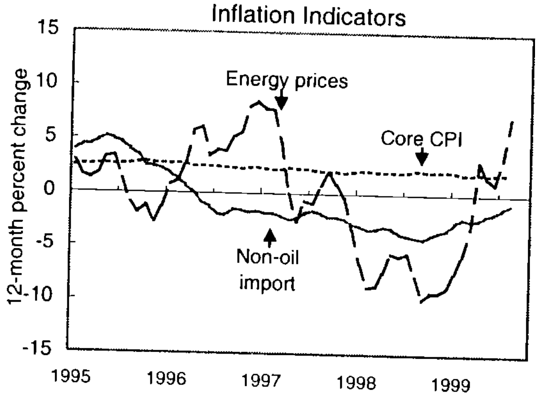
MACROECONOMIC UPDATE

Third Quarter Should Be Strong

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

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





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

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

EYES ONLY

SPECIAL ANALYSIS

Hot Economy, Cool Emissions?

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

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

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

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

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

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

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

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

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

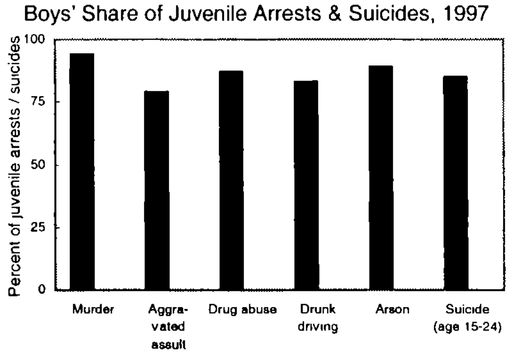
EYES ONLY

ARTICLE

"Reviving Laertes:" Recent Studies of Boys' Development

After a decade of influential studies on the development of girls, including the 1992 report *How Schools Shortchange Girls* and the 1994 book *Reviving Ophelia*, several recent studies have focused on boys. One important reason not to neglect the development of Ophelia's brother is that socially costly problems of crime and violence remain overwhelmingly problems of boys and men.

Boys' Share of Juvenile Arrests & Suicides, 1997



Crime and suicide. Juveniles arrested for property and violent crimes are overwhelmingly boys (see chart). Male students are substantially more apt to fight at school or to carry a weapon than female students in high school. And the suicide rate of young men aged 15 to 24 is more than five times that of young women that age.

The economic costs of crime and violence arise not only from the financial costs to victims but also from the loss of productive work arising from time spent in criminal activity and premature death. For example, the Justice Department's 1999 national report on juvenile offenders and victims estimates that the cost of a youth's dropping out of high school for a life of crime and drug abuse is between $1.7 and $2.3 million (in present value terms). This figure includes drug treatment and rehabilitation costs, medical costs, criminal justice costs, and victim costs, as well as the value of lost wages and output.

Insights from beyond the dismal science. One sociological insight into boys' greater involvement in crime and violence comes from *Raising Cain*, a recent book co-authored by a professor of public health at Harvard and a child psychologist. The book concludes that above and beyond the role of biology, differences between boys and girls are amplified by a culture that supports emotional development for girls and discourages it for boys. In particular, stereotypical notions of masculine toughness limit boys development of a full range of emotional resources, mitigating an "emotional literacy" needed to read and understand their emotions and those of others. The result, it argues, is that many boys are left to manage conflict, adversity, and change with a limited emotional repertoire, in turn leading to a higher propensity toward conflict and violence.

Conclusion and implications. Recently, researchers have shown an interest in the problems of boys. Besides crime and violence, these include school performance and, to some extent, self-esteem (see box on next page). In the future, the new research, combined with more standard economic analysis of the role of factors like family income and poverty status, might help in the design of policies to address problems such as the higher average crime rates and lower average educational attainment of African American boys relative to other boys.

Addressing the problems of boys is also one way to improve the future outcomes of men. With respect to fatherhood, for example, preliminary evidence finds that "emotionally illiterate" boys are more likely to become uninvolved fathers when they are adults. In addition, results from the 1999 National Survey of American Attitudes on Substance Abuse suggest the importance of healthy father-son relationships. It finds in two-parent families that a teenager whose relationship with the father is fair or poor is 68 percent more likely to smoke, drink, and use drugs than one whose relationship is average.

Developmental Differences between Boys and Girls

Besides findings on criminal and violent behavior, recent research has re-examined two other aspects of possible differences in boys' and girls' development that were raised in the earlier research on girls.

- School performance. Boys are more than twice as likely as girls to have a learning disability and two to three times more likely to have an attention deficit problem. From grade school to graduate school, females earn higher grades, on average—even in mathematics and sciences. In high school, girls now equal or outnumber boys in science classes, on average, except for physics. Differences in standardized test scores are small, with females scoring higher in writing ability and reading achievement and males scoring higher in science and mathematics (a gap that is shrinking). Men are a minority of college students (45 percent in 1995) and earn less than half of bachelor's and master's degrees.

- Self-esteem. *Raising Ophelia* argued that girls suffer a severe drop in self-esteem at adolescence, while boys gain in self-assurance as they age. Subsequent, more comprehensive research has revealed a less dramatic gap in self-esteem between genders. For example, a 1997 report found that girls had the advantage over boys in terms of future plans, teachers' expectations, and everyday experiences in school and in the classroom, with minority boys the most likely to feel discouraged about the future and the least interested in getting a good education. A recent study of self-esteem summarizes over 150 previous findings and concludes that males score higher on standard measures of self-esteem than females, but that the differences are small.

EYES ONLY

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

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

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

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

EYES ONLY

INTERNATIONAL ROUNDUP

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

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

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

EYES ONLY

RELEASES THIS WEEK

U.S. International Trade in Goods and Services

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

MAJOR RELEASES NEXT WEEK

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

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

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

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

EYES ONLY

FINANCIAL STATISTICS

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

INTERNATIONAL STATISTICS

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

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

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

EYES ONLY

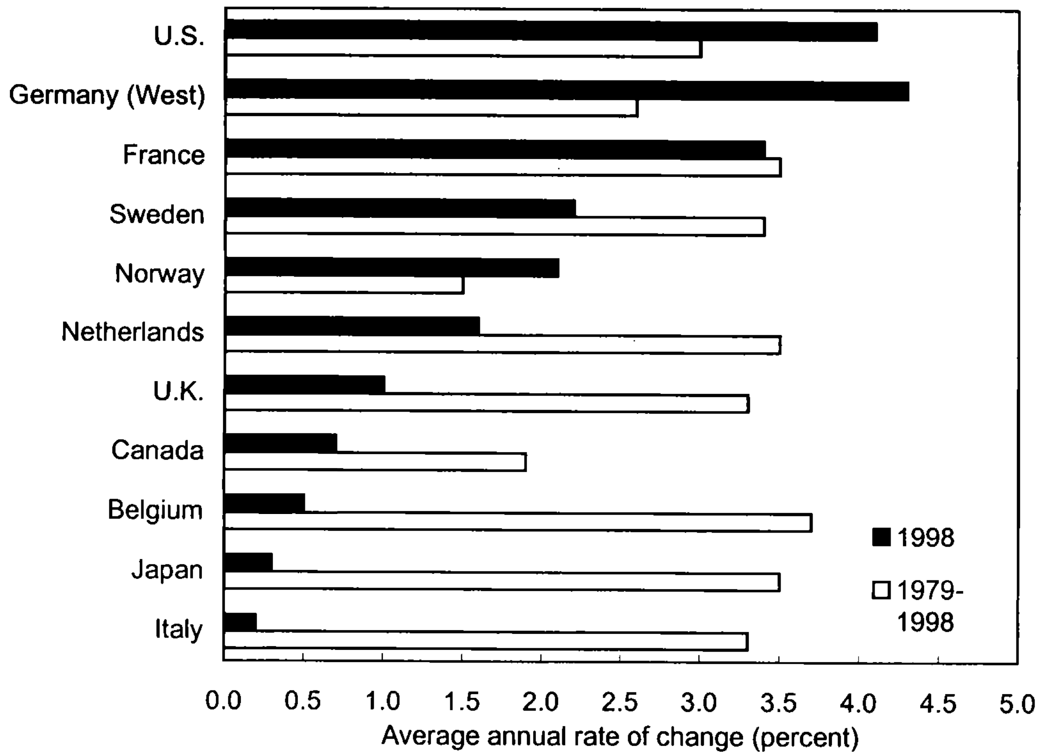
WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

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

September 17, 1999

CHART OF THE WEEK

Manufacturing Productivity Growth in Selected Countries



The latest international comparisons of manufacturing productivity from the Bureau of Labor Statistics show that labor productivity in U.S. manufacturing increased 4.1 percent in 1998, second only to Germany's 4.3 percent. The United States and Germany (together with Norway) were also the only countries to achieve faster growth in 1998 than their long-term trend growth rate. (The U.S. output series used for international comparisons is different from the one used in the standard quarterly series on productivity and costs.)

EYES ONLY

CONTENTS

"Is this the year, Pumpkin? Goodbye, love boat, hello, elder hostel?"

EYES ONLY

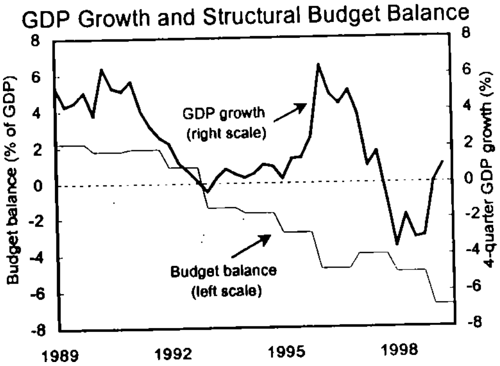
CURRENT DEVELOPMENT

Has Japan Turned the Corner?

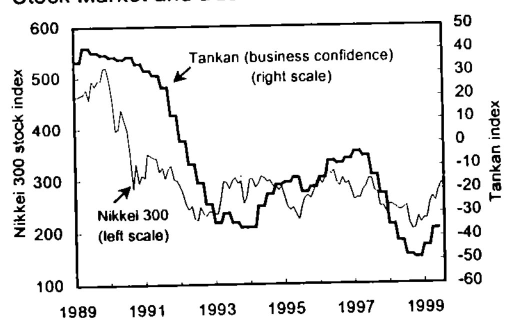
Japanese real GDP growth has recovered strongly in 1999 (see upper chart), following the longest downturn since the war. Despite hopeful signs, however, macroeconomic and structural concerns suggest a need for continued caution.

Slowdown, decline, and rebound. Despite a brief upward blip in 1996, Japan has suffered lackluster economic performance throughout the 1990s. Faced with rising budget deficits, Japan implemented a sharp fiscal consolidation in 1997. But this coincided with the onset of the Asian financial crisis and the collapse of several major financial institutions. The country plunged into recession.

GDP Growth and Structural Budget Balance



Stock Market and Business Confidence Indexes



Despite the large budget deficit, Japan implemented a major fiscal stimulus package in late 1998. Monetary policy became more aggressive in early 1999, as already low short-term interest rates were cut to virtually zero. Structural reforms may also have helped the recovery. For example, Japan has put in place a comprehensive framework to deal with banking weaknesses, and announced a package of tax and regulatory measures to promote corporate restructuring. These steps may have contributed to a recent surge in stock prices and an improvement in (the still low levels of) business confidence in 1999 (see lower chart).

Risks remain. Japan is not necessarily out of the woods. For example, public investment boosted demand in late 1998 and early 1999, but declined in the second quarter and would be a drag on growth if it returns to normal levels as proejcted. Residential investment surged in the second quarter, reflecting tax breaks, but its rapid pace is not sustainable. In addition, non-residential investment remains weak, and yen strength could curtail net exports.

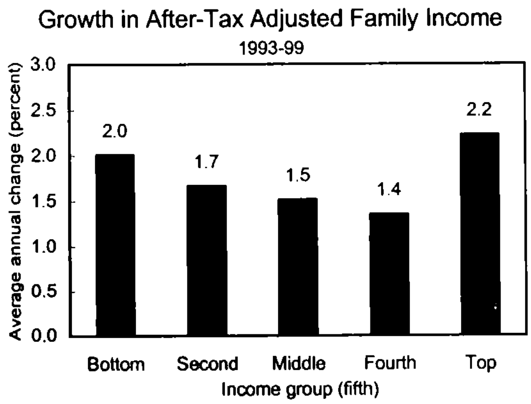
Observers also point to the need to further strengthen the financial system, encourage corporate restructuring, increase labor mobility, and accelerate deregulation. Without continuing structural reforms, combined with appropriate fiscal and monetary policy, Japan runs the risk that rising growth will turn out to be transitory. After all, Japan has already had a previous, sharp recovery of growth—which, unfortunately, ended abruptly with the recession of 1997 and 1998.

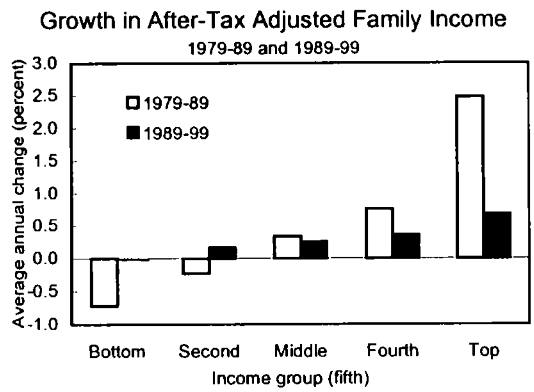
SPECIAL ANALYSIS

The Distribution of Family Income

In the current long economic expansion, labor market outcomes and family incomes have improved for traditionally disadvantaged groups. Income inequality, by contrast, has remained relatively high.

A rising tide... Since the economy began to pick up steam in 1993, growth in after-tax family income (adjusted for family size) has been strongest in the top and bottom fifths of the distribution, but it has also been solid in the middle (see upper chart). The chart is based on Congressional Budget Office calculations in which each family's income is expressed relative to the poverty rate for a family of its size. It includes CBO estimates for 1999.





...but a dragging anchor. While the strong growth in family income at the bottom of the distribution during this expansion is encouraging, overall growth since since 1989 (the last high-employment year in the previous expansion) has been less so. The largest gains in after-tax adjusted family income have come at the top of the distribution, while the income of the bottom fifth of families remained the same (see lower chart).

This pattern is similar to, but not so severe as, the pattern that prevailed in the 1980s. One reason is that changes in Federal taxes in the 1980s aggravated income inequality, while they have ameliorated it in the 1990s. It is also possible that some of the growth in the current expansion represents an improvement in the long-term trend—though we are still far from the 1948-73 trend, when strong productivity and real wage growth contributed to an approximate doubling of average family income and the gains were shared up and down the distribution.

Conclusion. Official Census Bureau statistics on money income and poverty for 1998 are due to be released at the end of this month. While the Census Bureau, unlike the CBO, does not adjust for taxes or family size, its data are likely to reveal the same trends as the CBO estimates: rising incomes in this expansion but not yet to levels substantially above previous peaks at lower income levels. Evidence on whether long-term trends in inequality may have improved is likely to be inconclusive.

EYES ONLY

SPECIAL ANALYSIS

Privatization of Air Traffic Control in Canada

Recently, U.S. fliers have experienced delays attributable to air traffic control, raising questions about whether the delivery of air navigation services could be improved. Canada's experience with a privatized air traffic control system may provide a useful perspective on this issue.

The decision to privatize. In 1996, Canada transferred the authority to run its air traffic control system to a non-profit private company, Nav Canada. One of the important benefits for Canada from privatization was the ability of the new corporation to raise the funds necessary for long-term capital improvements. Another benefit was separating the role of regulating safety from that of operating the air traffic control system. Responsibility for safety regulation remained with the government, eliminating any possible conflicts of interest.

Getting started. Nav Canada raised more than $2 billion (Canadian) in debt-based financing to fund its start-up and paid the government $1.5 billion for existing assets and operating rights. Nav Canada covers its costs by charging user fees to airlines and other major users of its services. Any excess funds remaining after covering its costs are returned to the users in the form of lower fees. When the user fee system was implemented, the Canadian government eliminated the Air Transport Tax that had been charged to individual consumers.

Building a better air traffic control system. After beginning operations as a private company, Nav Canada made a series of changes designed to improve customer service. It began by setting aside $600 million to fund capital improvements. In addition, the company has tried to improve safety by hiring and training more controllers to overcome chronic shortages inherited from the government-run system. Nav Canada has also implemented a number of cost-control measures, including streamlining its management structure. Because of lower costs, traffic growth, and a broader base of paying customers, Nav Canada has been able to set its fees below the levels originally anticipated, with the result that customers paid approximately 27 percent less than they would have under the Air Transport Tax.

A user-based governance structure. Although Nav Canada is a privatized monopoly, Canada does not impose direct government regulation of its fee level. Instead, responsibility for setting fees is entrusted to Nav Canada's board of directors, which is composed of representatives drawn from the community that uses its services. Five of the 15 board members are drawn from the commercial and general aviation community, with the remainder being representatives of the government, the unions, and the general public. This board composition allows the users most directly affected by the fees to have a say in both the fees charged and in the programs Nav Canada chooses to undertake to improve customer service.

EYES ONLY

ARTICLE

Asset Transfers and Medicaid Receipt

About 35 percent of 65 year-olds will use a nursing home at some point during the remainder of their lifetimes, according to one estimate. Medicaid is the main source of government support for such care. However, it is a needs-based program and is unavailable to individuals who have not first exhausted their own resources.

Policymakers have been concerned individuals have an incentive to transfer their assets to other family members in order to qualify for support. Past research had found little evidence of such asset shifting, but a recent study, using improved data, finds that those who believe they are more likely to enter nursing homes do indeed transfer assets with greater frequency and in larger amounts than others.

The high cost of care. An average nursing home stay now costs more than $40,000 per year, and many people mistakenly believe that Medicare will cover the costs of their long-term care. In fact, however, nearly 50 percent of the costs of long-term care are paid out-of-pocket by nursing home patients and their families, and most of the remaining costs are borne by *Medicaid.* Because costs are so high, spend-down (the process by which individuals first exhaust their own assets before qualifying for Medicaid) typically occurs very rapidly. Using a sample of Massachusetts residents over age 66, one study estimated that 63 percent of those living alone would become Medicaid-eligible within 13 weeks after entering a nursing home.

Evidence of asset transfers. Previous efforts to examine the extent to which people transfer assets to others as a means of qualifying for Medicaid used data on individuals who were already in nursing homes or were very likely to enter them, and hence whose transfer behavior might already have occurred. (Current rules prohibit the transfer of assets within 3 years of entering a nursing home, the so-called "look back" period.) The new study makes use of a nationally representative survey of individuals above age 70 that contains, among other key information, individuals' assessments of the likelihood that they will enter a nursing home within 5 years and the amount of money already transferred to others. It finds that a household with average net worth and a self-assessed 60 percent probability of entering a nursing home within 5 years will make transfers that are 21 percent higher than a household with average net worth and the average self-assessed probability of entering a nursing home (19 percent). In addition, among those who made transfers of more than $1,000 the average amount transferred was over $6,000.

Costs to Medicaid. The recent research suggests that the cost savings to the Medicaid program could be larger than previously thought. It is estimated that close to 12 million households might transfer assets for the purpose of qualifying for Medicaid. If everyone transferred assets at the same rate as the study population, these 12 million households would make $3.5 billion in transfers, representing 15 percent of Federal Medicaid spending on nursing homes in 1993. Of course, not all of these transfers represent a loss to the Medicaid system since some of the individuals who transfer money to qualify for Medicaid do not actually need nursing home care, and the study suggests that the actual loss to the Medicaid system from these transfers is likely to be less than half of this amount.

Implications. Although the new evidence suggests that asset transfers are large enough to raise Medicaid costs, efforts to control costs by tightening rules regarding transfer behavior have been unpopular. Alternative approaches might examine ways to control rising long-term care costs, increase the availability of long-term care insurance, and create positive incentives for individuals who can afford it to share responsibility for payment.

EYES ONLY

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

Long-Term Temps Are a Rare Breed. Although popular perceptions may be otherwise, employment in the temporary help services industry is relatively small (about 1 to 2 percent of the labor force). Moreover, only a small fraction of temps represent long-term jobholders, according to a recent analysis of Bureau of Labor Statistics data by a private foundation. In fact, 54 percent of all temps leave their jobs within 6 months. And while 38 percent of new temps cite inability to find a permanent job as their reason for temping, this percentage drops to below 6 percent for those with more than 48 months of tenure. Those with longer tenure are also considerably more likely to prefer their current arrangement. This study emphasizes the positive side of temporary work for some, while previous analyses in the *Weekly Economic Briefing* (November 14, 1997 and September 11, 1998) have also recognized that lower wages and changeable work settings may create problems for other temporary workers.

How Do Layoffs Affect Stock Prices? Layoffs may be getting more attention in the press than they used to, but a recent study finds that the total number of layoff announcements follows the business cycle quite closely. What has changed, according to the study, is the stock market's reaction to layoff announcements: on average, a layoff announcement is more likely to be associated with a rise in the price of the company's stock than it used to be. One possible explanation for this change is that reductions in force designed to improve efficiency are becoming more common relative to those designed to deal with reductions in demand for the company's product. The study found that layoffs associated with reorganization have, in fact, increased dramatically and that the fraction associated with plant closings has declined. It also found that layoffs due to plant closings received a negative stock market reaction while those due to reorganization were generally positively received. However, the authors were more confident in documenting that stock market reactions to layoffs have become less negative over time than they were in attributing this change to any particular cause.

Attending Elite Colleges May Have Little Payoff—Except for Minorities. A new study finds that attending a more selective (higher average SAT score) college does not appear to boost future earnings, contrary to previous findings. The study uses 1995 earnings data for about 14,000 students who entered college in 1976. Because factors affecting college admission may also affect future earnings, the study groups together students who were accepted and rejected from a similar set of schools, and then compares, within groups, the outcomes of those who chose to attend a more selective college with those who chose a less selective one. Post-college earnings were found to be similar for those who attended elite colleges and those who could have, but did not—except for students from more disadvantaged backgrounds, whose earnings were raised by attending a more selective college. An implication of the study is that efforts to attract qualified students from more disadvantaged family backgrounds to elite colleges could improve matching of these students' abilities to their future jobs, without adversely affecting that matching for others, on average.

EYES ONLY

INTERNATIONAL ROUNDUP

Asian Recovery Exceeds Forecasts. After strong first-quarter regional growth of 4.8 percent (relative to year earlier levels), reinforced by continued strong growth in the second quarter, the Asian Development Bank raised its forecasts for most countries in the 14 "Developing Asia" economies. The faster-than-expected recovery in 1999, from 1 percent growth in the last quarter of 1998, has been fueled by domestic demand stimulated by expansionary policies and increased global demand for semi-conductors and electronic products. The implementation of corporate and financial sector reforms has helped raise industrial production and exports in most of the crisis-affected economies and, in many cases, reverse capital outflows. However, the recovery has not been evenly spread, with South Korea, Taiwan, Singapore, the Philippines, and Thailand leading the way, while Hong Kong, Malaysia, and Indonesia are lagging behind. Despite an overall positive forecast, the Asian Development Bank notes several factors that could moderate the effectiveness of the reforms in the region, including debt and structural problems of Korean Chaebols, the slow pace of bank restructuring and consolidation, and the problems associated with China's banking and state-owned enterprise sectors.

Israel Moves Toward ILO Core Labor Standards. Although Israel has made progress in ratifying International Labor Organization core labor standards, progress still needs to be made in order to protect some groups of workers from abuses, according to a WTO-commissioned report by the International Confederation of Free Trade Unions (ICFTU). The report found that, while most Israeli workers are able to exercise their basic trade union rights, the government has at times forced striking workers to return to work in arbitrarily defined "essential" public services. The report also found that significant discrimination against women and Israeli Arabs remains despite legislative improvements in recent years, due in part to lack of resources for enforcement. Also, while child labor is a relatively minor phenomenon, it is reported to be a problem for some groups of the population. The ICFTU recommends that Israel amend its law on the definition of "essential" public services, remove the penalty of forced labor for those engaging in an illegal strike, extend full freedom of association and collective bargaining rights to all workers including those from the West Bank and Gaza, and provide adequate resources for implementing its laws regarding discrimination against women and Israeli Arabs.

UK sees record lows in unemployment, inflation. Unemployment as measured in the United Kingdom fell by 22,300 in August to a 19-year low of 4.2 percent of the workforce. (The unemployment rate approximating U.S. concepts is nearly 2 percentage points higher.) The number of people employed in the UK rose to a record high in the May-July period, increasing by almost 300,000 from the same period last year. Average earnings also increased in July by 4.6 percent, up from 4.4 percent in June. At the same time, inflation fell to its lowest level since the mid-1960s, standing at just over 1 percent.

EYES ONLY

RELEASES THIS WEEK

Housing Starts

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

Housing starts were about unchanged in August at 1.676 million units at an annual rate. For the first 8 months of 1999, housing starts are 5 percent above the same period a year ago.

Industrial Production and Capacity Utilization

The Federal Reserve's index of industrial production rose 0.3 percent in August following an increase of 0.7 percent in July. Capacity utilization rose 0.1 percentage point to 80.8 percent.

Consumer Price Index

The consumer price index increased 0.3 percent in August. Excluding food and energy, consumer prices rose 0.1 percent.

Retail Sales

Advance estimates show that retail sales rose 1.2 percent in August following an increase of 1.0 percent in July. Excluding sales in the automotive group, retail sales rose 0.7 percent following an increase of 0.4 percent.

MAJOR RELEASES NEXT WEEK

U.S. International Trade in Goods and Services (Tuesday)

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

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

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

New or revised data in **boldface**.

EYES ONLY

FINANCIAL STATISTICS

	1997	1998	July 1999	August 1999	Sept. 16, 1999
Dow-Jones Industrial Average	7441	8626	11052	10935	10737
Interest Rates (percent per annum)					
3-month T-bill	5.06	4.78	4.55	4.72	4.57
10-year T-bond	6.35	5.26	5.79	5.94	5.90
Mortgage rate, 30-year fixed	7.60	6.94	7.63	7.94	7.82
Prime rate	8.44	8.35	8.00	8.06	8.25

INTERNATIONAL STATISTICS

Exchange Rates	**Current level September 16, 1999**	**Percent Change from** Week ago	Year ago
Euro (in U.S. dollars)	1.042	-1.2	N.A.
Yen (per U.S. dollar)	105.1	-2.7	-22.1
Major currencies index (Mar. 1973=100) (trade-weighted value of the U.S. $)	93.11	-0.3	-3.6

International Comparisons 1/	**Real GDP growth** (percent change last 4 quarters)	**Unemployment rate** (percent)	**CPI inflation** (percent change in index last 12 months)
United States	3.9 (Q2)	4.2 (Aug)	2.3 (Aug)
Canada	3.7 (Q2)	7.7 (Jul)	1.8 (Jul)
Japan	1.1 (Q2)	4.9 (Jul)	-0.1 (Jul)
France	2.1 (Q2)	11.3 (Jun)	0.3 (Jun)
Germany	0.6 (Q2)	7.1 (Jul) 2/	0.6 (Jul)
Italy	0.9 (Q1)	12.1 (Apr)	1.7 (Jul)
United Kingdom	1.2 (Q2)	6.1 (May)	1.3 (Jul)

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.

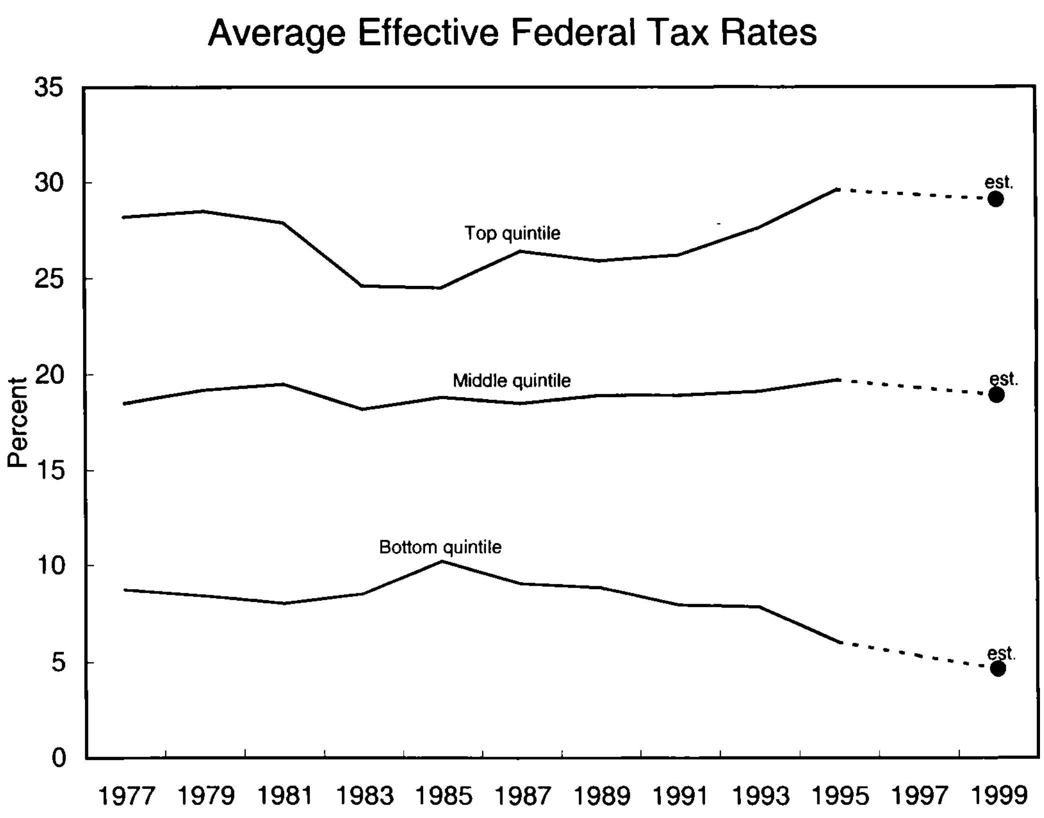
EYES ONLY

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

September 10, 1999

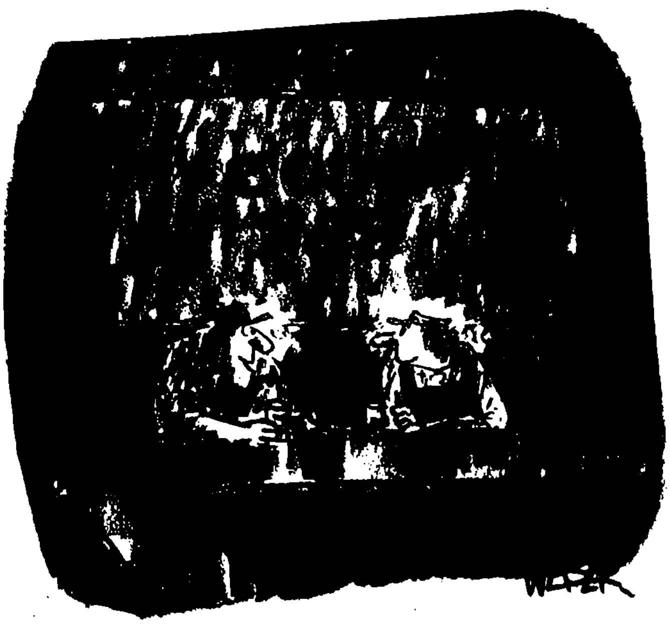
CHART OF THE WEEK



The Congressional Budget Office has just released estimates of average effective Federal tax rates for 1999. Federal taxes as a share of family income for the bottom fifth of families are the lowest they have been since 1977.

EYES ONLY

CONTENTS



"See, Jimmy? If they give a big tax cut to the wealthy, those guys'll feel good and have us come fix their roof and stuff."

EYES ONLY

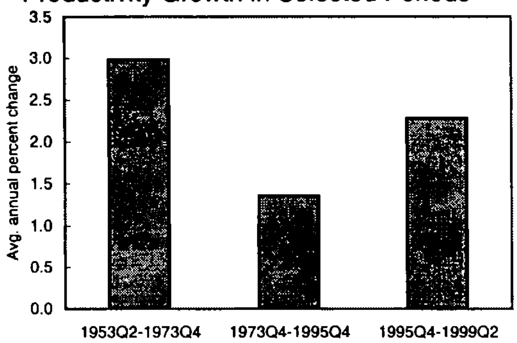
CURRENT DEVELOPMENT

The Role of Computers in Productivity Growth

Productivity growth in the computer and semiconductor industries contributes directly to aggregate productivity growth and, according to one estimate, has been the dominant source of the recent productivity spurt in the U.S. economy. Productivity growth in the manufacture of computers and semiconductors reflects the ability to produce faster processors, greater memory capacity, and larger disk drives without proportional increases in costs. But business investment in computers also adds to the quantity and quality of the capital stock, boosting productivity growth throughout the private sector. In the past, this latter effect on productivity growth was relatively small, but has recently increased.

The importance of computers in aggregate productivity growth. Productivity in the non-farm private business sector grew at a 2.3 percent annual rate over the last 3½ years (see chart). Adjusting for the typical cyclical pattern of productivity, overall "trend" productivity growth is estimated to be about 2.0 percent per year over this period. This marks a 0.6 percentage point pickup in trend productivity growth over the 1.4 percent annual rate estimated for the previous 22 years.

Productivity Growth in Selected Periods



Note Data are on a consistently-measured basis for nonfarm private business.

So far, the pickup in productivity has been mostly limited to the computer industry, which has seen a 40 percent annual growth rate in productivity since the end of 1995—double the rate recorded over the previous two decades. After accounting for cyclical factors and changes in measurement, trend productivity in the private business sector excluding computers shows very little acceleration. Although computers and semiconductors make up only about 5 percent of private output, the awesome acceleration in productivity growth in these industries more than makes up for their relatively small size. This localization of the productivity boom contrasts sharply with the experience of the productivity slowdown of the 1970s, when trend productivity slowed across most sectors of the economy.

The outlook for productivity growth. The outlook for productivity growth depends on the computer and semiconductor industries' ability to continue their recent pace of innovation and improvements in manufacturing efficiency, together with the effects from the use of growing stocks of computers throughout the economy. It is hard to predict whether the unprecedented pace of productivity growth in the computer and semiconductor industries observed over the last few years can be sustained. On the more positive side, the estimated contribution to

EYES ONLY

productivity growth from the use of computers has increased relative to the previous 25 years and will remain at a high level for the near future. During the 1970-95 period, when the share of computers in the capital stock was very small, the contribution to the annual rate of productivity growth from the use of computers is estimated to have been only about 0.2 percentage points. But, the contribution has been growing and is estimated to have been about 0.4 percentage points per year over the last 3½ years, with the largest effects occurring this year.

EYES ONLY

SPECIAL ANALYSIS

Benefits for China of Greenhouse Gas Emissions Trading

A recent analysis by the Council of Economic Advisers finds that an international greenhouse gas emissions market would offer substantial economic opportunities for China. By adopting an emissions growth target under the Kyoto Protocol and participating in emissions trading, China could attract significant amounts of capital and technology to reduce its greenhouse gas emissions. By reducing its emissions, China would gain from selling unused emissions allowances to developed countries.

Creating a greenhouse gas market. The Kyoto Protocol calls for the design of an international trading system that will facilitate the transfer of capital and technology to the countries where emissions can be abated at least cost. A country that can abate greenhouse gas emissions at lower cost than others has the opportunity to attract investment for climate-friendly technology. By reducing its emissions, a country can then sell emissions allowances to countries with higher abatement costs. Ideally, an international greenhouse gas emissions market would be similar to the sulfur dioxide trading program in the U.S., which allows trading of permits to emit sulfur dioxide among electric utilities. In the U.S., power plants that can reduce emissions cheaply sell permits to plants for which emissions reduction is more expensive, resulting in estimated cost-savings of 25 to 43 percent. The principle of gains from trade in emissions allowances is basically the same as it is for trade in goods and services.

In order to engage in trading, the Kyoto Protocol requires a country to have a greenhouse gas emissions target. It is broadly recognized that any such targets must be made compatible with a country's legitimate development needs. One way to do so would be for a developing country to set its target above current emissions levels, but below what emissions are forecast to be without additional abatement policies during the Protocol's first commitment period (2008 to 2012). Such an "emissions growth target" could provide for continued economic development, but with a lower emissions growth rate. To mitigate the risk that a target could end up being too stringent (or too lax), a target could be indexed to a country's economic performance between now and the 2008-2012 commitment period.

Economic gains for China. While China is making impressive strides towards lowering its greenhouse gas emissions intensity (emissions per unit of output), a variety of economic analyses and modeling efforts indicate that there are still many low-cost emissions abatement opportunities in China. Some analyses suggest that China has lower abatement costs than virtually any other country in the world. These international economic models can simulate an international emissions market by assessing the projected marginal cost of abating carbon dioxide emissions across countries and then estimating the extent of buying and selling until no further economic gains can be achieved through additional trades – i.e., they find the market clearing price for an emissions allowance.

Results from six international economic models indicate that by taking on an emissions target and actively participating in international emissions trading, China would find it economic to reduce emissions 14 to 24 percent below projected 2010 emissions levels and would be able to sell emissions allowances worth from $4 billion to over $14 billion annually.

Environmental gains for China. Efforts to abate carbon dioxide emissions will likely result in significant reductions in emissions of local air pollutants, such as sulfur dioxide and particulate matter, since both kinds of emissions are by-products of fossil fuel combustion. Local air pollution levels are a significant threat both to China's economy and to its citizens. Current pollution levels increase mortality rates, the incidence of chronic illness, and the number of hospital and emergency room visits. China's position as a low-cost producer in a global greenhouse gas emissions market offers a promising avenue for attracting investment in the energy and industrial technologies necessary to significantly address the high levels of local air pollution.

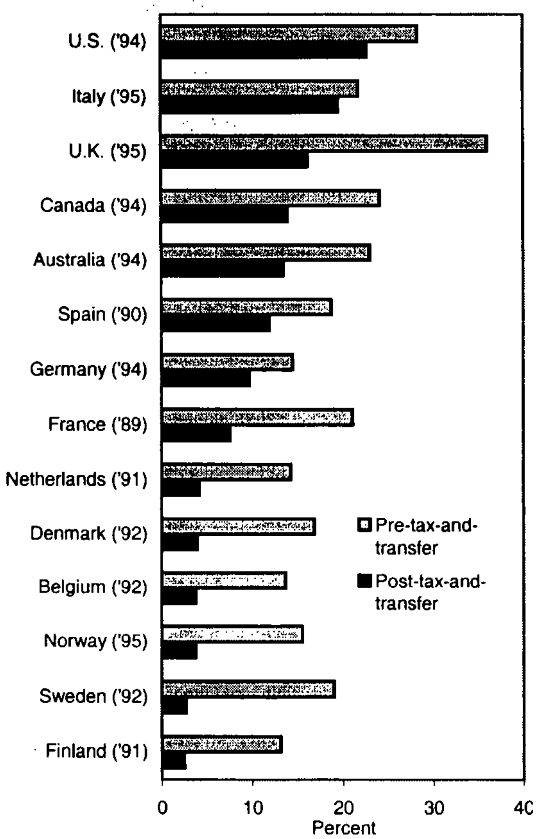
ARTICLE

Child Poverty Across Industrialized Nations

Although the official U.S. child poverty rate declined from 22.7 percent in 1993 to 19.9 percent in 1997, child poverty remains more prevalent in the United States than in many other industrialized countries. A major reason is that government support for low income families is typically more generous in these other countries. However, there is a tradeoff. More generous policies may be associated with adverse labor market effects such as higher unemployment and less job creation.

Child poverty comparisons, relatively speaking. No official international standard exists for measuring poverty, but a common approach in making cross-country comparisons is to use a relative income measure. For example, a forthcoming study examines pre- and post-tax-and-transfer child poverty rates for a number of countries using a poverty threshold based on 50-percent-of-median household income (see chart). This threshold is similar to the official European Commission poverty definition of 50 percent of average household disposable income, but the use of medians rather than averages makes the statistics less sensitive to extremely large or small incomes.

Child Poverty Rates



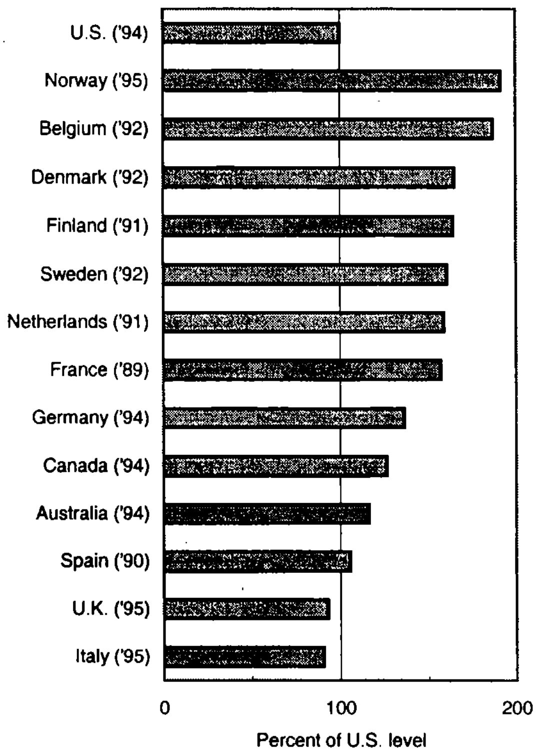
Unlike the money income concept used in the official U.S. poverty measure, the income measure used in the study reflects taxes and tax credits (including the EITC) and near-cash transfers (such as food stamps). Like the official U.S. measure, it excludes non-cash transfers such as public housing and publicly-provided health care. The estimated U.S. pre-tax-and-transfer child poverty rate is higher than that of most of the other countries, and it is reduced only modestly through taxes and transfers. In fact, the U.S. post-tax-and-transfer poverty rate is the highest among the countries shown.

Comparing absolute living standards. One reason for the relatively high U.S. child poverty rate is that half of U.S. median income is a high absolute threshold in comparison to other countries. Other countries would have higher child

EYES ONLY

poverty rates based on the U.S. absolute threshold. A consistent measure based on the same absolute threshold does not exist. But, one available measure suggests that many poor children in the United States have limited resources relative to poor children in other countries. In particular, the chart shows that the dollar value of the household income available to the U.S. child at the 10th percentile of the U.S. income distribution is less than that of children at the 10th percentile of many other countries' distributions. Canada's level, for example, is roughly 26 percent higher than ours.

Household Income of Poor Children



Note: The chart shows the level of income at the 10th percentile of the country's distribution of children's household income as a percent of the level of income at the 10th percentile of the U.S. distribution.

Accounting for the differences. Demographic differences explain part of the story. For example, the high proportion of poor single mothers certainly raises the U.S. child poverty rate. But research has suggested that differences in demographics only partially explain the differences in child poverty rates across nations. Instead, the most important factors appear to be differences in taxes and the level of government assistance to low-income families. The United States, for example, provides less cash assistance to low-income families than most industrialized nations. Many European countries pay high levels of unemployment assistance for more than a year after people leave a job, no matter how short their period of employment. Others provide "family allowances"—special cash transfers to families with children.

Conclusion. Child poverty rates vary dramatically across nations, from less than 3 percent to more than 20 percent (using the relative measure). Differences in public policies account for a significant portion of this range. These policies, of course, come with tradeoffs: many European nations have high unemployment rates *and* low child poverty rates, due in part to their extensive system of income transfer programs. The situation in the United States is the reverse. Some poverty experts have criticized both models as being either "too expensive" (in Europe) or "too cheap" (in the U.S).

EYES ONLY

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

NAFTA Spurs Agricultural Trade with Canada and Mexico. As NAFTA enters its 6th year, the importance of the agreement for U.S. agriculture is more apparent than ever, according to a new report issued by the U.S. Department of Agriculture. While U.S. agricultural exports to non-NAFTA countries rose only 2.6 percent per year from 1994 to 1998, exports to Canada and Mexico rose 8.1 percent annually over the same period. Both U.S. exporters and importers are placing a greater emphasis on the North American market. In 1990, Canada and Mexico purchased 17 percent of U.S. agricultural exports and supplied 25 percent of imports; by 1998, the share of exports had risen to 25 percent and that of imports to 34 percent. The report argues that U.S. beef and pork trade has benefited greatly from NAFTA, with beef exports to Canada estimated to be twice as high as they would have been without the trade agreement. It finds that NAFTA has also facilitated the flow of U.S. and Canadian foreign direct investment in the processed food industry in North America, leading to the dissemination of new technology and efficiency gains for producers, as well as lower food costs and greater choices for consumers.

Minorities Are Less Likely to Have Health Insurance. American minorities are less likely than whites to have health insurance, according to a report from the Commonwealth Fund. The report finds that among Americans aged 18 to 64, 14 percent of whites were uninsured in 1995 compared with 24 percent of blacks and 38 percent of Hispanics. Minorities are also less likely to be covered through work (69 percent of white workers have employer-sponsored coverage compared with 52 percent of black workers and 44 percent of Hispanic workers). Differences in socioeconomic status and type of jobs held may partially explain this discrepancy. For example, workers earning less than $10 per hour are less likely to be insured, and adults who work in large firms, are employed full-time, hold manufacturing or public administration jobs, or are trade union members are more likely to be covered through work. However, even within these categories, minorities are less likely to have employer-based insurance. The study finds that, after controlling for workforce and sociodemographic characteristics, blacks and Hispanics are 21 percent less likely than whites to have coverage through their employers. One possible barrier to minority health insurance mentioned in the report is the out-of-pocket cost associated with obtaining employer-sponsored coverage.

EYES ONLY

INTERNATIONAL ROUNDUP

Malaysia Eases Investment Controls. The Malaysian government allowed capital controls instituted last September to expire. The government originally imposed these controls to insulate the Malaysian economy from the risks and vulnerabilities of global financial markets. Prior to September 1, 1999, foreign investors could only repatriate their investments by paying a tax of up to 30% of the principal. This tax was lifted on September 1, so that portfolio funds that have been in Malaysia for a year or more are now eligible for repatriation without any levy.

China Set to Impose Savings Tax. China's economic growth rate has declined steadily since 1992 and moderate price deflation has set in over the last two years. Based on a recent article in the Beijing Daily News (China's official English language newspaper), the Chinese government has proposed to impose a 20 percent flat tax on interest earned on bank savings accounts in hopes of stimulating consumption. This follows a recent amendment to the Personal Income Tax Law, allowing taxation of interest from savings accounts. National saving was estimated to be more than 40 percent of GDP in 1997. Anecdotal evidence suggests that the saving rate may have risen recently, in part reflecting uncertainty associated with economic reforms and rising unemployment. Even if the tax fails to boost consumption, it should help improve the weak fiscal condition of the government, which limits its ability to finance expenditures. According to the Chinese Minister of Finance, this new tax revenue will be used to increase payments to laid-off workers from state-owned enterprises, raise the minimum income of urban residents, and increase pensions.

IMF Warns of Risks in Capital Markets. Despite recent favorable developments in the world economy such as strong U.S. growth and Asian recovery, conditions in global financial markets remain fragile, cautions the IMF in its annual report, *International Capital Markets.* The IMF report listed the possibility of a large correction in the U.S. equity market or a sudden weakening of the dollar as particular risks to the developed economies. Risks to emerging markets include a reduced investor base, the level and structure of external financing, and the possibility of a slowdown in capital inflows that could be brought about by inflationary pressures and resultant tight monetary policies in mature markets. The report draws attention to the public policy issues posed by excessive off-balance sheet leverage in modern finance, the impact of highly-leveraged institutions (HLIs) on small and medium-sized financial markets, and the emerging market responses to severe external pressure. In the IMF's view, policies should aim to enhance market discipline, improve disclosure of off-balance sheet risk, provide for more rigorous creditor and counterparty assessments of exposures, and strengthen private risk management and control systems. The report also suggests that closer monitoring of global liquidity conditions could help alert officials to the buildup of excessive leverage and other imbalances.

EYES ONLY

RELEASES THIS WEEK

Producer Price Index

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

The producer price index for finished goods rose 0.5 percent in August. Excluding food and energy, producer prices fell 0.1 percent.

MAJOR RELEASES NEXT WEEK

Retail Sales (Tuesday)
Consumer Prices (Wednesday)
Industrial Production and Capacity Utilization (Thursday)
Housing Starts (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	1.8
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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
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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
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increase per month			281	338	124
increase since Jan. 1993					19403
Inflation (percent per period)					
CPI	5.8	1.6	0.0	0.3	N.A.
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**.
PPI data **embargoed until 8:30 a.m., Friday, September 10, 1999**.

EYES ONLY

FINANCIAL STATISTICS

	1997	1998	July 1999	August 1999	Sept. 9, 1999
Dow-Jones Industrial Average	7441	8626	11052	10935	11079
Interest Rates (percent per annum)					
3-month T-bill	5.06	4.78	4.55	4.72	4.68
10-year T-bond	6.35	5.26	5.79	5.94	5.97
Mortgage rate, 30-year fixed	7.60	6.94	7.63	7.94	7.88
Prime rate	8.44	8.35	8.00	8.06	8.25

INTERNATIONAL STATISTICS

Exchange Rates	**Current level**	**Percent Change from**	
	September 9, 1999	**Week ago**	**Year ago**
Euro (in U.S. dollars)	1.054	-1.4	N.A.
Yen (per U.S. dollar)	108.0	-1.1	-20.9
Major currencies index (Mar. 1973=100) (trade-weighted value of the U.S. $)	93.36	-0.3	-4.6

International Comparisons [1]	**Real GDP growth** (percent change last 4 quarters)	**Unemployment rate** (percent)	**CPI inflation** (percent change in index last 12 months)
United States	3.9 (Q2)	4.2 (Aug)	2.1 (Jul)
Canada	3.7 (Q2)	7.7 (Jul)	1.8 (Jul)
Japan	1.1 (Q2)	4.9 (Jul)	-0.1 (Jul)
France	2.1 (Q2)	11.3 (Jun)	0.3 (Jun)
Germany	0.6 (Q2)	7.1 (Jul)[2]	0.6 (Jul)
Italy	0.9 (Q1)	12.1 (Apr)	1.7 (Jul)
United Kingdom	1.2 (Q2)	6.1 (May)	1.3 (Jul)

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.

EYES ONLY

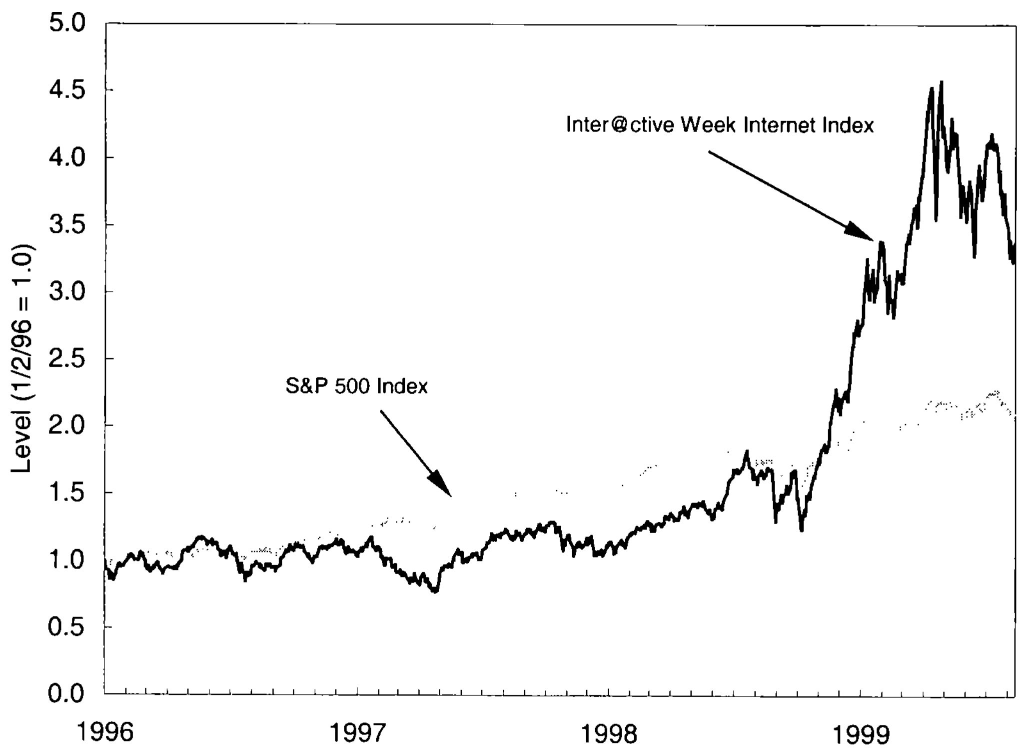
WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

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

August 13, 1999

CHART OF THE WEEK

Internet Stocks and the S&P 500



Between 1996 and late 1998, the Inter@ctive Week index of Internet stocks performed no better than the Standard & Poor's 500 index. Since the beginning of October last year, however, the Internet index has more than doubled in value, despite recent retreats from much higher levels.

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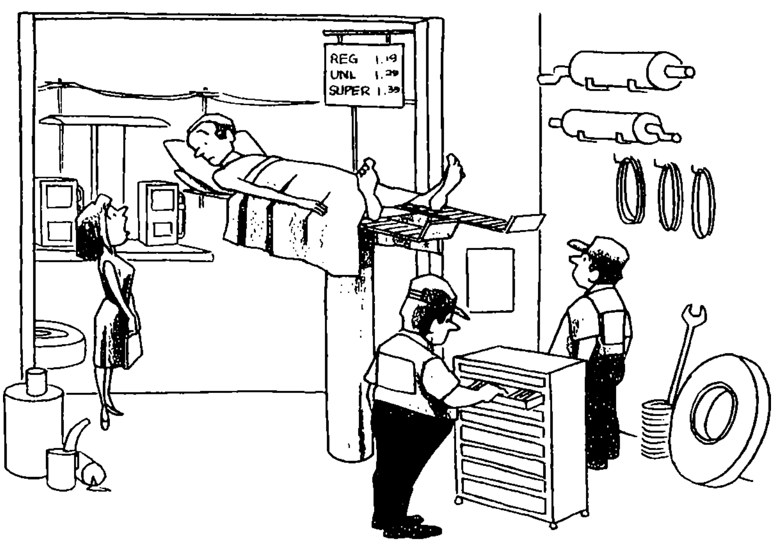
EYES ONLY

TREND

SPECIAL ANALYSES

DEPARTMENTS



"I checked your company's medical plan again, and these guys *are* authorized through your HMO."

EYES ONLY

TREND

Employment Changes in Manufacturing Industries

While the overall economy has performed strongly in this expansion, international factors have retarded manufacturing since 1997. This has led to significant employment declines in many of the durable goods industries that had been growing prior to 1997 and accelerated job losses in most nondurable industries.

1993-97: the durable divide. Between 1993 and 1997, manufacturing output grew at a 5.6 percent annual rate—faster than the rest of the economy, despite an increase in the manufacturing trade deficit. Because productivity growth was particularly rapid, employment growth was more sluggish. Nevertheless, manufacturing employment grew at an average annual rate of 0.8 percent and manufacturing employment increased by 769,000 between December 1992 and December 1997.

As might be expected in an expansion with particularly strong growth in investment, manufacturing employment gains were concentrated in durable goods (see chart on next page), with rapid advances over this period in motor vehicles and equipment, lumber and wood products, industrial machinery and equipment, fabricated metal products, and electronic and electrical equipment. Even in this period, however, employment growth in nondurables was sluggish. Indeed, labor-intensive industries heavily engaged in international trade, such as textiles, apparel, and leather and leather products (footwear), experienced significant employment declines.

1997-99: the global divide. More recently, the growth pattern has changed. Weak foreign demand and declining foreign currencies have brought manufacturing export growth to a halt. The volume of U.S. merchandise exports in the second quarter of 1999 was just 0.7 percent higher than it was in the fourth quarter of 1997, while merchandise imports increased by 18 percent. In the first 5 months of this year, the annualized trade deficit in manufactured goods has been \$270 billion—almost double the level prior to the Asian crisis.

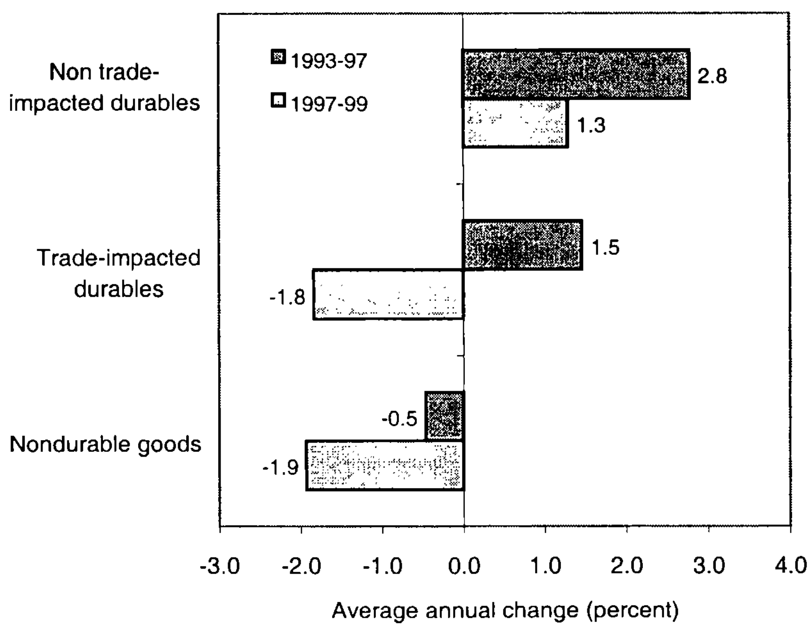
The most rapid employment declines since 1997 were again in labor-intensive sectors such as leather products, apparel, and textile mill products. In addition, however, many durable goods industries that had been doing well began to experience declining employment (trade-impacted durables in the chart). These include electronic and electrical equipment, industrial machinery and equipment, transportation equipment, and primary metals (including steel). Indeed, even employment in computer manufacturing fell by about 21,000 during this period.

Since machinery accounts for about half of all U.S. manufactured goods exports, durable goods manufacturers and their suppliers have clearly been adversely impacted by the export slump. Not only have they lost export sales directly but they have also been damaged indirectly as the decline in manufacturing capacity utilization (from 82.5 percent in the fourth quarter of 1997 to 79.4 percent in June) has depressed spending on industrial equipment. (In the second quarter, for example, expenditures on industrial equipment were only 2.6 percent above the level in the fourth quarter of 1997.) This weakness appears to explain why capacity utilization in steel remains low, despite the fact that steel imports have returned to near their pre-surge levels.

By contrast, manufacturers experiencing strong domestic demand growth have seen employment growth (non trade-impacted durables in the chart). Strong expenditures on construction have sustained employment growth in lumber and wood products; stone, clay, and glass; and furniture and fixtures. Similarly, buoyant demand for autos and trucks has maintained stable employment levels in motor vehicles and equipment despite strong import growth.

Implications. Manufacturing is an important provider of high-wage jobs, particularly for blue-collar men with a high school education. While rapid productivity growth in this sector is likely to limit the additional opportunities for such employment in the future, other developments can affect job availability. Increased exports, driven by foreign growth, would mitigate these employment declines. By contrast, higher domestic interest rates could depress industrial investment and construction spending and deal another blow to a sector that is already troubled.

Changes in Manufacturing Employment



EYES ONLY

SPECIAL ANALYSIS

Can Competition Control Health Care Costs?

In most markets, competition is viewed as a powerful force for encouraging low prices, high quality, and innovation. However, distinctive features of the health care market—particularly differences in what providers and patients know and the diversity of individual health care needs—have led some to question whether more competition is beneficial. While unique features of the health care market may have weighed against the benefits of competition in the past and remain important today, recent developments in the health care industry appear to have shifted the balance in favor of competition.

Concerns about competition in health care. Prior to the mid-1980s, health insurance premiums were typically heavily subsidized by employers, which dampened individuals' sensitivity to cost and price differences. To the extent that employee contributions did not increase in line with costs, employees had an incentive to choose more expensive plans. Among providers, incentives to contain costs were poorly structured and resulted in little restraint on health care spending (encouraging, for example, a "medical arms race" among hospitals to provide more expensive equipment and facilities). Greater competition in such an environment could lead to excess capacity, higher costs, adverse patient health outcomes, and risk selection that isolates high-risk individuals into groups that insurers find prohibitively costly to serve.

The benefits of competition. Dramatic changes in the private health insurance environment have made competition more effective in controlling costs. In the past 15 years, employees have had to pay a larger share of health plan premiums, restoring price sensitivity. In addition, traditional fee-for-service health plans allowing for complete choice have given way to more tightly managed preferred provider organizations, resulting in cost containment. In the current environment greater competition can lower the costs associated with achieving any given quality of health insurance while giving consumers a choice of plans offering different menus of price and quality.

The effect of price on switching among health plans. The projected success of competition as a strategy for controlling health costs depends in part on the willingness of consumers to switch health plans in response to a change in plan premiums. Evidence that consumers are very sensitive to out-of-pocket premiums and are willing to switch health plans in response to small changes comes from a study of what happened at University of California campuses after 1994, when they stopped paying the full premium for most health plans and subsidizing the cost of the most expensive plan. The study found that individuals facing monthly premium increases of as little as $10 were roughly five times as likely to switch plans as those whose premiums remained constant.

Attention to adverse selection remains important. Potentially, the switch to a less expensive plan in response to higher premiums could go too far, given limits on what beneficiaries and insurers know about each other and the diversity of individual health care needs. This is illustrated by what happened when Harvard shifted to a voucher system in 1995, in which beneficiaries were paid a fixed contribution irrespective of which plan they chose. Harvard experienced cost savings of 5 to 8 percent of baseline health spending, due largely to lower insurer profits as a result of increasing plan choice and more stringent bargaining. However, this change increased the price to employees in the most generous plan by over $500 annually. Most individuals switched away from this plan, so that the provider of this policy experienced rising expenses beyond what was projected. Within 3 years, this health care option was driven out of the market.

Conclusion. In the current health care environment, increasing price sensitivity and requiring providers to bid competitively for contracts to provide health care should prove beneficial. While issues such as adverse selection cannot be ignored, recent research suggests that the cost savings from increased competition are likely to be enough to generate net benefits. In the case of competitive bidding, reductions in the cost of providing care are transferred to the organization soliciting the bids, with some of these savings passed on to patients. Such an incentive structure should lead to shifts away from costly plans and create additional savings. With the right structuring of incentives, competition can achieve desired cost objectives without unduly sacrificing quality.

SPECIAL ANALYSIS

Labor Market Explanations for a Lower NAIRU

[This material was discussed at Wednesday's economic briefing, but was not contained in the written material for that briefing.]

One of the most notable features of the current expansion is how long the unemployment rate has remained below 5 percent without triggering rising inflation. A new study highlights four changes in the labor market that may have lowered the unemployment rate consistent with stable inflation (the NAIRU).

Demographics. The maturing of the baby boom and rising educational attainment of the labor force could reduce the amount of unemployment associated with frequent job changes by younger and less-educated workers (because they represent a smaller fraction of the labor force) and hence lower the aggregate unemployment rate. The study estimates that the changing age composition of the labor force can account for an estimated 0.4 percentage point of the decline in the overall unemployment rate since the mid-1980s. Because it has been going on for decades, increasing average educational attainment appears to be a less plausible explanatory factor for *recent* changes in the NAIRU.

Growth in the prison population. The study notes that nearly 2 percent of the adult male population is currently incarcerated and that the prison population has almost doubled in the past decade. To the extent that convicted criminals had weak employment histories (and hence high unemployment rates) prior to their arrest, their removal from the labor force would lower the unemployment rate without much impact on labor market tightness. The study estimates that the increase in the incarcerated population can account for roughly a 0.3 percentage point decline in the male unemployment rate, and a 0.17 percentage point decline in the overall unemployment rate, since 1985.

Improved matching. The rise of the temporary help industry and, since 1993, the expanded provision of job search assistance (JSA) to unemployed workers could have reduced frictional unemployment by matching unemployed workers to job vacancies more quickly and more efficiently. The study finds that JSA is unlikely to affect a large enough number of workers to significantly affect the aggregate unemployment rate. By contrast, it finds that the rise of the temporary help industry may account for as much of the decline in unemployment since the mid-1980s as do demographic shifts.

Weak unions and worker anxiety. Finally, the study examines the "weak backbone hypothesis," which holds that workers have become more reluctant to press for wage gains. It points to declining union membership and the watershed Professional Air Traffic Controllers Organization (PATCO) strike in 1981 as evidence that the threat of unionization is now so low in many industries that the labor market has passed a "tipping point" beyond which unions and the threat of unionization have very little influence on wage setting. Although worker anxiety is frequently advanced as a source of wage restraint, the study concludes that worker surveys do not reveal widespread insecurity and there is little evidence of a link between insecurity and wage growth.

Implications. Demographic shifts and the rise of the temporary help industry appear to be the major labor market developments that have allowed the economy to achieve sustained low unemployment rates. While it remains an open question whether they are the main reason for the improved inflation-unemployment trade-off during the current expansion, they are unlikely to be reversed in the near future. Thus, they would be a force operating to maintain the high-pressure labor markets of this expansion that have begun to bring benefits to low-wage workers and disadvantaged families as well as the rest of the labor force.

EYES ONLY

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

Do Local Communities Benefit from Foreign Direct Investment? Investment by foreign manufacturing firms in American communities raises wages by more than an equivalent amount of domestic investment, but that investment may come at a cost to government budgets, according to a recent study. The study found that attracting a representative foreign manufacturing firm increased wages for all jobs in the industry in the same county by 2.3 percent, compared with 0.3 percent for a new domestic firm. However, state and local governments often offer incentives to attract firms, and the study finds that attracting foreign firms is associated with larger reductions in real per capita local government revenues and expenditures than attracting new domestic firms. Also, increased foreign investment is associated with lower public school enrollment and a shift in spending away from education toward public safety and transportation.

Can New York Bank on Wall Street? A recent study by the Federal Reserve Bank of New York addresses concerns that a future downturn in the securities industry would be quite disruptive to the New York City economy. The study reports that the securities industry is disproportionately large in New York City. It accounts for 4.7 percent of total employment (roughly 10 times the national average) and generates 19 percent of total earnings. In some way, 14 percent of all New York City employment depends on the securities industry. The study also notes that Wall Street was a large factor in New York City's two major downturns in the 1970s and early 1990s. However, it finds that other factors might soften the blow of a decline in securities market employment. Specifically, several sectors that were hard hit in earlier downturns (including manufacturing and real estate) appear to be on more solid footing in this expansion. Other fast-growing industries not tied to the financial sector might also cushion the effects of securities industry job losses.

State Regulators Highlight Problems with Day Trading. This week, state securities regulators issued a report based on a 7-month investigation of the day-trading industry. Day trading is a strategy in which individuals make numerous small stock trades each day trying to exploit small movements in share prices. The day-trading industry consists of specialty firms where customers go to make such trades using proprietary software. The report, released by the North American Securities Administrators Association (NASAA), concluded that day-trading firms are misleading in their advertising and ought to screen potential customers better. It also questioned the practice at some firms of arranging inter-customer loans to meet margin calls. These practices seem to be aimed at evading legal restrictions on investment firms' lending to customers—restrictions that are meant to prevent customers from investing beyond their means. The report contained an independent analysis of accounts at one Massachusetts firm where at least 70 percent of traders lost money and only 11.5 percent showed the ability to conduct profitable short-term trading. However, this firm had been shut down last year by state authorities and may not be representative of the industry.

EYES ONLY

INTERNATIONAL ROUNDUP

IEA Sees Tighter Oil Markets. With supply constrained and a recovery in demand underway, oil markets are set to tighten, according to the International Energy Agency (IEA). Demand is expected to grow beginning in the second half of this year, and oil demand in 2000 is forecast to be about 1.8 million barrels per day, or 2.4 percent, higher than 1999 levels. On the supply side, OPEC ministers have been quoted in the press saying that they do not anticipate raising output quotas at their next meeting in September. OPEC compliance with recent cutback agreements was 91 percent in July, and continued compliance will keep OPEC supplies constrained. Meanwhile, non-OPEC oil supply is expected to increase much less than demand, following a small decrease this year.

World Bank Sees Commodity Markets Vulnerable to Y2K Bug. Anticipation of the Y2K technology bug could disrupt global commodity markets, according to the World Bank's most recent *Global Commodity Markets* report. Demand for essential commodities is expected to increase as consumers stockpile basic staples such as fuels and foods and speculators buy in anticipation of higher prices—though some producer response should be expected as well. Stocks of most commodities appear to be sufficiently large to prevent significant price increases, but oil markets may be vulnerable, not only because of the supply considerations discussed above but also because oil production is highly technology intensive, which heightens the risk of production disruptions, especially for producers like Russia and Nigeria that might lack the resources to fix problems. The report also warns that Y2K-related transportation disruptions could lead to local imbalances. For example, efforts by importers to stockpile goods before the end of 1999 could put strains on shipping capacity. Also, low-valued or bulky commodities such as grains and timber may be crowded out by high-valued commodities and manufactures, leading to price volatility as surpluses build in exporting countries and shortages develop in importing countries.

OECD Reviews Mexico's Regulatory Restructuring. In its new report *Regulatory Reform in Mexico,* the OECD praises the regulatory reforms that have helped transform Mexico from an inward-looking economy to an open and market-based economy over the last 15 years. The report emphasizes that reforms have produced major benefits by reducing prices and increasing quality and choice for Mexican consumers and businesses. It notes that privatization and the elimination of red tape have encouraged firms to invest in new technologies. The report finds that the Mexican economy is now more adaptable, allowing it to rebound more quickly and at lower cost from major economic crises. However, it observes that further reform is needed in some sectors, notably telecommunications, where prices remain very high. It recommends improving regulation of dominant firms after privatization, enhancing the efficiency and coherence of regulations at state and local levels, and increasing regulatory transparency to boost investment, market entry, and innovation. And it stresses the importance of securing the benefits of the program through sustained policy stability and strengthened public administration.

EYES ONLY

RELEASES THIS WEEK

Producer Price Index

****Embargoed until 8:30 a.m., Friday, August 13, 1999****

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

Retail Sales

Advance estimates show that retail sales rose 0.7 percent in July. Excluding sales in the automotive group, retail sales rose 0.3 percent.

MAJOR RELEASES NEXT WEEK

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

EYES ONLY

U.S. ECONOMIC STATISTICS

	1970-1993	1998	1998:4	1999:1	1999:2
Percent growth (annual rate)					
Real GDP (chain-type)	2.7	4.3	6.0	4.3	2.3
GDP chain-type price index	5.4	0.9	0.8	1.6	1.6
Nonfarm business (NFB) sector:					
Productivity (chain-type)	1.5	2.6	4.1	3.6	1.3
Real compensation per hour:					
Using CPI	0.6	2.5	2.0	2.9	1.5
Using NFB deflator	1.3	3.7	3.4	3.0	3.3
Shares of Nominal GDP (percent)					
Business fixed investment	10.9	11.0	11.0	11.0	11.2
Residential investment	4.5	4.3	4.5	4.6	4.6
Exports	8.2	11.3	11.3	10.9	10.9
Imports	9.2	13.0	13.1	13.2	13.5
Personal saving	5.2	0.3	-0.0	-0.5	-0.8
Federal surplus	-2.7	0.9	0.8	1.4	N.A.

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

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

New or revised data in **boldface**.
PPI data **embargoed until 8:30 a.m., Friday, August 13, 1999**.

EYES ONLY

FINANCIAL STATISTICS

	1997	1998	June 1999	July 1999	August 12, 1999
Dow-Jones Industrial Average	7441	8626	10704	11052	10808
Interest Rates (percent per annum)					
3-month T-bill	5.06	4.78	4.57	4.55	4.66
10-year T-bond	6.35	5.26	5.90	5.79	6.08
Mortgage rate, 30-year fixed	7.60	6.94	7.55	7.63	8.15
Prime rate	8.44	8.35	7.75	8.00	8.00

INTERNATIONAL STATISTICS

Exchange Rates	**Current level August 12, 1999**	**Percent Change from Week ago**	**Year ago**
Euro (in U.S. dollars)	1.064	−1.5	N.A.
Yen (per U.S. dollar)	115.8	1.6	−20.8
Major currencies index (Mar. 1973=100) (trade-weighted value of the U.S. $)	95.01	0.8	−5.6

International Comparisons [1]	**Real GDP growth** (percent change last 4 quarters)	**Unemployment rate** (percent)	**CPI inflation** (percent change in index last 12 months)
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2/ Rate for former West Germany. Using OECD standardized unemployment data, the unemployment rate for unified Germany for May was 9.1 percent.

EYES ONLY

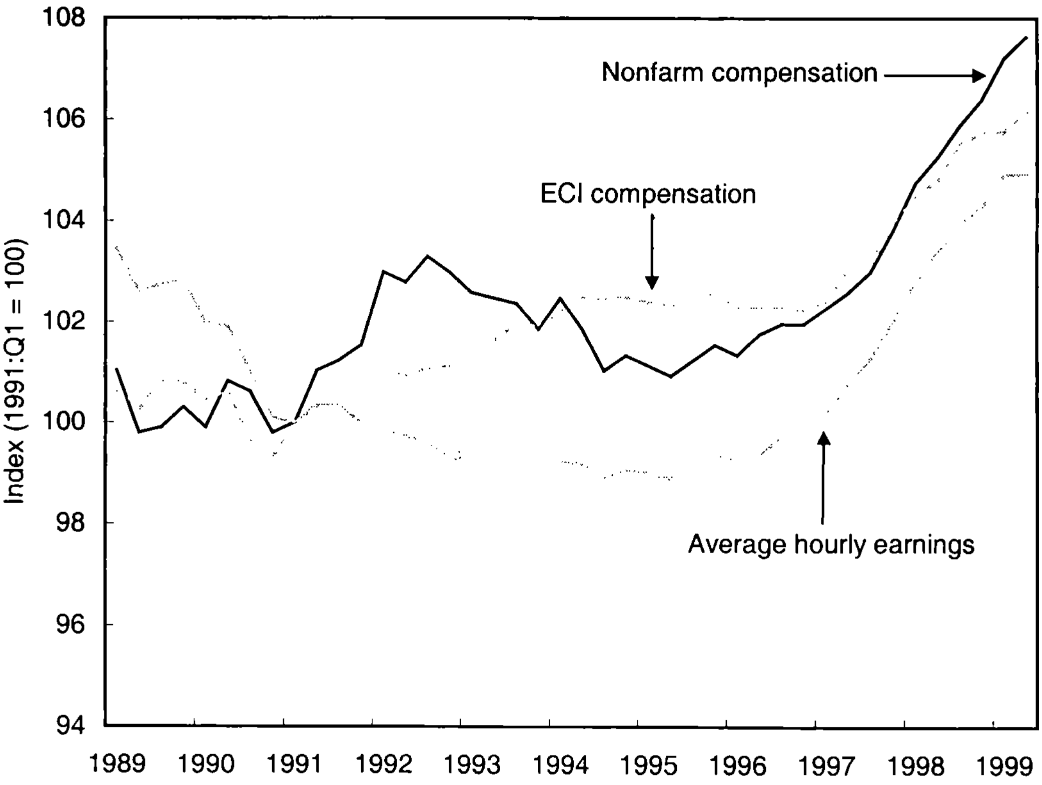
WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

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

August 6, 1999

CHART OF THE WEEK

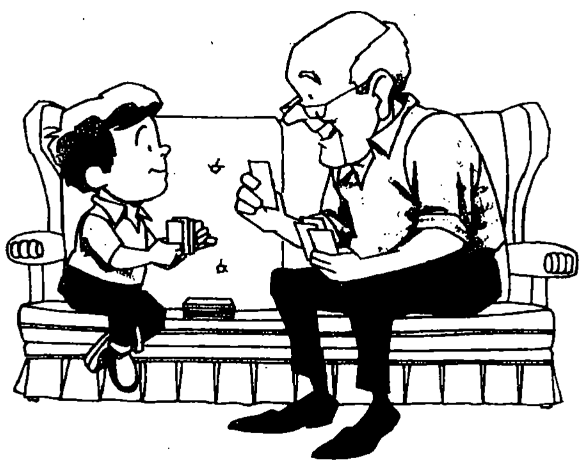
Three Measures of Real Wages



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

EYES ONLY

CONTENTS



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

EYES ONLY

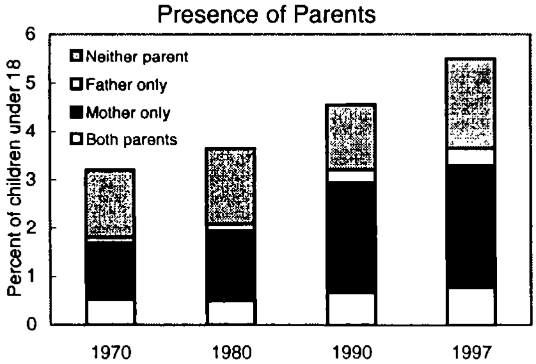
SPECIAL ANALYSIS

Balancing Work and Childcare: the Role of Grandparents

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

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

Grandchildren in Grandparents' Homes by Presence of Parents



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

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

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

EYES ONLY

SPECIAL ANALYSIS

Farm Program Costs and the WTO

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

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

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

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

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

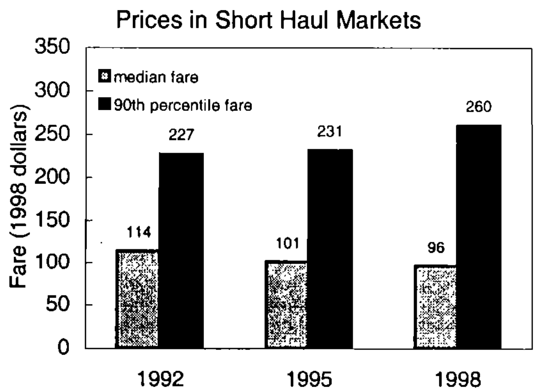
Conclusion. If farm program spending continues to rise, the distinction between amber-box support and so-called "green box" non- and minimally trade distorting support (such as research and extension, pest and disease control, domestic food aid, and income support payments that are de-coupled from prices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

EYES ONLY

ARTICLE

Why Are Fares Flying Higher for Business Travelers?

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



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

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

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

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

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

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

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

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

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

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

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

INTERNATIONAL ROUNDUP

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

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

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

EYES ONLY

RELEASES THIS WEEK

Employment and Unemployment

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

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

Productivity

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

Leading Indicators

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

NAPM Report on Business

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

MAJOR RELEASES NEXT WEEK

Retail Sales (Thursday)
Producer Prices (Friday)

EYES ONLY

U.S. ECONOMIC STATISTICS

	1970-1993	1998	1998:4	1999:1	1999:2
Percent growth (annual rate)					
Real GDP (chain-type)	2.7	4.3	6.0	4.3	2.3
GDP chain-type price index	5.4	0.9	0.8	1.6	1.6
Nonfarm business (NFB) sector:					
Productivity (chain-type)	1.5	**2.6**	**4.1**	**3.6**	**1.3**
Real compensation per hour:					
Using CPI	0.6	**2.5**	**2.0**	**2.9**	**1.5**
Using NFB deflator	1.3	**3.7**	**3.4**	**3.0**	**3.3**
Shares of Nominal GDP (percent)					
Business fixed investment	10.9	11.0	11.0	11.0	11.2
Residential investment	4.5	4.3	4.5	4.6	4.6
Exports	8.2	11.3	11.3	10.9	10.9
Imports	9.2	13.0	13.1	13.2	13.5
Personal saving	5.2	0.3	−0.0	−0.5	−0.8
Federal surplus	-2.7	0.9	0.8	1.4	N.A.

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

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

New or revised data in **boldface**.
Employment and unemployment data **embargoed until 8:30 a.m., Friday, August 6, 1999**.

EYES ONLY

FINANCIAL STATISTICS

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

INTERNATIONAL STATISTICS

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

International Comparisons [1/]	**Real GDP growth** (percent change last 4 quarters)	**Unemployment rate** (percent)	**CPI inflation** (percent change in index last 12 months)
United States	4.1 (Q2)	**4.3** (Jul)	2.0 (Jun)
Canada	3.2 (Q1)	8.1 (May)	1.5 (Jun)
Japan	0.1 (Q1)	4.7 (May)	0.0 (Jun)
France	2.3 (Q1)	11.4 (Apr)	0.5 (Apr)
Germany	0.8 (Q1)	7.2 (May)[2/]	0.4 (Jun)
Italy	0.9 (Q1)	12.1 (Apr)	1.4 (Jun)
United Kingdom	1.2 (Q2)	6.2 (Mar)	1.4 (Jun)

U.S. unemployment data **embargoed until 8:30 a.m., Friday, August 6, 1999.**

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

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

EYES ONLY

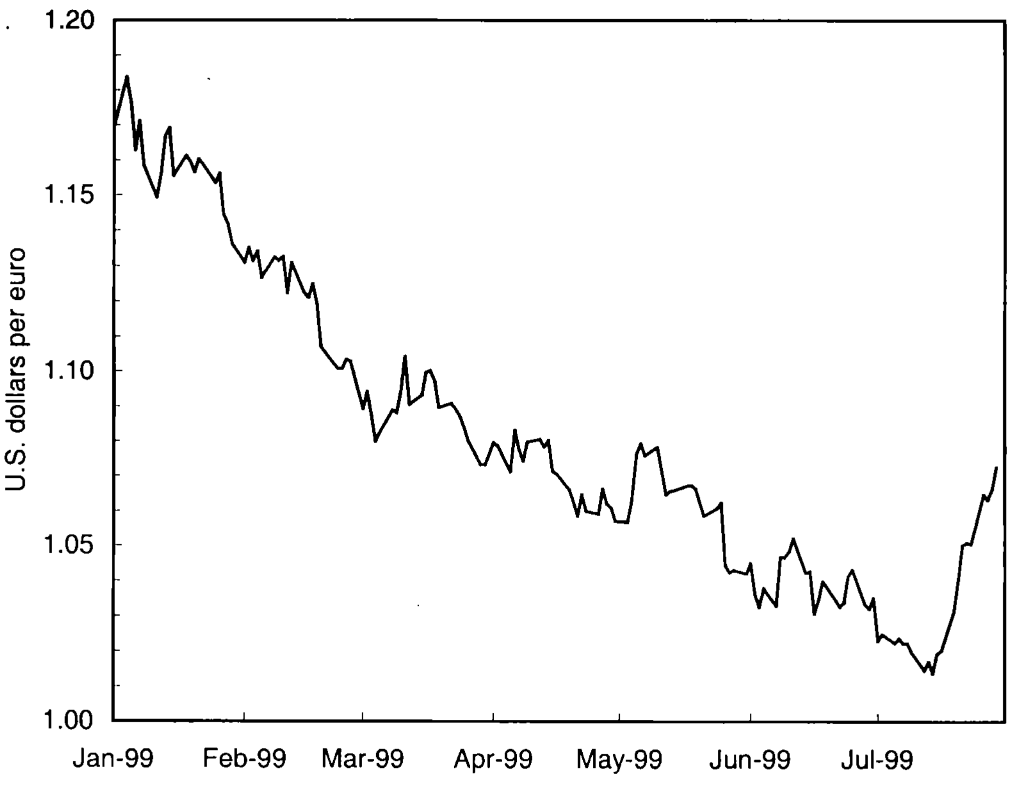
WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

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

July 30, 1999

CHART OF THE WEEK

Euro Rebounds before Reaching $1.00



Since the euro was introduced, its foreign exchange value has slid, coming close to $1.00 in mid-July. In the past 2 weeks, however, the euro has rallied to rise above $1.05. A range of reasons has been offered for the rebound, including a heightened perception of economic strength in the euro zone and the possibility that the European Central Bank would adopt a bias toward higher interest rates.

EYES ONLY

CURRENT DEVELOPMENT

SPECIAL ANALYSES

DEPARTMENTS

"Eight years of unprecedented expansion, and yet the kid sector has failed to participate."

EYES ONLY

CURRENT DEVELOPMENT

GDP Scorecard: Second Quarter 1999

Real GDP is estimated to have increased at a 2.3 percent annual rate in the second quarter of 1999. Strong gains in consumption and equipment investment were partially offset by declines in stockbuilding and net exports. The price index for GDP increased at a 1.6 percent annual rate—somewhat higher than the 1.1 percent annual rate of increase over the previous four quarters.

Component	Growth*	Comments
Total consumer expenditures	4.0%	Although consumption has slowed from the 5½ percent pace over the previous four quarters, consumers' spending ran further ahead of their income, dropping the saving rate to–1.1 percent.
Producers' durable equipment	15.3%	As has been typical in this expansion, most of the strength was in computers or other information processing equipment.
Nonresidential structures	-1.2%	Construction of industrial buildings continues to fall. Office building construction leveled off in the second quarter after a solid gain in the first.
Residential investment	5.1%	Although housing starts fell sharply in the second quarter, residential investment was supported by commissions on existing home sales.
Inventories (change, billions of 1992 dollars)	$19.3	The pace of stockbuilding was much lower in the second quarter than in the first. Inventories are now extraordinarily lean with respect to sales. CEA expects renewed stockbuilding to boost GDP growth in the second half.
Federal purchases	-3.2%	The drop reflects continued declines in Federal employment and budget authority.
State & local purchases	-0.1%	Road construction did not suffer the normal seasonal drop in the first quarter. Reciprocally, it failed to post the normal seasonal increase in the second.
Exports	4.5%	Coming after only a 0.5 percent gain over the previous four quarters, the gain in exports suggests a rebound in foreign GDP.
Imports	9.7%	Most of the increase was in capital goods, especially computer-related equipment.

*Percent real growth in the second 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

Wives' Earnings and Family Income Inequality Revisited

New research on the impact of wives' earnings on family income inequality has confirmed earlier findings that over the broad sweep of three decades increases in wives' labor force participation and earnings have, on balance, moderated inequality. However, the new research finds that in more recent years wives' earnings have had a neutral effect on the distribution of income across families.

Conflicting forces. Married women's earnings have risen dramatically during the past three decades as their time devoted to paid work has risen substantially and their hourly wages have increased. As male earnings stagnated during this period, wives' earnings have been the main source of growth in family income. The impact on family income inequality has reflected two conflicting effects:

- Reduced inequality in wives' earnings. Although married women's earnings are less equally distributed than those of married men (largely because more women have zero earnings), the inequality in wives' earnings has declined over time as more have taken paid employment (and the proportion with zero earnings has declined). This effect has tended to moderate family income inequality over time.

- Increasing correlation with husbands' earnings. Wives' and husbands' earnings have been positively correlated throughout the past three decades, and the increase in labor force participation has been greatest among wives of high-earning husbands. In addition, more highly educated, higher-wage men tend to marry more highly educated, higher-wage women. As a result, the correlation between husbands' and wives' earnings increased between 1976 and 1990, increasing inequality among married couples.

How it all adds up. The new study confirms earlier research findings that the changes in wives' earnings over the entire period after 1967 made the married-couple family income distribution more equal than it would otherwise have been in 1994. This equalizing effect was smaller (but still existed) when all families, including single-parent ones, were included. However, the equalizing effect virtually disappears for married couples (and becomes slightly *dis*equalizing for all families) for the period after 1979. The correlation between wives' and husbands' earnings did not begin rising until the mid-1970s. Before that time, therefore, the declining inequality of married women's earnings dominated the picture; but from 1979 until at least 1994, it was balanced by the increasing correlation between wives' earnings and those of their husbands.

Conclusion. The impact of increases in wives' earnings and labor force participation on family income inequality depends on a complex set of interactions. Recently, the rising correlation between wives' and husbands' income (and its aggravating effect on inequality) has become important enough to offset other factors, leaving little net effect.

EYES ONLY

SPECIAL ANALYSIS

Effects of WIC on Birth Outcomes

Relative to many other industrialized countries, the United States has surprisingly high rates of low-weight births, pre-term births, and infant mortality, particularly among blacks. Research on the impact of the Special Supplemental Food and Nutrition Program for Women, Infants, and Children (WIC) finds that WIC participation leads to significantly better outcomes in important measures such as birth weight for black infants—though not for whites.

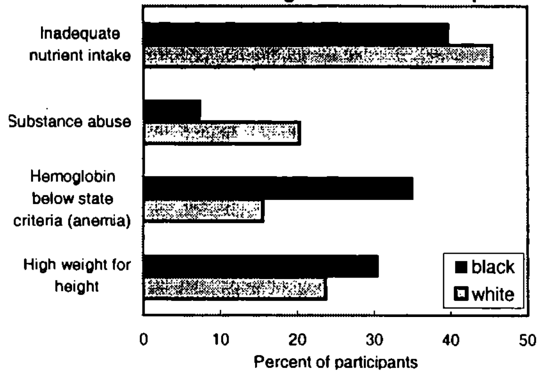
The WIC program. WIC is specifically designed to combat the negative birth outcomes that are often associated with the socioeconomic status of the mother and conditions during pregnancy (such as smoking, drug use, and inadequate prenatal care and nutrition). It is a national clinic-based program that provides a variety of nutritional and health-related goods and services to pregnant and postpartum women, infants, and children under the age of 6. The program had 7.4 million participants in 1998 and an appropriation of $3.9 billion in FY 1999. To be eligible, participants must have a low family income (at or below 185 percent of the poverty level) and a demonstrated "nutritional risk" factor (such as anemia, low weight, or drug-use). One estimate is that roughly 50 percent of income-eligible women were covered by WIC in the early 1990s.

Research findings. Evaluating WIC's effectiveness is complicated by selection issues. On the one hand, women most in need of services may be the ones who choose to participate, making the program appear more effective than it might be for others. On the other hand, women who pay particular attention to their health may be the ones who seek additional assistance, in which case the program may appear to be less effective than it might be for others. However, a new study that pays particular attention to these selection issues provides some of the strongest evidence to date on the effectiveness of the program.

Its results suggest that prenatal WIC participation increases birth weights for black infants by 5 to 13 percent. The study also finds a statistically significant increase in gestational length of 1.4 percent, a reduction in the likelihood of a pre-term birth of 5 percent, and significant reductions in the likelihood of a neonatal and infant death. However, the new study for the most part found no significant effect of WIC on birth outcomes for whites. This last finding is consistent with previous research, which has found smaller or no effects for whites.

Accounting for racial differences. The study suggests possible explanations for why WIC appears to have a stronger effect for blacks. First, it may be the case that prior to any WIC intervention, white mothers are, in ways unobservable to the researcher, healthier at the time of their pregnancy, so that the marginal impact of WIC may be smaller for them. Second, some evidence suggests that black and white women differ in the risk factors that make them eligible for the

Nutritional Risks of Pregnant WIC Participants



program (see chart), suggesting the possibility that the program may be more effective at combating the ill effects of some risk factors than of others.

Implications. The new study provides strong evidence that WIC is effective at improving birth outcomes, at least for a needy subgroup of the population. As welfare caseloads decline and fewer expectant mothers receive assistance through the traditional welfare system, the importance of WIC could increase.

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

Child Support Enforcement is Working Better Than We Think. Although the share of single mothers receiving child support has remained roughly the same (about 30 percent) over the past 20 years, child-support enforcement has actually improved, according to an Urban Institute study. The study finds that a shift in the composition of single mothers away from divorced or separated mothers toward never-married mothers has masked improvements in the receipt rate for both groups. Between 1976 and 1997, the receipt rate of never-married mothers increased from 4 to 18 percent while that of previously married mothers rose from 36 to 42 percent. However, the proportion of never-marrieds (with their lower receipt rates) increased from 17 percent in 1976 to 46 percent in 1997. The study estimates that over half of the rise in child support rates for never-married mothers and a third of the rise in child support receipt rates for previously married mothers can be attributed to greater enforcement efforts and the expansion of funding for child support enforcement.

Study Examines the Gender Gap in Retirement Income. On average, single women have less wealth and income in retirement than single men. In addition, women aged 65 and older are about twice as likely to live in poverty as are similarly-aged men. A number of studies have examined widowhood as an important determinant of these differentials, but a new study looks at differences in work histories, since women earn less on average than men, are concentrated in female-dominated fields, and work fewer years during their prime. The study finds that the first two of these factors significantly lower a single woman's retirement wealth and that the three combined can explain 85 percent of the retirement wealth gap. The authors conclude that if women's earnings continue to climb as they have over the past decade or so, future cohorts of women approaching retirement will enjoy higher well-being, both absolutely and relative to men. Continuation of the slow but steady observed fall in occupational segregation should contribute further to that improvement.

Recent Studies Show Sharp Differences in Well-Being in the DC Region. The District of Columbia ranks last in a recent ranking of the best states for raising children, well below its neighbors Maryland (7) and Virginia (23). This finding is complemented by a new Brookings Institution study finding that metropolitan Washington is prosperous but deeply divided. Signs of overall prosperity include a remarkably low regional unemployment rate and a growing number of jobs, partly due to the exploding technology industry; rising capital investment; and housing, retail, and office markets that are among the hottest in the country. However, the western areas (including parts of Northwest DC) typically enjoy wealth and prosperity while the eastern parts suffer from high rates of poverty. DC and Prince George's County are home to a disproportionately high percentage of the region's poor citizens, single mothers, and struggling schools. The area is also racially segregated, with 70 percent of the area's African American population living in DC or Prince George's County. Most of the region's job growth took place in the western parts and outside of the Capital Beltway.

EYES ONLY

INTERNATIONAL ROUNDUP

OECD Warns Against Complacency in South Korean Restructuring. In its recent survey of the South Korean economy, the Organization for Economic Co-operation and Development noted that the country has been remarkably successful in overcoming the financial crisis at the end of 1997. The OECD concludes that supportive macroeconomic policies and progress in structural reform have laid the foundation for positive growth in 1999. However, the survey warns that the success to date should not lead to complacency about the necessity of fully implementing the new framework put in place after the crisis and in making additional improvements. A priority emphasized by the OECD is further progress in establishing a healthy, market-based financial system. The OECD also argues that much needs to be done to restructure the corporate sector, using the new governance framework that has been put in place. Events this week surrounding the restructuring of Daewoo, Korea's second largest chaebol (business conglomerate), have focused attention on the country's commitment to structural reform. After falling almost 15 percent over the previous 5 trading days, the Korean stock market rose over 6 percent on Tuesday, in part apparently on news that the government has strengthened its commitment to push corporate reform and that the restructuring of Daewoo would proceed apace. Meanwhile, the latest production data show that South Korea's industrial output rose 29.5 percent from a year earlier in June, the largest such increase since August 1988.

European Central Bank Keeps Interest Rates Unchanged. The Governing Council of the European Central Bank (ECB) decided at its July 29 meeting to keep interest rates unchanged, despite speculation earlier this week that an interest rate hike might be announced. The speculation was fueled by the recent remarks of ECB president Wim Duisenberg indicating that a reassessment of the ECB's interest rate policy might be appropriate once economic growth starts to accelerate. As discussed in the Chart of the Week, Duisenberg's comments were probably one factor contributing to the recent rise in the euro. In addition, positive market sentiment regarding the prospects for euro area output growth has been reflected in a narrowing of the gap between United States and euro area bond yields (as well as in the appreciation of the euro). The most recent ECB Monthly Bulletin discusses how new data point to a stabilization of overall output growth in the euro area in early 1999 and to an economic recovery in the second part of 1999 and into the year 2000. Press reports also indicate that the most recent German and French business confidence indexes were stronger than expected. On the monetary side, rapid credit expansion and sustained growth of the monetary aggregates at rates above the ECB's reference rate of 4.5 percent per year have raised concerns in some quarters about future price stability. For the present, however, the ECB has not decided to raise rates.

EYES ONLY

RELEASES THIS WEEK

Gross Domestic Product

According to advance estimates, real gross domestic product grew at an annual rate of 2.3 percent in the second quarter.

Employment Cost Index

The employment cost index for private industry workers rose 3.3 percent for the 12-month period ending in June.

Advance Durable Orders

Advance estimates show that new orders for durable goods rose 0.3 percent in June, following an increase of 0.8 percent in May.

Consumer Confidence

Consumer confidence, as measured by The Conference Board, fell 3.4 index points in July, to 135.6 (1985=100).

MAJOR RELEASES NEXT WEEK

NAPM Report on Business (Monday)
Leading Indicators (Tuesday)
Productivity (Thursday)
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	**2.3**
GDP chain-type price index	5.4	0.9	0.8	1.6	**1.6**
Nonfarm business (NFB) sector:					
Productivity (chain-type)	1.5	2.7	4.3	3.5	N.A.
Real compensation per hour:					
Using CPI	0.6	2.6	2.2	2.6	N.A.
Using NFB deflator	1.3	3.8	3.8	2.6	N.A.
Shares of Nominal GDP (percent)					
Business fixed investment	10.9	11.0	11.0	11.0	**11.2**
Residential investment	4.5	4.3	4.5	4.6	**4.6**
Exports	8.2	11.3	11.3	10.9	**10.9**
Imports	9.2	13.0	13.1	13.2	**13.5**
Personal saving	5.2	0.3	-0.0	-0.5	**-0.8**
Federal surplus	-2.7	0.9	0.8	1.4	N.A.

	1970-1993	1998	April 1999	May 1999	June 1999
Unemployment Rate (percent)	6.7**	4.5**	4.3	4.2	4.3
Payroll employment (thousands)					
increase per month			321	-5	268
increase since Jan. 1993					18895
Inflation (percent per period)					
CPI	5.8	1.6	0.7	0.0	0.0
PPI-Finished goods	5.0	0.0	0.5	0.2	-0.1

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

New or revised data in **boldface**.

FINANCIAL STATISTICS

EYES ONLY

	1997	1998	May 1999	June 1999	July 29, 1999
Dow-Jones Industrial Average	7441	8626	10854	10704	10791
Interest Rates (percent per annum)					
3-month T-bill	5.06	4.78	4.50	4.57	4.59
10-year T-bond	6.35	5.26	5.54	5.90	5.88
Mortgage rate, 30-year fixed	7.60	6.94	7.15	7.55	7.70
Prime rate	8.44	8.35	7.75	7.75	8.00

INTERNATIONAL STATISTICS

Exchange Rates	**Current level July 29, 1999**	**Percent Change from**	
		Week ago	**Year ago**
Euro (in U.S. dollars)	1.072	2.0	N.A.
Yen (per U.S. dollar)	115.2	–1.8	–19.1
Major currencies index (Mar. 1973=100) (trade-weighted value of the U.S. $)	95.06	–1.2	–4.5

International Comparisons [1]	**Real GDP growth** (percent change last 4 quarters)	**Unemployment rate** (percent)	**CPI inflation** (percent change in index last 12 months)
United States	4.1 (Q2)	4.3 (Jun)	2.0 (Jun)
Canada	3.2 (Q1)	8.1 (May)	1.6 (May)
Japan	0.1 (Q1)	4.7 (May)	-0.4 (May)
France	2.3 (Q1)	11.4 (Apr)	0.5 (Apr)
Germany	0.8 (Q1)	7.2 (May)[2]	0.4 (May)
Italy	0.9 (Q1)	12.1 (Apr)	1.6 (May)
United Kingdom	1.2 (Q1)	6.2 (Mar)	1.3 (May)

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

EYES ONLY

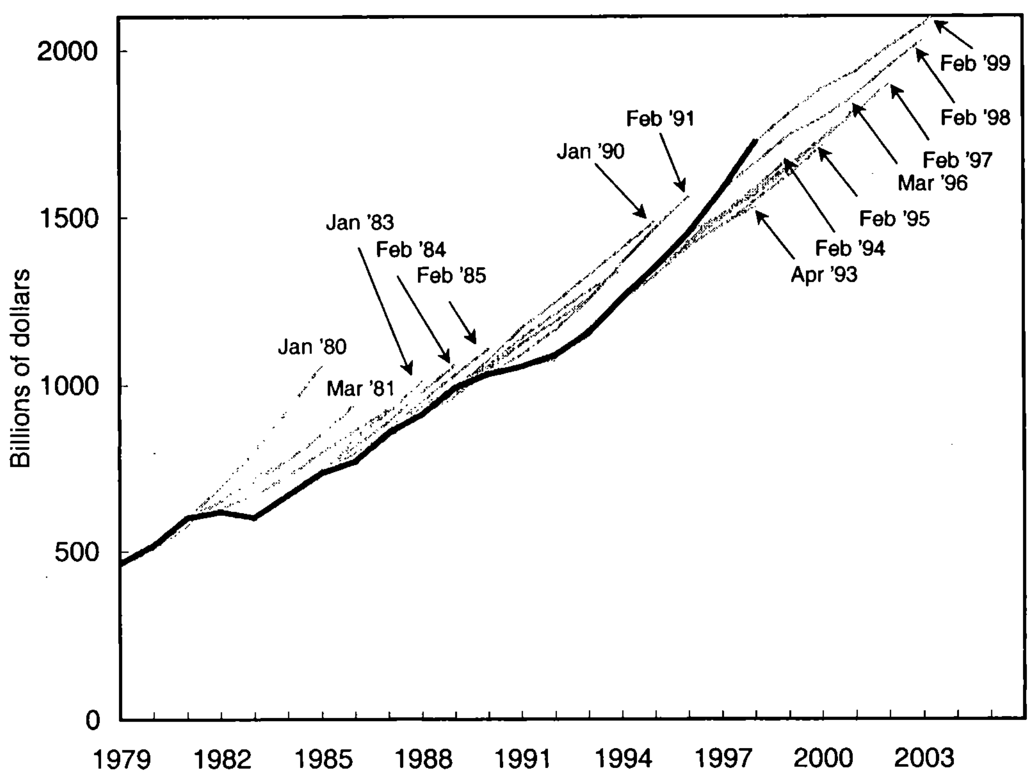
WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

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

July 23, 1999

CHART OF THE WEEK

Federal Revenue Projections, 1979-99



Since 1993 Administration revenue projections (the light gray lines) have been conservative and have underestimated actual revenues (the dark line). This stands in marked contrast to Administration projections during the 1982-90 expansion, which tended to overestimate revenues, even prior to the 1990-91 recession.

EYES ONLY

CONTENTS

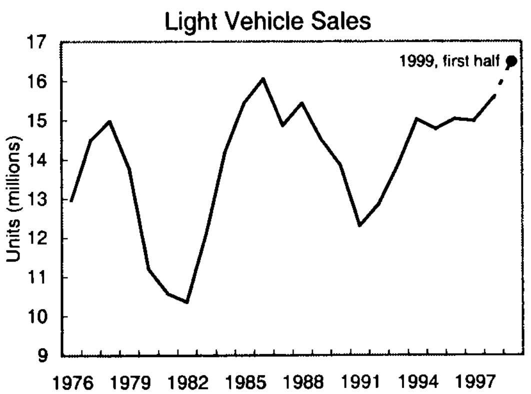
"Very scary, Jennifer—does anyone else have an H.M.O. horror story?"

EYES ONLY

MACROECONOMIC UPDATE

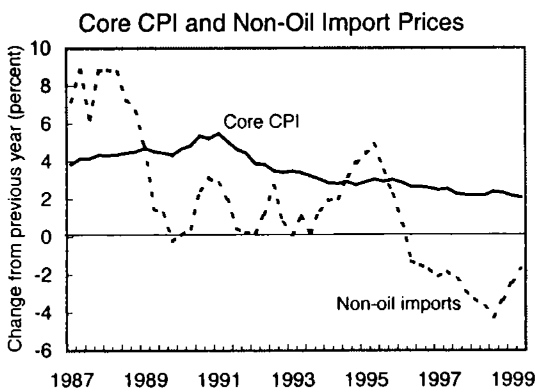
As Good As It Gets?

GDP may slow in the second half of this year, but not because the recovery is showing signs of old age. With inventories lean and inflation low and stable, the limits to growth are more likely to be set by slower growth in consumer spending or the capacity limits of selected industries.

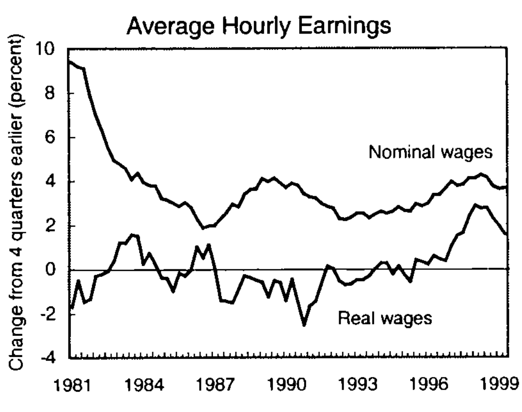


Motor vehicles. Light vehicles sold at a 16.5 million unit annual pace in the first half of 1999, putting them on track to achieve the best annual sales ever (see upper chart). However, motor vehicle production is approaching capacity limits—especially for trucks.

Housing. The housing sector also appears to be constrained by limited capacity as the unemployment rate in construction hovers at very low levels. Builders were unable to make the usual springtime increases.



Consumption. The consumption rate is now so high that it seems unsustainable. Energized by stock market gains, consumers appear to have spent about 1¼ percent more than their income in the second quarter.



Inflation. Despite low unemployment and rapid GDP growth, inflation as measured by the core CPI has been flat at about 2¼ percent per year for 3 years. Foreign competition remains stiff, and non-oil import prices have fallen during each of the past 4 years (see middle chart).

Wage gains. Also holding down inflation has been a surprising moderation in nominal wage inflation, which has actually fallen over the past year (see lower chart). Despite this, real wages grew another 1.5 percent during the past four quarters, the fourth year of solid real wage gains after 9 years of stagnation (see lower chart). The increase in real wages has been supported by an acceleration of productivity.

EYES ONLY

SPECIAL ANALYSIS

New Evidence on the Causes of Welfare Caseload Changes

The 1996 welfare reform legislation and the strong economy have both been important contributors to the unprecedented decline in welfare caseloads in recent years, according to a new CEA analysis. The new study, which uses data and program information provided by the Department of Health and Human Services, updates a 1997 CEA study of caseload change.

A widespread and continuous decline in caseloads. In January 1993, 5.0 million families received welfare, but by December 1998 this number had fallen to 2.8 million. All states have experienced double-digit percentage declines. In 23 states, the caseload is less than half of what it was in January 1993, and for 22 states, the percent drop was larger in 1998 than in 1997.

Accounting for change. The 1997 CEA study examined the relative importance of a variety of economic and policy changes on caseload declines between 1993 and 1996. The new study incorporates data through 1998 and analyzes the effects of additional factors, including the 1996 welfare reform and the minimum wage. The new study shows that economic factors were more important in explaining the decline in caseloads between 1993 and 1996 than they were in the later period. Policy factors were more important after 1996.

- 1993-96. Roughly 26 to 36 percent of the caseload decline was due to improved economic conditions, in particular falling state unemployment rates. Another 14 percent was due to welfare waivers, which were issued to states to allow them to experiment with alternative program designs. Caseloads fell 5 to 8 percent due to the rise in the minimum wage, 6 to 21 percent due to lower welfare benefits (measured by the real value of the state's maximum benefit for a family of three), and the remainder because of other factors.

- 1996-98. The 33 percent decline in the recipiency rate following the enactment of the Personal Responsibility and Work Opportunity Reconciliation Act of 1996 (PRWORA) was due largely to the changes in state welfare programs implemented under the Temporary Assistance for Needy Families (TANF) block grant. About 34 to 39 percent of the caseload decline from 1996 to 1998 was due to TANF-funded programs, 8 to 10 percent was due to the improved labor market, 3 to 5 percent was due to the higher minimum wage, and 1 to 5 percent was due to lower cash welfare benefits.

The smaller contribution of the labor market to caseload declines in the latter period reflects the fact that the unemployment rate had already fallen substantially by 1996. The decline in the unemployment rate between 1996 and 1998 was much smaller than the decline between 1993 and 1996.

EYES ONLY

Conclusion. The new study confirms that the policy changes enacted in PRWORA have been an important contributor to the continued strong decline in welfare caseloads. The study also shows the impact of the minimum wage in reducing caseloads. However, a full assessment of the impact of welfare reform awaits analysis of other indicators such as work and earnings among welfare leavers, marriage rates, out-of-wedlock pregnancies, child health, and poverty rates.

EYES ONLY

ARTICLE

Economic Issues Facing China

Chinese leaders will soon gather for informal meetings in Beidaihe, a seaside resort town about 90 miles from Beijing. Economic issues are central to their agenda.

Background. Compared with the firestorm that hit many other Asian economies, China's moderate slowdown from double-digit annual growth in the first half of the 1990s seems enviable. Real GDP was about 7 percent higher in the second quarter of 1999 than it was in the same period a year ago. But there are reports of scattered protests about unpaid wages and rising unemployment—and the economy may well continue to slow, fueling further social unrest. It remains possible that China has not avoided crisis, but simply deferred it.

The exchange rate. China has received substantial credit since the crisis began for keeping its exchange rate fixed relative to the dollar despite the turmoil elsewhere. Given China's capital controls and enormous foreign-exchange reserves, market forces are unlikely to force a Chinese devaluation. However, press reports this week speculate that because of slower growth and a falling trade surplus, China may back away from its earlier pledge not to devalue this year.

The trade balance. China has experienced some weakening of export growth since early 1998, but its narrowing trade surplus primarily reflects a surge in the recorded level of imports since the beginning of this year (see chart). This surge is probably due less to growing income or an overvalued exchange rate than to the country's recent anti-smuggling campaign, which has led to previously unrecorded imports now being recorded (and taxed). Thus, the falling trade surplus in 1999 is probably less real than it first appears.

Chinese Exports and Imports

A weaker currency, should China devalue, could help boost exports and the economy. Of course, a Chinese devaluation during the depths of the emerging markets crisis would have risked provoking a renewed round of currency turmoil—which would have been counterproductive to China as well as to the rest of the world. Now the effect of such a devaluation is less clear.

Prospects for continuing economic reforms. A clear lesson of the Asian crisis is that it is dangerous for a country to have weak, poorly regulated banks making policy loans to inefficient, over-leveraged state enterprises. Unfortunately, this is a reasonable description of China. As a result, Chinese leaders often suggest a desire to push ahead with economic and financial reforms. At the same time, China's economic controls—such as the non-convertibility of the currency—probably helped insulate it during the crisis. Indeed, many of the policies implemented since the crisis began work against the goal of economic and financial reform. For example, China has tightened currency controls. And when growth slowed in mid-1998, China forced state-owned banks to sharply increase their lending to (generally unprofitable) state enterprises—increasing growth in the short run at the expense of the economy's long-run health.

Conclusion. Elsewhere in Asia, decades of strong growth ended—one hopes only briefly—in metaphorical fire. In China, a serious risk is that it could instead end in ice, with an increasingly sluggish, frozen economy. Chinese leaders appear to be aware of the risks. But their choices are hard, requiring a trade-off between, on the one hand, the political risks of a further short-term contraction if reforms (potentially including entrance into the WTO) accelerate, and, on the other hand, the economic risks of a long-term slowdown.

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

Was Greenspan Humphrey-"Hawkish?" Remarks by Federal Reserve Chairman Greenspan that the Fed needed to be "especially alert to inflation risks" caused some stir in financial markets Thursday. However, the Fed chairman also noted that, to date, this has been an exceptional year for the American economy and that the root of the impressive expansion of economic activity has been a marked acceleration of productivity. Greenspan observed that if productivity should fail to continue to accelerate and demand growth persist or strengthen, the economy could overheat. Should signs of such overheating occur, the Fed Chairman argued, it could be appropriate for the Fed to take pre-emptive actions to preserve price stability and obviate more drastic actions later.

Interpreting Differences in Care Delivery among Types of HMOs. Patients enrolled in investor-owned HMOs are less likely to receive many of the basics of good medical care than patients enrolled in not-for-profit HMOs, according to a study published in last week's *Journal of the American Medical Association*. The study of 329 HMOs found that patients in investor-owned HMOs (which have shown dramatic enrollment gains in recent years) received significantly fewer immunizations, routine mammograms, pap smears, prenatal care, and lifesaving drugs after a heart attack. Although the study's finding are descriptive of differences in health care received by the majority of HMO enrollees, its conclusions should be interpreted with some caution. First, the study does not control for individual patient characteristics; to the extent that different people select into these plans, the relationship between type of HMO and the quality of care received may not be causal. Second, investor-owned HMOs may provide a lower cost alternative to some patients. Third, the 14 measures compared in the study focus on relatively inexpensive preventive services and do not assess outcomes of care. Finally, the data used in the study are from 1996 and, given the rapid pace of change in the health industry, may not reflect the current state of health care.

Study Looks at the Demographics of HIV Treatment. American adults seeking treatment for HIV are disproportionately black, male, and poor, according to the initial report from the HIV Cost and Services Utilization Study sponsored by the Agency for Health Care Policy Research in HHS. Of the sample of HIV-infected people seeking medical treatment, 48 percent had some college education, 37 percent were employed, and 72 percent had household incomes of less than $25,000 per year. Expenditures on the personal health care of HIV-infected Americans accounted for less than 1 percent of all U.S. expenditures for personal health care in 1996. However, financing HIV medical care is more problematic: Americans with HIV were half as likely to have private insurance as the non-elderly population generally. Only 32 percent had private health insurance, 29 percent were covered only by Medicaid, 20 percent had no health insurance and 19 percent were covered by Medicare, usually in conjunction with Medicaid. Finally, the study estimates that up to two-thirds of American adults with HIV are not receiving regular care.

INTERNATIONAL ROUNDUP

Study Examines Japanese Households' Saving Behavior. The household saving rate in Japan has risen in the 1990s as a result of increased uncertainty about future welfare among different segments of the population, according to a new study by a researcher at the Bank of Japan. The study finds that higher future income risk has increased saving rates, while real interest rates have had no significant effect. Surveys reveal that anxiety about post-retirement income has increased considerably over the last decade and that the young are highly pessimistic about the adequacy of future pension benefits. Also, among low-income households, the middle-aged especially have decreased their expenditures in recent years, possibly due to fears about employment conditions. And, in fact, the percentage of workers dismissed at their companies' convenience has been highest for workers aged 55-64. The study also finds that the average saving rate among households aged 60 and over is higher than the national average, with little evidence that the elderly are spending down their assets. This conservatism appears to arise from anxiety regarding future payment burdens for nursing care. Since the majority of assets held by elderly Japanese are in the form of housing, land, and other real assets, the study recommends developing a system that would enable the elderly to receive a secure cash flow from these assets. One specific measure could be the use of reverse mortgages, whereby the elderly would put up their housing assets as collateral for a loan that would be paid off when they died.

International Business Group Rises to UN Challenge. The International Chamber of Commerce (ICC) responded favorably to a challenge from UN Secretary General Kofi Annan asking businesses to join a global compact to promote world values, including a commitment to the environment, human rights, and labor standards. In a joint statement issued by the ICC and UN, the two sides expressed agreement that the goals of business and the United Nations can be mutually supportive. They agreed that a strong worldwide private sector contributes to UN goals because, by creating wealth and jobs, companies help to defeat poverty. However, the ICC added that companies cannot be expected to take on responsibilities outside their own sphere that are properly the preserve of governments. The private sector and the UN have already undertaken a project to promote foreign direct investment in Africa. International companies are providing corporate expertise to the investment promotion agencies of the least developed countries. The Guide to Ethiopia is the first in the series.

Hong Kong Unemployment Rate Declines. Although many hard-hit Asian economies had already begun to show signs of recovery this year, Hong Kong's unemployment rate was still rising as recently as the March-May period, when it reached an historic high of 6.3 percent. This compares with 2.2 percent in July-September 1997. Thus, the news that the unemployment rate edged down to 6.1 percent in the April-June period may be a hopeful sign that the Hong Kong economy is also beginning to recover.

EYES ONLY

RELEASES THIS WEEK

Housing Starts

Housing starts decreased 6 percent in June to 1.571 million units at an annual rate. For the first six months of 1999, housing starts are 7 percent above the same period a year ago.

U.S. International Trade in Goods and Services

The goods and services trade deficit increased to $21.3 billion in May from $18.6 billion in April.

MAJOR RELEASES NEXT WEEK

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

EYES ONLY

U.S. ECONOMIC STATISTICS

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

	1970-1993	1998	April 1999	May 1999	June 1999
Unemployment Rate (percent)	6.7**	4.5**	4.3	4.2	4.3
Payroll employment (thousands)					
increase per month			321	-5	268
increase since Jan. 1993					18895
Inflation (percent per period)					
CPI	5.8	1.6	0.7	0.0	0.0
PPI-Finished goods	5.0	0.0	0.5	0.2	-0.1

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

EYES ONLY

FINANCIAL STATISTICS

	1997	1998	May 1999	June 1999	July 22, 1999
Dow-Jones Industrial Average	7441	8626	10854	10704	10969
Interest Rates (percent per annum)					
3-month T-bill	5.06	4.78	4.50	4.57	4.48
10-year T-bond	6.35	5.26	5.54	5.90	5.78
Mortgage rate, 30-year fixed	7.60	6.94	7.15	7.55	7.52
Prime rate	8.44	8.35	7.75	7.75	8.00

INTERNATIONAL STATISTICS

Exchange Rates	**Current level July 22, 1999**	**Percent Change from Week ago**	**Percent Change from Year ago**
Euro (in U.S. dollars)	1.051	2.8	N.A.
Yen (per U.S. dollar)	117.3	-2.7	-16.9
Major currencies index (Mar. 1973=100) (trade-weighted value of the U.S. $)	96.19	-1.2	-3.2

International Comparisons 1/	**Real GDP growth** (percent change last 4 quarters)	**Unemployment rate** (percent)	**CPI inflation** (percent change in index last 12 months)
United States	4.0 (Q1)	4.3 (Jun)	2.0 (Jun)
Canada	3.2 (Q1)	8.1 (May)	1.6 (May)
Japan	0.1 (Q1)	4.7 (May)	-0.4 (May)
France	2.3 (Q1)	11.4 (Apr)	0.5 (Apr)
Germany	0.8 (Q1)	7.2 (May) 2/	0.4 (May)
Italy	0.9 (Q1)	12.1 (Apr)	1.6 (May)
United Kingdom	0.7 (Q1)	6.2 (Mar)	1.3 (May)

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

EYES ONLY

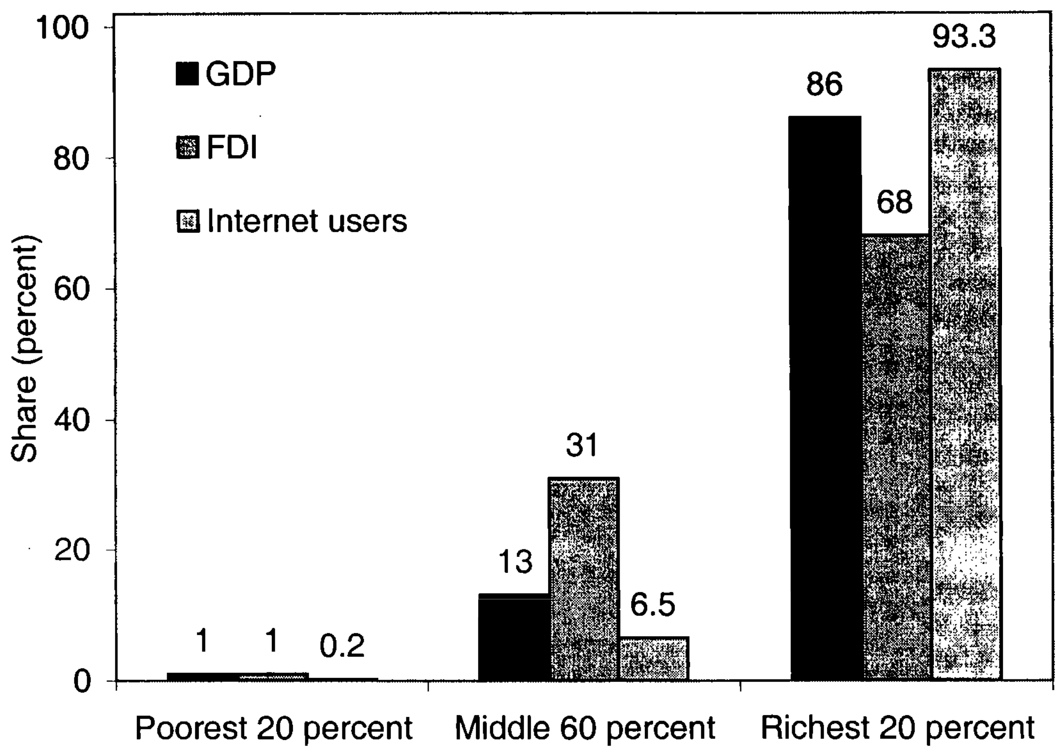
WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

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

July 16, 1999

CHART OF THE WEEK

World Distributions of GDP, FDI, and Internet Users, 1997



One theme of the United Nations' *Human Development Report, 1999* (described in the International Roundup) is the disparity between rich and poor countries in a number of areas. In 1997, the fifth of the world's population living in the highest income countries had 86 percent of world GDP. Foreign direct investment (FDI) was somewhat more equally distributed, but Internet users were very highly concentrated in the richest countries.

EYES ONLY

CONTENTS

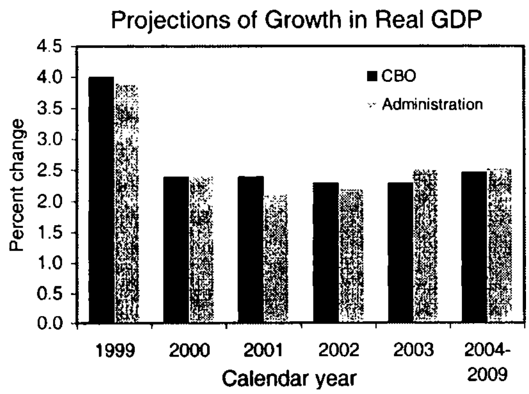
"I'd love to ask you in, Howard, but they start trading in Hong Kong in ten minutes."

EYES ONLY

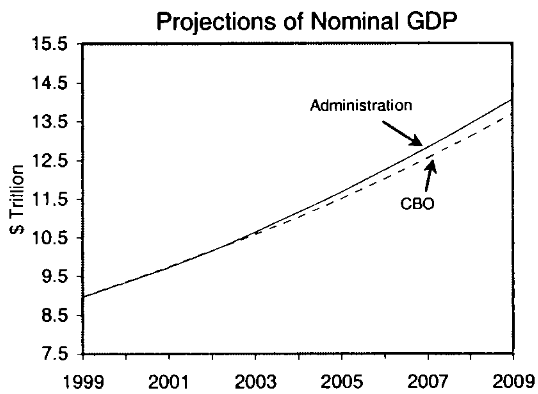
CURRENT DEVELOPMENT

CBO and Administration Forecasts Differ Subtly

The CBO and the Administration now base their budget projections on similar economic assumptions. As a result, their budget forecasts are also similar. However, subtle differences in economic assumptions (as well as technical differences) result in CBO projecting slightly larger surpluses during the first 7 years, while the Administration projects larger surpluses thereafter.



Similarities. Over the budget window ending in 2009, both CBO and the Administration project an annual rate of real GDP growth of 2.6 percent and both project an annual rate of increase in the CPI of about 2.5 percent. One must look very closely indeed to detect that the CBO projects slightly faster real GDP growth through 2002, after which the Administration projection catches up (see upper chart).



Differences. The Administration and CBO agree on the CPI forecast, which is the inflation measure that matters most for spending projections. However, the Administration expects the price index for GDP—which contributes to determining the growth of the tax base—to rise about ¼ percentage point faster per year than does the CBO. As a result of this difference in assumptions about the "wedge" between the CPI and the GDP price index, the Administration's projection of nominal GDP (and the revenues associated with it) grow faster than CBO's after 2003 (see lower chart). Over the very long run, this difference results in larger cumulative surpluses in the Administration's projection.

Revisions from February. In the wake of another two quarters of strong real GDP growth with steady unemployment and low inflation, both groups have elevated their projections of real GDP growth. Over the complete 11-year span, both have revised up real GDP growth by about ¼ percentage point per year.

Technicals. In addition to differences in economic assumptions, the CBO and Administration budget projections reflect different technical assumptions (including how much tax receipts are generated per dollar of GDP). These technical differences boost CBO's estimate of the surplus through 2008.

EYES ONLY

SPECIAL ANALYSIS

Taking Account of the Environment

A National Research Council (NRC) panel has just released a report concluding that extending the U.S. national income and product accounts (NIPAs) to include assets and production activities associated with natural resources and the environment is an essential investment for the nation. The report argues that it would be even more valuable to develop a *comprehensive* set of environmental and other nonmarket accounts—though not at the expense of maintaining and improving the current core national accounts.

Background. The NIPAs were designed to measure production and income that arise primarily from the market economy. However, much economic activity takes place outside the market economy. Thus, by omitting important activities such as nonmarket work, environmental services, and investment in human capital, the NIPAs provide an incomplete and potentially misleading picture. Recognizing this, private scholars and governments have begun to develop methods of extending national accounts to measure as much economic activity as is feasible, whether that activity takes place inside or outside the boundaries of the marketplace. In the United States, the Bureau of Economic Analysis began intensive work on environmental accounting in 1992, but was directed by the Congress in 1994 to suspend further work and obtain an external review of environmental accounting. The NRC report represents this review.

Benefits of integrated environmental and economic accounting. The NRC panel argues that environmental and natural-resource accounts would provide useful data on resource trends and help governments, businesses, and individuals better plan their economic activities and investments. They would provide valuable information on the interaction between the environment and the economy; help in determining whether the nation is using its stocks of natural resources and environmental assets in a sustainable manner; and provide information on the implications of different regulations, taxes, and consumption patterns. The report notes that the rationale for augmented accounts is solidly grounded in mainstream economic analysis and is consistent with an extensive domestic and international effort to improve and extend national accounts.

A phased or comprehensive approach? BEA's proposal for developing such accounts envisions a phased approach, starting with subsoil mineral assets such as fossil fuels and metals; expanding to renewable and other natural resources such as forests, agricultural resources, and fisheries; and only then addressing the most difficult to measure environmental assets such as clean air and water or biodiversity. While recognizing the value of a phased approach, the NRC panel concludes that it would be even better to pursue a comprehensive approach in which a broad set of nonmarket accounts would be developed in parallel with those for minerals and near-market activities—even though the former pose considerably greater conceptual and data challenges than the latter.

EYES ONLY

Launching satellites. In order to preserve the integrity of the well-developed core income and product accounts, the NRC panel supports BEA's preference for developing natural resource and environmental accounts as satellite or supplemental accounts. Satellite accounts serve the basic purpose of the national accounts in providing useful information. In addition, and in light of the current state of knowledge and preliminary nature of the data and methodologies involved, developing satellite accounts allows experimentation and encourages the testing of a wide variety of approaches.

Conclusion. Much important economic activity takes place outside the market activity measured in the NIPAs. The NRC report estimates that an incremental expenditure of about $10 million per year for a decade or more would be required to implement a more comprehensive set of environmental and augmented accounts—and that that investment would provide valuable benefits to the nation. However, as the NRC panel observes, the core NIPAs are a precious national asset and their maintenance and improvement should not be compromised.

EYES ONLY

ARTICLE

A New Future for Securities Trading?

With its vast potential for disseminating information quickly to a broad audience, the Internet may revolutionize the way securities are traded. Recent developments suggest that important changes are already underway.

A virtual trading floor. Electronic trading is not new. The NASDAQ, a trading system that exists solely on computer screens, was established in 1971 as the world's first electronic stock market. However, the recent rapid growth of the Internet now allows for a virtual trading floor on which anyone can trade at any time without the restrictions of conventional exchanges, such as a fixed location or set trading hours based on the conventional workday.

Change is underway. Increasingly, people are expecting to be able to conduct business on a 24-hour basis, in part perhaps because of changing cultural attitudes but also because of advances in technology. In the case of securities trading, the Internet could allow market participants to trade on late-breaking news even when standard exchanges are closed. That same technology-culture link has also broadened market access, opening trading up to more intermediaries and individuals (including "day traders" who may buy and sell stocks many times over the course of a day). Demand for more decentralized trading across both dimensions is putting pressure on the structure of equity trading in two key areas:

- Stock exchanges. Both traditional floor exchanges and electronic exchanges may be feeling heightened competitive pressure from alternative trading systems such as electronic communication networks (ECNs) that can more easily adapt to extended trading hours. While the big exchanges have agreed to form working groups with the Securities and Exchange Commission (SEC) on the effects of extended trading, at least one ECN is planning to lengthen hours unilaterally this summer.

- Brokerages. It appears that the success of discount brokerages that have harnessed the Internet has pushed at least one large, full-service brokerage (Merrill Lynch) toward offering low-cost online trading as well. To the extent that some of the information traditionally provided by full-service brokerages is now readily available online, the value of trading through such brokerages may be reduced.

Implications. Opening up trading to more investors, possibly during a longer period of time each day, may have a number of repercussions:

- Volatility. Extending trading hours will probably thin out markets considerably during evening sessions. Some believe that all things equal, market thinness may increase price volatility because completed orders of a given size will move a price by more relative to the market. But rational investors will recognize this and may choose simply to wait until markets thicken. Empirical evidence suggests that market thinness is actually associated with lower volatility.

- Timing the release of information. Currently, many firms release sensitive data strategically after stock trading has closed for the day, in order to allow time for news to sink in gradually rather than immediately jolting stock prices. With expanded trading, companies will have to find different strategies for releasing information.

- Investor protection. With more investors and especially more individuals having access to trading, the potential for fraud and deception might increase. In addition, investors who go it alone could be hurt if they lack knowledge about sophisticated, risk-minimizing trading techniques often used by professional traders. However, the SEC is charged with protecting investors from illegal practices and educating them about the risks of individual trading, whether it be Internet, day, or after-hours trading.

Conclusion. In today's strong stock market, the possibilities opened up by the Internet are forcing changes in the traditional structure of securities trading. The full ramifications of new phenomena such as day trading and extended hours remain to be seen—though there is little reason at this point to expect them to generate excessive volatility or pose insuperable challenges to the SEC. Another possibility altogether is that a cooling off of stock prices may lessen the demand for expanded trading and therefore slow the pace of change.

EYES ONLY

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

Employers Likely to Take a Minimum Wage Hike in Stride. The percent of employers responding that a minimum wage increase to $6.00 per hour would affect their employment or hiring decisions was lower in this year's survey by the Jerome Levy Institute than it was in last year's. Only 13.4 percent of businesses surveyed indicated that a rise in the minimum wage to $6.00 per hour would affect their employment, down from 20.7 percent in 1998. Of those firms that would be affected, 15 percent (or 2 percent of all firms) would lay off workers or reduce hours, while the remainder would resort to other tactics such as hiring fewer workers, hiring adults over teenagers, or hiring more experienced workers over less experienced workers. When asked about an increase to $7.25 per hour, 35.8 percent of the firms surveyed said their employment or hiring decisions would be affected. The study argues that these results indicate that the current minimum wage is well below the level likely to have substantial employment impacts and that it would be safe to raise the minimum wage to at least $6.00 per hour.

Metro Labor Markets Should Absorb Welfare Recipients. Despite the concern that the increase in low-skilled labor supply caused by welfare reform would overwhelm demand, a recent study of 20 metropolitan areas found reason to believe that these labor markets will successfully absorb welfare recipients searching for employment. The growing employment of low-skilled workers should substantially outpace the number of new welfare recipient entrants (which account for only between 0.3 and 1.3 percent of low-skilled employment). However, metropolitan areas vary with respect to their expected success: Atlanta, Dallas, Indianapolis, Jacksonville, Phoenix, and San Jose should see overall drops in their low-skilled unemployment rates while Baltimore, New York, St. Louis, and the District of Columbia face likely increases. These metropolitan variations are due mostly to differences in the rates of job growth and the number of welfare recipient job seekers as a percent of the low-skilled labor force.

New Car Shoppers Are Turning to the Internet. The Internet is quickly growing as a source for help when purchasing a car, according to a recent survey. The percentage of new vehicle buyers who used the Internet in their car search has grown from 25 percent to 40 percent since 1998. Moreover, people are placing increased reliance on information found online to help them decide which vehicle to purchase. Increased availability of the Internet as well as a greater percentage of consumers with online access who turn to the Internet when shopping for a vehicle are cited as causes for this increase. Purchasers of late-model used cars are also using the Internet heavily; 26 percent of consumers turned to the Internet, mostly to locate specific cars for sale.

EYES ONLY

INTERNATIONAL ROUNDUP

WTO Lauds Administration Trade Stance. In its latest review of U.S. trade policy, the WTO praised the Administration for its commitment to trade and investment liberalization in the face of protectionist pressures at home. The organization's Trade Policy Review Board (TPRB) noted that the strong performance of the U.S. economy has provided support for the world economy in the wake of the Asian financial crisis, while at the same time low-priced imports have been helpful in meeting U.S. domestic demand and in subduing inflationary pressures. However, members of the TPRB expressed concern that it may become more difficult for the Administration to resist protectionist pressures if the U.S. economy slows substantially and unemployment begins to rise. Some members also asked clarification or expressed concern about certain facets of the U.S. trade regime including the recent anti-dumping actions in steel, the export enhancement program for agriculture, state-Federal relations relating to WTO commitments, and the extra-territorial application of U.S. labor, health, sanitary, and environmental standards.

UN *Human Development Report* Looks at Globabilization. The tenth annual *Human Development Report* issued by the United Nations acknowledges that globalization offers great opportunities for human advance but questions whether the benefits have been shared as widely as they could be. For example, it notes that global income inequality has widened, with the income gap between the 20 percent of the world's population living in the richest countries and the 20 percent living in the poorest standing at 74-to-1 in 1997, up from 60-to-1 in 1990 and 30-to-1 in 1960. In addition, although 40 countries have sustained average per capita growth of more than 3 percent per year since 1990, 80 countries still have per capita incomes lower than they were a decade or more ago. As in the past, the report includes a Human Development Index (HDI) ranking 174 countries in terms of life expectancy, education, and income. Canada ranks first for the sixth consecutive year, with the United States third after Norway.

How Exports Stimulate Productivity. While increased exporting activity does not appear to increase the productivity of individual firms, it does raise productivity at the industry level, according to a recent study. The study, based on 1983-92 plant level data for U.S. manufacturing industries, finds that exporting firms experience substantially higher output and employment growth than non-exporters, so that an expansion of exports leads to a reallocation of resources toward the more efficient producers in the sector. The study estimates that between 1983 and 1992, more than 40 percent of the efficiency gains in U.S. manufacturing resulted from changing output shares across plants.

EYES ONLY

RELEASES THIS WEEK

Industrial Production and Capacity Utilization
****Embargoed until 9:15 a.m., Friday, July 16, 1999****

The Federal Reserve's index of industrial production increased 0.2 percent in June. Capacity utilization decreased 0.1 percentage point to 80.3 percent.

Consumer Price Index

The consumer price index was unchanged in June. Excluding food and energy, consumer prices rose 0.1 percent.

Retail Sales

Advance estimates show that retail sales rose 0.1 percent in June following an increase of 1.2 percent in May. Excluding sales in the automotive group, retail sales rose 0.4 percent following an increase of 0.5 percent.

Producer Price Index

The producer price index for finished goods decreased 0.1 percent in June. Excluding food and energy, producer prices fell 0.2 percent.

MAJOR RELEASES NEXT WEEK

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

EYES ONLY

U.S. ECONOMIC STATISTICS

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

	1970-1993	1998	April 1999	May 1999	June 1999
Unemployment Rate (percent)	6.7**	4.5**	4.3	4.2	4.3
Payroll employment (thousands)					
increase per month			321	-5	268
increase since Jan. 1993					18895
Inflation (percent per period)					
CPI	5.8	1.6	0.7	0.0	**0.0**
PPI-Finished goods	5.0	0.0	0.5	0.2	**-0.1**

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

New or revised data in **boldface**.

EYES ONLY

FINANCIAL STATISTICS

	1997	1998	May 1999	June 1999	July 15, 1999
Dow-Jones Industrial Average	7441	8626	10854	10704	11186
Interest Rates (percent per annum)					
3-month T-bill	5.06	4.78	4.50	4.57	4.57
10-year T-bond	6.35	5.26	5.54	5.90	5.72
Mortgage rate, 30-year fixed	7.60	6.94	7.15	7.55	7.58
Prime rate	8.44	8.35	7.75	7.75	8.00

INTERNATIONAL STATISTICS

Exchange Rates	**Current level July 15, 1999**	**Percent Change from**	
		Week ago	**Year ago**
Euro (in U.S. dollars)	1.022	0.2	N.A.
Yen (per U.S. dollar)	120.5	–1.7	–14.3
Major currencies index (Mar. 1973=100) (trade-weighted value of the U.S. $)	97.39	–0.3	–2.0

International Comparisons 1/	**Real GDP growth** (percent change last 4 quarters)	**Unemployment rate** (percent)	**CPI inflation** (percent change in index last 12 months)
United States	4.0 (Q1)	4.3 (Jun)	2.0 (Jun)
Canada	3.2 (Q1)	8.1 (May)	1.6 (May)
Japan	0.1 (Q1)	4.7 (May)	-0.4 (May)
France	2.3 (Q1)	11.4 (Apr)	0.5 (Apr)
Germany	0.8 (Q1)	7.2 (May) 2/	0.4 (May)
Italy	0.9 (Q1)	12.1 (Apr)	1.6 (May)
United Kingdom	0.7 (Q1)	6.2 (Mar)	1.3 (May)

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

EYES ONLY

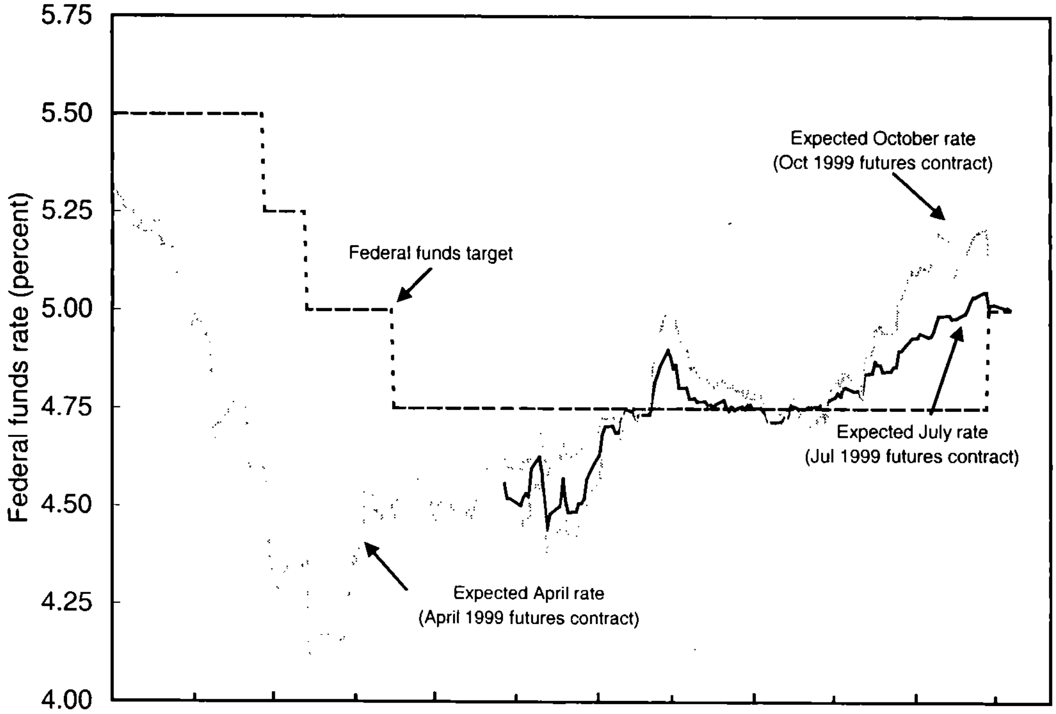
WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

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

July 9, 1999

CHART OF THE WEEK

Market Expectations of Fed Actions



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

EYES ONLY

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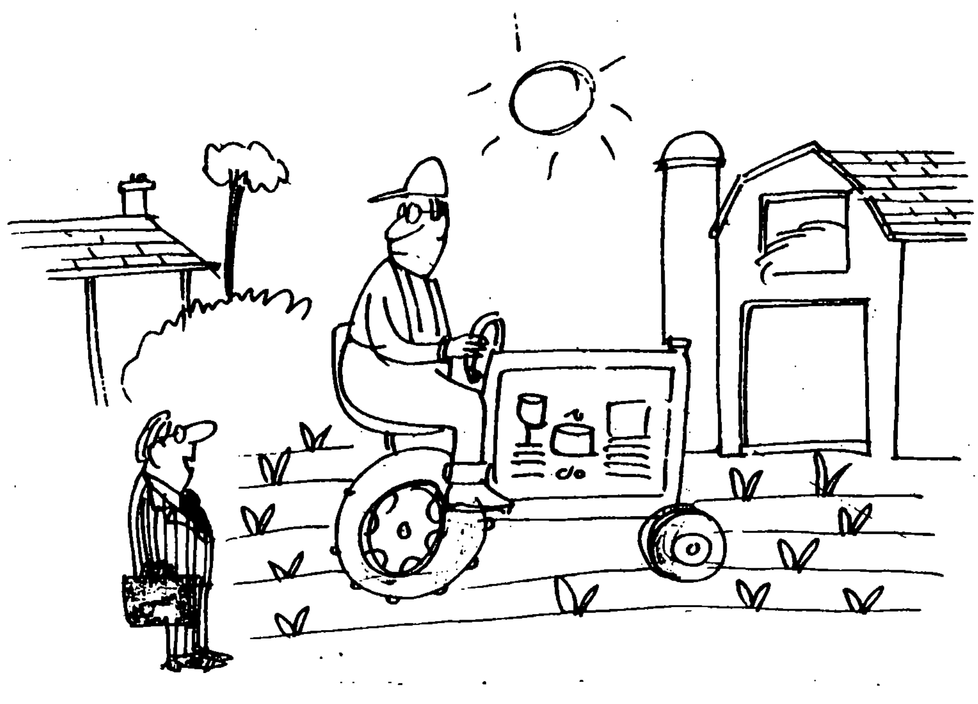


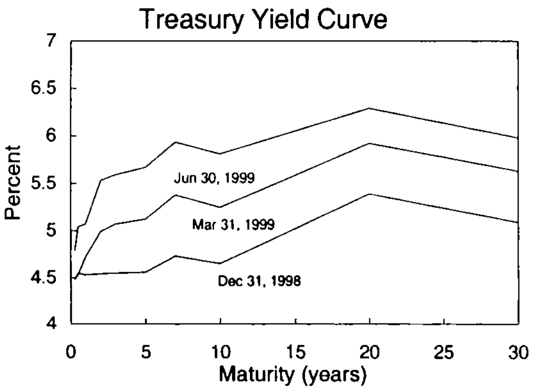
"I'm sorry, Dad. If I ever decide to get involved in farming, it will be strictly as a middleman."

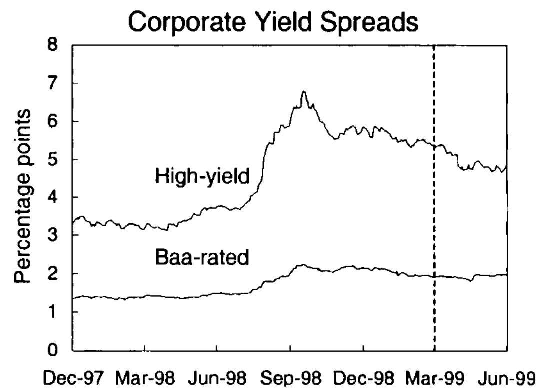
EYES ONLY

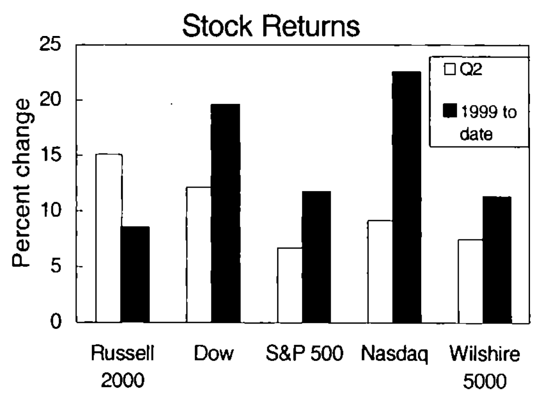
FINANCIAL MARKET UPDATE

Second Quarter 1999

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







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

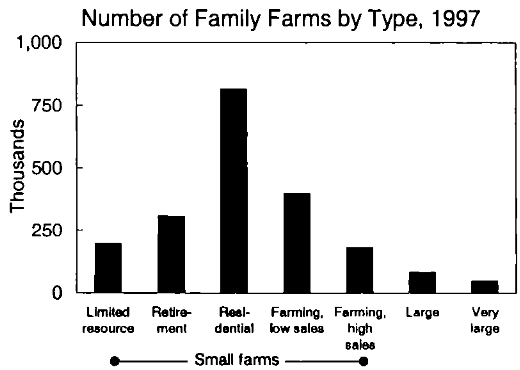
Stock prices. The major stock indexes all recorded substantial gains in the second quarter, though of varying size (see lower chart) and with different relative strengths compared with the first quarter. For example, price gains for Internet stocks cooled off significantly from their rapid first-quarter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

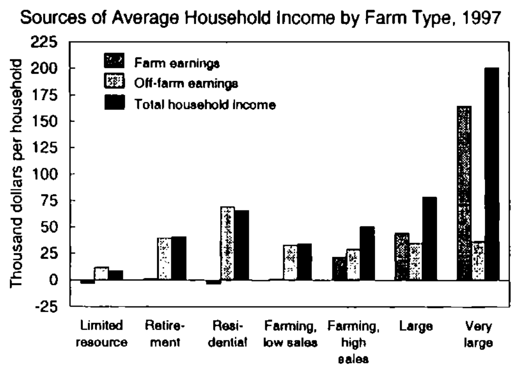
EYES ONLY

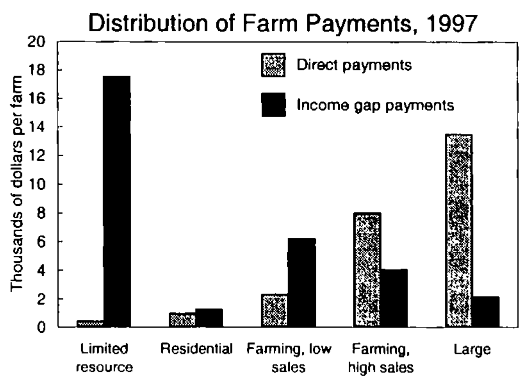
Special Analysis

Farm Households and the Distribution of Farm Payments

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







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

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

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

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

EYES ONLY

ARTICLE

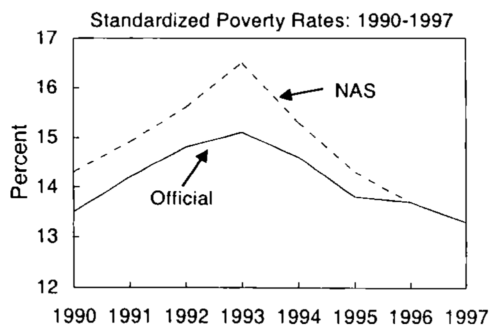
Census Releases Experimental Poverty Measures

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

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

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

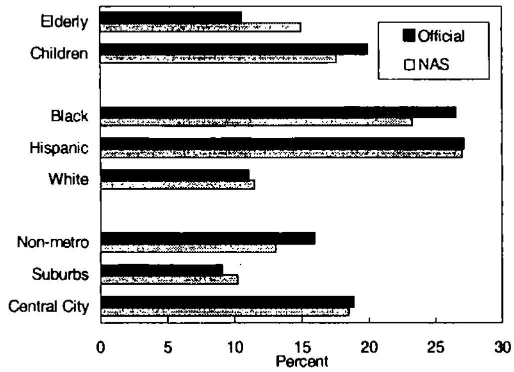
- Outdated threshold. The NAS recommended that thresholds should: cover necessary spending for food, clothing, and shelter (including utilities); reflect regional variation in housing costs; use better adjustments for family size; and be updated regularly using data on consumer spending.
- Omission of taxes and non-cash transfers. The effect of anti-poverty policies such as the Earned Income Tax Credit (EITC), food stamps, school lunches, housing subsidies, and heating assistance are not reflected in official poverty rates.
- Distortions of income adequacy. Medical care and work-related expenses such as transportation and child care are not netted out of income, even though they are not available to pay for food, clothing, and shelter; geographic differences in the cost of living are ignored. Such treatment distorts comparisons of income adequacy for old and young, working and non-working families, and those living in different parts of the country.



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

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

Standardized Poverty Rates, 1997



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

EYES ONLY

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

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

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

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

EYES ONLY

INTERNATIONAL ROUNDUP

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

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

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

EYES ONLY

RELEASES THIS WEEK

There were no major releases scheduled.

MAJOR RELEASES NEXT WEEK

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

EYES ONLY

U.S. ECONOMIC STATISTICS

	1970-1993	1998	1998:3	1998:4	1999:1
Percent growth (annual rate)					
Real GDP (chain-type)	2.7	4.3	3.7	6.0	4.3
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Federal surplus	-2.7	0.9	1.1	0.8	1.4

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

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

EYES ONLY

FINANCIAL STATISTICS

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

INTERNATIONAL STATISTICS

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

International Comparisons [1]	**Real GDP growth** (percent change last 4 quarters)	**Unemployment rate** (percent)	**CPI inflation** (percent change in index last 12 months)
United States	4.0 (Q1)	4.3 (Jun)	2.1 (May)
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France	2.3 (Q1)	11.4 (Apr)	0.5 (Apr)
Germany	0.8 (Q1)	7.2 (Apr)[2]	0.4 (May)
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1/ For unemployment data, rates approximating U.S. concepts as calculated by the U.S. Department of Labor, Bureau of Labor Statistics.
2/ Rate for former West Germany. Using OECD standardized unemployment data, the unemployment rate for unified Germany for April was 9.1 percent.

EYES ONLY

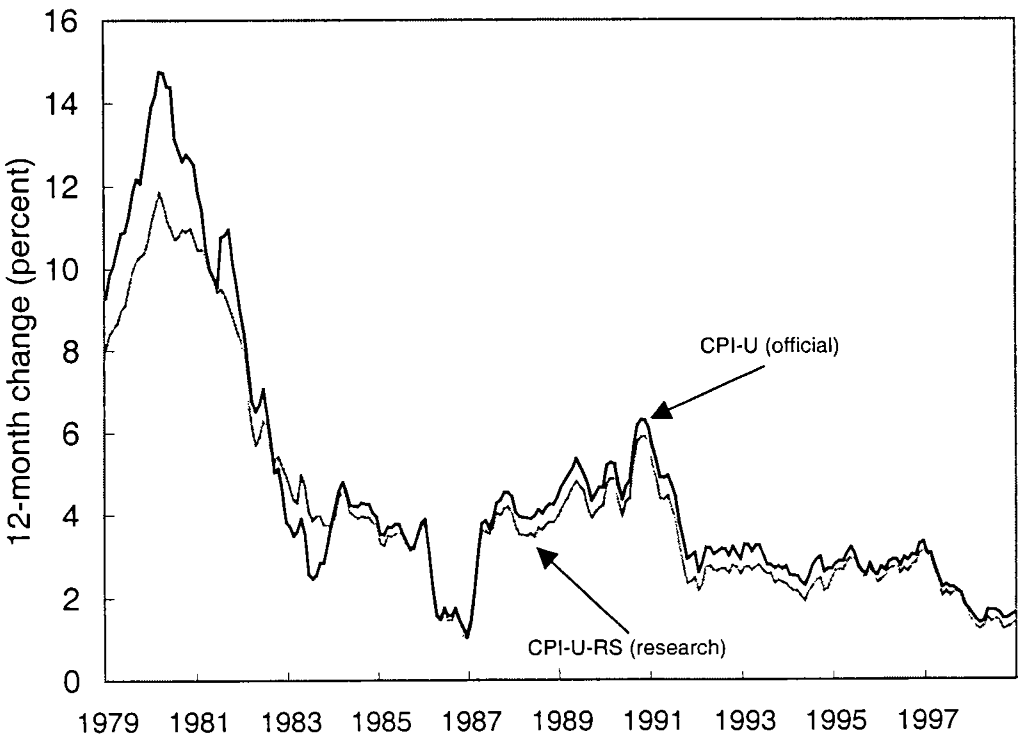
WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

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

June 25, 1999

CHART OF THE WEEK

Consumer Price Inflation



When the Bureau of Labor Statistics changes the way the consumer price index is calculated, it does not adjust the historical price series to reflect the changes. However, BLS researchers have recently developed an alternative to the official CPI for all urban consumers (CPI-U) that incorporates most of the improvements made since 1978 into the entire 1978-98 period. On average, this consumer price index research series (CPI-U-RS) has grown 0.45 percentage point per year more slowly than the CPI-U—though the pattern of changes is similar.

EYES ONLY

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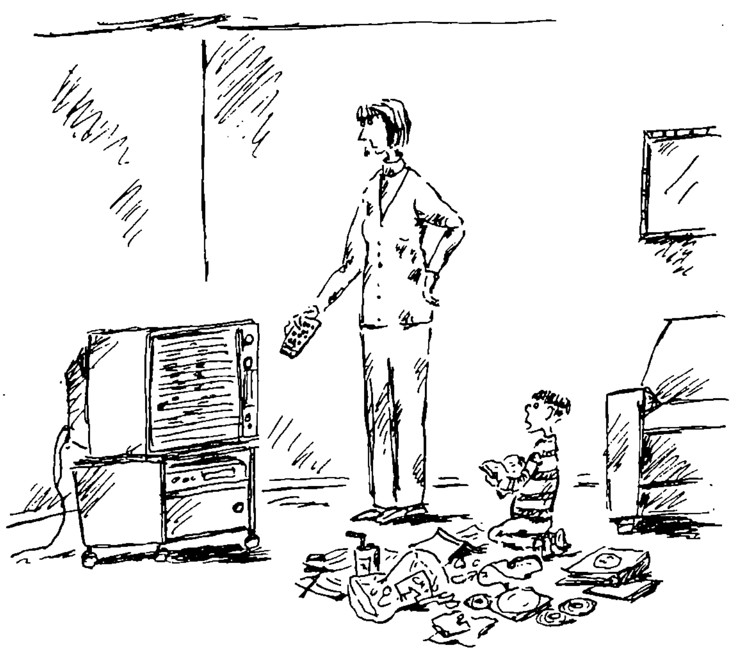


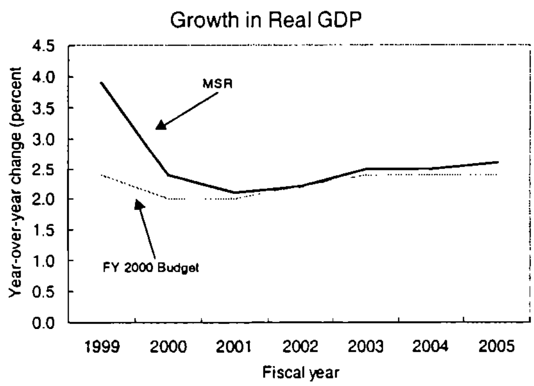
"Have some respect for my learning style."

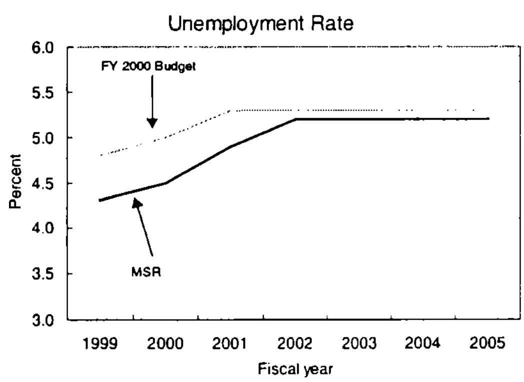
EYES ONLY

CURRENT DEVELOPMENT

MSR Forecast Remains Cautious on the "New Economy"

Stronger-than-expected economic performance over the past few years has engendered a lively debate about whether the economy has entered a new era of substantially faster sustainable growth. The economic assumptions in the Mid-Session Review—though more optimistic than those of the Fiscal Year 2000 Budget—continue to reflect the conservative side of this debate.





Slow down, you move too fast. Based on traditional relationships, real GDP growth of close to 4 percent per year is unsustainable. The MSR assumes a slower but still solid 2¼ percent annual growth rate over the next 3 years (see upper chart), with the unemployment rate edging up by about a third of a percentage point per year (see lower chart) and slightly higher inflation as measured by the CPI. After 2002, real GDP is projected to resume its assumed trend growth rate of roughly 2.5 percent per year with a stable 5.2 percent unemployment rate and a 2.5 percent inflation rate.

What is the speed limit? The shift to moderate growth reflects restraint from both aggregate demand and aggregate supply. On the demand side, consumer spending (which constitutes two-thirds of GDP) has exceeded the growth of real income—most likely reflecting gains in the stock market. But unless the stock market continues to surge, consumer spending is likely to slow to rates consistent with gains in real income.

On the supply side, the MSR assumes that the long-run sustainable noninflationary growth rate of the economy—potential GDP growth—is well below the current growth rate and that actual GDP will have to grow less than potential while the unemployment rate rises to a more sustainable long-run rate. Very strong productivity growth has helped the economy to grow faster than potential recently, but the MSR assumes some of this strength is cyclical and will not persist. Accordingly, potential GDP is projected to grow 2.8 percent per year during 1999-2002 followed by a slowing to just under 2.6 percent per year thereafter.

Conclusion. The MSR economic assumptions are consistent with other mainstream forecasts, but they are not a prediction of the best the economy can do. They have incorporated recent strong performance while remaining skeptical about whether key economic relationships have changed fundamentally.

EYES ONLY

SPECIAL ANALYSIS

Throwing Money Out with the Trash

Many communities are abandoning traditional methods of paying for trash collection (through general revenues or a flat annual fee) in favor of unit-based pricing, in which households pay for disposal services based on the amount of waste they set out for collection or bring to collection centers. In principle, the switch should encourage households to economize on the amount of trash they generate and dispose of it more efficiently. But how has it worked in practice?

Pay-as-you-throw participation is on the rise. While the first unit-pricing programs started as early as 1916, this approach to residential waste collection did not come into vogue until recently. By 1998, more than 4,000 communities in 46 states had adopted unit-based pricing schemes for their residential waste collection, and three states (Washington, Wisconsin, and Minnesota) had legislated the mandatory use of this approach. Collection schemes usually take one of three forms: special bags; tags or stickers attached to waste receptacles; or subscription cans of varying sizes. Recycling programs and public education campaigns on viable substitutes for waste disposal often accompany the introduction of unit-based pricing programs.

Incentives. Unit-based pricing gives households an incentive to reduce the amount of waste they put out for disposal, especially when accompanied by recycling and special yard waste pick-up programs (such as for leaves and Christmas trees). For example, they may do more composting or buy products that generate less trash, such as reduced-packaging goods. On the negative side, some have worried that unit-based pricing could also promote illegal dumping and burning, although this has not been a serious problem in most communities.

Does it work? A recent statistical study found that unit-based pricing reduces the amount of waste collected for disposal relative to a flat-fee system—while increasing the amount of recycling and yard waste collection. Expanding the number of types of recyclables covered by a community's recycling program and introducing a yard waste collection program led to further reductions in waste collected for disposal. However, the total amount of waste generated (waste to landfills and incinerators plus recycling plus yard waste collection) was not significantly different under unit-based pricing than under a flat fee system. In other words, unit-based pricing has been more effective in changing the way people dispose of their trash than in reducing the amount of trash they generate. The study also found that household behavior is affected much more by whether there is *any* price signal than by more subtle differences in the level of that signal.

Conclusion. In line with economic theory, unit-based pricing encourages more efficient solid waste disposal. To date, however, it has not encouraged less overall waste generation.

EYES ONLY

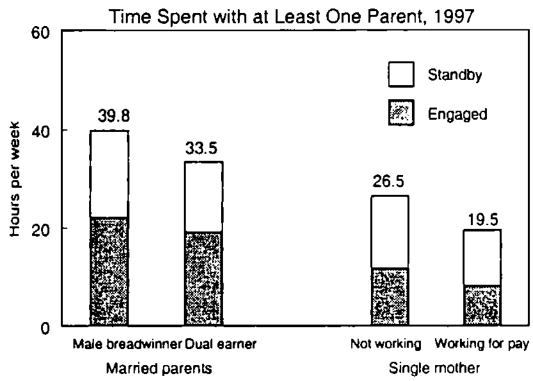
ARTICLE

What Do We Know about Children's Time with Parents?

The recent CEA report on "Families and the Labor Market" reported a decline since 1969 in the amount of time the average family had *available* for parents to spend with their children. A new study investigates the average amount of time children actually spend with their parents, depending on whether their parents are married and whether their mother works outside the home.

Time available. The CEA report found that the average family in 1996 had 22 fewer hours per week potentially available for parents to spend with children than in 1969. This calculation reflects the increase in single-parent families, the increase in hours mothers spend at paid jobs, and the slight decrease in hours fathers work for pay.

Time spent: a recent snapshot. A study based on 24-hour time diaries collected in 1997 shows how children's time with parents varies with family type (see chart). The study found that children in traditional two-parent families where the mother does not work outside the home get about 40 hours per week of at least one parent's time, excluding the child's personal care time (such as bathing and sleep). The child is directly engaged with at least one parent for 22 hours, and a parent is on "standby," that is, available at home but not interacting with the child, for 18 additional hours.



Differences among family types. As shown in the chart, the time children spend with at least one parent is less in other family types. In both single- and two-parent families, children whose mothers have paid jobs spend about 7 fewer hours per week with a parent than children whose mothers are not employed. About half of this difference reflects less direct involvement with a parent, and half is less time when a parent is available at home but not engaged with the child. The drop in the mother's own standby time is somewhat larger. The children of both stay-at-home and employed mothers get roughly 14 fewer hours of parental time per week if they live with a single mother instead of two parents—about 11 fewer hours of direct engagement and 3 fewer hours when a parent is available on "standby" basis. (For children in single-parent families, time spent with a parent includes time spent with a non-custodial parent.)

What about fathers? Perhaps surprisingly, fathers spend no more total time with their children if their wives are employed. This is not just because two-earner families have fewer children, or older children, or more income to pay for child care; the result persists even after controlling for those factors. However, the study's results suggest that when mothers go to work, the amount of time they spend with their children goes down by more than the total time the children spend with at least one parent, suggesting that parents deploy their time so that the father is at home with the children for some of the time that the mother is at work.

Other factors matter, too. Other things being equal, preschoolers are directly involved with their parents about 7 more hours per week than older children. The presence of siblings reduces the amount of time a child is engaged with a parent by about 1 hour per week per sibling. Children with younger and better-educated parents get more direct attention from their parents than other children do.

Conclusion. Whether they live with two parents or only one has a far more dramatic impact on children's time with parents than whether their mother works outside the home. It is difficult to draw further implications without more information about the quality and type of care children receive when their parents are not present.

EYES ONLY

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

Harvard Housing Center Sees More Households, More Homes. Over the next 10 years, the pace of household growth should match or slightly exceed the 1.1-1.2 million average annual rate of the 1990s, according to a new study from Harvard University's Joint Center for Housing Studies. The study finds that the overall aging of the population favors rising homeownership rates, strong home building and remodeling activity, and record home sales well into the next decade. However, it notes that the enduring strength of the housing markets may add to the affordability problems of poor households, and that expanding the supply of low-cost units and preserving the subsidized stock will be important housing challenges. While the suburbs continue to grab population share from central cities, the study sees hopeful signs that the exodus from some large cities is reversing: both Boston and New York posted modest population gains from 1994 to 1996, for example, although they would have continued to lose population if not for the arrival of foreign immigrants. Cities that continued to lose population though the mid-1990s include Baltimore, Buffalo, Chicago, Cincinnati, Cleveland, Milwaukee, New Orleans, Philadelphia, Pittsburgh, Rochester, St. Louis, and Washington, D.C.

Mixed Results for California's Class Size Reduction Initiative. A new study of the first 2 years of California's Class Size Reduction (CSR) initiative has found that smaller classes do lead to better student performance, although the effort to reduce class size has caused space problems and reduced teacher quality in urban schools. On average, third-graders in smaller classes had higher scores on statewide tests in reading, language arts, and mathematics than students in larger classes—though the differences were small (about one-tenth of a standard deviation). These gains were similar for students from all backgrounds. However, diverting resources (physical and financial) to reducing class size proved particularly burdensome for districts with the most low-income, minority, and English-as-a-second-language students. Furthermore, these schools were less able to attract highly qualified teachers. Statewide, the K-3 teacher workforce increased 38 percent, but the average qualifications of K-3 teachers declined.

Minimum Wage Increases Do Not Appear to Deter Training. Increases in state and Federal minimum wages do not appear to reduce employer-provided worker training, according to a new study. The study focuses on the period 1987 to 1992, analyzing a national sample of adults aged 22 to 34 with less than 12 years of education who were surveyed about their receipt of training outside of regular schooling. The period encompasses a number of state minimum wage increases as well as two Federal increases, in 1990 and 1991. The study finds no evidence that an increase in the minimum wage reduces training, contrary to the standard theory of human capital in which a minimum wage discourages employers from providing training by limiting wage cuts as a means of financing that training. The authors note that their results are limited to the impact of the minimum wage on rather formal training, whereas much on-the-job learning in low-wage jobs may be more informal.

EYES ONLY

INTERNATIONAL ROUNDUP

World Bank Urges China to Stimulate Consumer Spending. China must stimulate consumer spending if it is to avoid the worst effects of Asia's economic crisis and generate enough growth to allow the reform of deep systemic weaknesses, according to a World Bank report released last week. The report urges the development of a service sector that would include industries such as telecommunications, tourism, auditing, accounting, media, public relations, and the legal field to alleviate a significant shortage of employment opportunities amid swelling industrial layoffs and an annual increase in the workforce. Household consumption could be boosted by strengthening the social safety network and dispelling fears over future income security. Less than 0.5 percent of GDP would be needed to fully fund social protection programs already established by the government.

More Resources, Good Implementation Matter for Mexican Schools. Past research on learning outcomes in developing countries has found that students' socio-economic and cultural backgrounds are the most important factors explaining differences in test scores, leading to the conclusion that government intervention could have little effect. However, a new study of the Mexican program PARE has found that this program led to increased language skills in rural and native schools. The 5-year PARE program focused on the four Mexican states with the highest incidence of poverty and low-education indicators and gave schools additional resources for libraries, textbooks, training for teachers, and physical improvements to schools. In addition to improving students' cognitive achievement while at school, the PARE program increased the probability that a student remained in school, lowering drop-out rates for rural students by 20 percent. The study emphasizes the importance of proper design and implementation of the program: in urban schools, where implementation was particularly faulty, students' scores did not improve.

Industry Argues That Sale of Gold to Fund Debt Relief May Backfire. A new report by the World Gold Council criticizes proposals by the International Monetary Fund to sell 10 percent of its gold to provide debt relief to the world's poorest countries. The report claims that the recent fall in the price of gold is a direct consequence of the plans of the IMF, Switzerland, and the UK to sell gold and has already cost the gold producers among these developing nations more than $150 million in annual export earnings. This is more than they stand to gain from the IMF's proposed sale of 10 percent of its gold reserves, according to the report. Data in the report suggest that, of the more than 30 Heavily Indebted Poor Countries (HIPCs) that are gold producers or potential producers, those most likely to be affected are Ghana and Mali, where gold accounts for more than 30 percent of merchandise export revenues.

EYES ONLY

RELEASES THIS WEEK

Gross Domestic Product

****Embargoed until 8:30 a.m., Friday, June 25, 1999****

According to revised estimates, real gross domestic product grew at an annual rate of 4.3 percent in the first quarter.

Advance Durable Orders

Advance estimates show that new orders for durable goods rose 1.4 percent in May, following a decrease of 2.3 percent in April.

MAJOR RELEASES NEXT WEEK

Consumer Confidence—Conference Board (Tuesday)
Leading Indicators (Wednesday)
NAPM Report on Business (Thursday)
Employment (Friday)

EYES ONLY

U.S. ECONOMIC STATISTICS

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

	1970-1993	1998	March 1999	April 1999	May 1999
Unemployment Rate (percent)	6.7**	4.5**	4.2	4.3	4.2
Payroll employment (thousands)					
increase per month			83	343	11
increase since Jan. 1993					18665
Inflation (percent per period)					
CPI	5.8	1.6	0.2	0.7	0.0
PPI-Finished goods	5.0	0.0	0.2	0.5	0.2

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

New or revised data in **boldface**.
GDP data **embargoed until 8:30 a.m., Friday, June 25, 1999**.

EYES ONLY

FINANCIAL STATISTICS

	1997	1998	April 1999	May 1999	June 24, 1999
Dow-Jones Industrial Average	7441	8626	10444	10854	10535
Interest Rates (percent per annum)					
3-month T-bill	5.06	4.78	4.29	4.50	4.60
10-year T-bond	6.35	5.26	5.18	5.54	6.05
Mortgage rate, 30-year fixed	7.60	6.94	6.92	7.15	7.63
Prime rate	8.44	8.35	7.75	7.75	7.75

INTERNATIONAL STATISTICS

Exchange Rates	**Current level June 24, 1999**	**Percent Change from Week ago**	**Percent Change from Year ago**
Euro (in U.S. dollars)	1.037	0.4	N.A.
Yen (per U.S. dollar)	121.8	2.0	-13.4
Major currencies index (Mar. 1973=100) (trade-weighted value of the U.S. $)	96.87	0.6	-2.1

International Comparisons [1]	**Real GDP growth** (percent change last 4 quarters)	**Unemployment rate** (percent)	**CPI inflation** (percent change in index last 12 months)
United States	**4.0** (Q1)	4.2 (May)	2.1 (May)
Canada	3.2 (Q1)	8.3 (Apr)	1.7 (Apr)
Japan	0.1 (Q1)	4.9 (Apr)	-0.1 (Apr)
France	2.3 (Q1)	11.4 (Mar)	0.5 (Apr)
Germany	0.8 (Q1)	[2] 7.2 (Apr)	0.6 (Apr)
Italy	0.9 (Q4)	12.3 (Jan)	1.5 (Apr)
United Kingdom	0.6 (Q1)	6.3 (Feb)	1.6 (Apr)

U.S. GDP data **embargoed until Friday, June 25, 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 April was 9.1 percent.

EYES ONLY

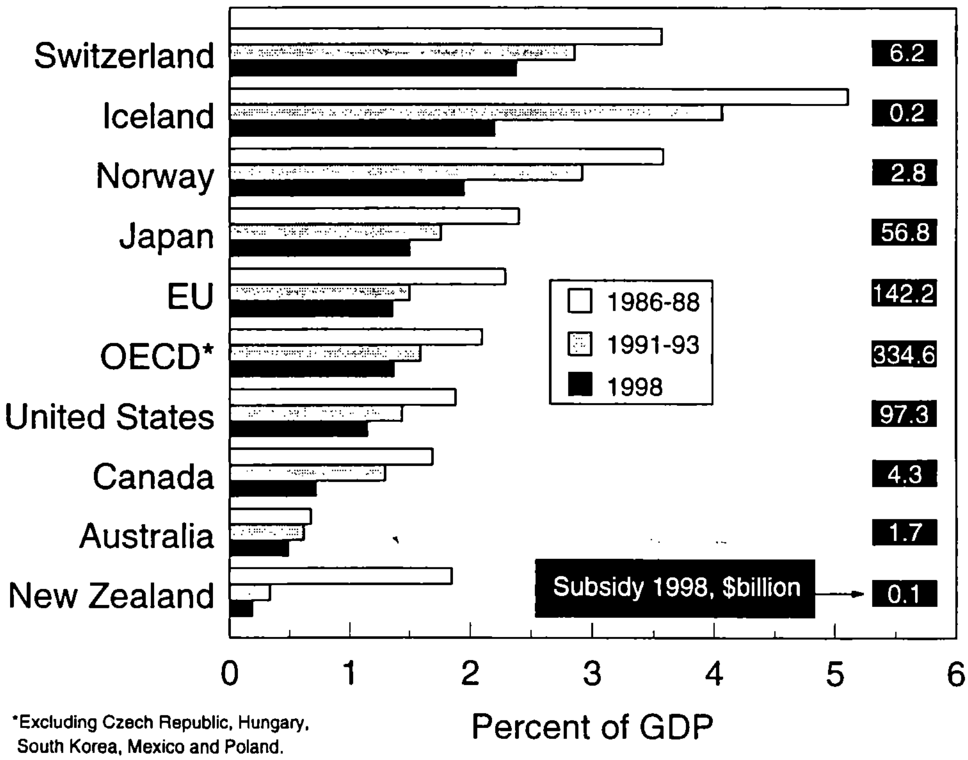
WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

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

June 11, 1999

CHART OF THE WEEK

OECD Farm Subsidies



*Excluding Czech Republic, Hungary, South Korea, Mexico and Poland.

As in most OECD countries, farm subsidies in the United States have declined as a share of GDP. OECD projections show that, in 1998, U.S. farm subsides were a slightly smaller percent of GDP than those of the EU or the OECD as a whole (excluding the newest member countries).

EYES ONLY

CONTENTS

"Forget about me—save Social Security."

EYES ONLY

SPECIAL ANALYSIS

Defined Contribution Plans May Deliver the Benefits

Will the trend away from traditional defined benefit (DB) pension plans toward 401(k)-type defined contribution (DC) pension plans reduce the adequacy of future retirees' private pension benefits? A recent study suggests not.

DB plans appear to be more generous. Current retirees with DB plans tend to have more pension wealth than those with DC plans. For example, an analysis of workers aged 51 to 61 in 1992 found that those with a DB plan on their current job had more than twice the median pension wealth in their current plan than did those with a DC plan. When pensions from past jobs were included, median DB wealth was found to be 50 percent greater than median DC wealth. However, a number of factors other than the characteristics of the pension plans could have contributed to these differences in pension wealth, including differences in salary and job tenure between workers covered by the two types of pensions in the past. In addition, many more workers today have DC plans, the plans may be more generously funded by employers, and workers' contributions and investment allocations may be different from those representative of past DC plans.

A different comparison. To see whether today's workers will have better or worse pension benefits than current DB beneficiaries, the new study develops a methodology for comparing today's DC plans with yesterday's DB plans. In particular, it looks at a representative sample of DB plans in 1983 and a representative sample of DC contributions and investment allocation patterns from 1995. It simulates earnings histories and stock market returns and generates probabilistic distributions of pension benefits for the same group of people under the two different kinds of plans. The key finding is that the DC plans generated higher benefits than the DB plans in 80 percent of the cases.

Risks and rewards. The trend away from DB plans entails a major shift of responsibility and risk from employers to workers. In a typical DB plan, the employer takes all the responsibility for providing the worker with a guaranteed retirement income for life; in a 401(k) plan the worker has the responsibility for saving and investing to accumulate funds for retirement and for managing those funds to provide retirement income. With DB plans, the nominal benefits of workers who leave a firm are usually frozen. With 401(k) plans, assets are portable and can continue to grow after workers leave a firm—as long as they reinvest rather than spend their lump-sum distributions. Similarly, workers with 401(k) plans bear the risk for poor investment choices or market performance.

The cloudy crystal ball. The new study's findings suggest that, relative to past DB plans, current DC plans provide ample reward for taking on these responsibilities and risks. The mean DC benefit was 2.4 times the mean DB benefit, while the DC benefit at the tenth percentile of the DC distribution was only 20 percent smaller than the corresponding tenth percentile DB benefit. Even quite risk-averse individuals, if asked to choose in advance, might judge that the expected benefit in the DC plans was enough higher to outweigh the greater risk.

Future pension benefits are uncertain, of course, because they depend on future stock market returns and real wage growth, as well as on workers' job mobility and whether they save or spend their pension accounts when they change jobs. The study found that the DC plans provided higher average benefits even under assumptions that were relatively disadvantageous to DC plans such as lower stock market returns. It also found that workers could end up with as much pension income under today's DC plans as under yesterday's DB plans even if they saved only a quarter to half of their DC plan assets when changing jobs. Saving at least that much may be common, as evidenced by other data showing that the fraction of workers who reinvest their entire lump sum distribution rises from about half among those aged 35 to 44 to three-fourths among those aged 55 to 64.

Implications. Current DC plans appear to measure up quite well to past DB plans, suggesting that the historical shift to DC plans will not lead to lower pension benefits in the future. However, the analysis does not allow us to draw conclusions about the future outcomes likely under current DC plans and current DB plans, because current DB plans are probably better than their 1983 counterparts and current DC plans are likely to produce a wider distribution of outcomes than current DB plans. Additionally, one response of workers facing greater financial market risk in their private pensions may be to place even greater value on a public pension benefit system that does not carry such risk.

EYES ONLY

SPECIAL ANALYSIS

The Economics of Inmate Labor

It is common for prisoners to have institutional jobs such as helping with cooking or cleaning, but it is far less common for them to have industrial jobs producing goods for sale. In today's tight labor market, however, the idea of tapping this unconventional source of workers is attracting increasing attention, and economists have begun to look at the economic consequences of greater inmate employment.

Background. Of the 1.2 million U.S. prisoners in 1997, fewer than 80,000 worked for pay. Wages are typically low and some requirements limit the extent to which firms employing prison labor can compete with other firms. Industrial employment of Federal prisoners takes place through Federal Prison Industries, Inc. (FPI), a nonprofit corporation created in 1934 that employs Federal inmates to produce products sold exclusively to Federal agencies. The Prison Industry Enhancement Act (PIE) of 1979 allows certified private companies to employ state and local prison labor and to sell goods in interstate commerce. Such firms must pay prevailing wages (subject to deductions including room and board and victim compensation funds) and satisfy other conditions designed to minimize the impact on free workers.

Direct economic impacts are likely to be small. Even if every prisoner in the United States were employed full-time, prison labor would account for only 0.2 to 0.4 percent of GDP. Such small effects reflect two factors. First, the size of the inmate population is less than 1 percent that of the non-institutionalized civilian labor force. Second, the productivity of prison labor is likely to be low. Prisoners are unskilled relative to the workforce as a whole. Inmates are 2.4 times more likely to lack a high school diploma or GED than are those in the non-institutional U.S. population. High turnover and disruptions due to periodic lockdowns are structural impediments that limit productivity in work conducted inside prisons.

Recidivism. Given the low skills of the inmate population, providing prisoners with a chance to gain work experience could improve their post-release employment. Studies have estimated that prison labor reduces recidivism by between 3 and 20 percent. Some of the major benefits of reduced recidivism include reduced costs to victims of crime, reduced costs of incarceration, and reduced court costs. It also means better outcomes for the prisoners themselves. While prisoners constitute a small fraction of the overall population, 28 percent of black men are estimated to spend time in prison during their lives, so that improved post-release outcomes for prisoners generally should be particularly beneficial for black men.

Would non-inmate labor be hurt? The small size of the potential inmate labor force relative to the overall labor force means that overall wages and employment would be relatively unaffected by an influx of prison labor (paid the prevailing wage for unskilled labor). However, workers who are demographically similar to the inmate population and for whom prison labor could be viewed as a substitute, might be hurt. For example, young unskilled men would be more likely to be affected than the general population. The available evidence, albeit imprecise, suggests that if the entire prison population were to enter the labor force, workers with less than a high school degree would see a decline in wages of up to 5 percent. Some workers who might be displaced by inmate labor could themselves turn to crime.

Implications. The positive benefits of opening prisons to private employers (decreased recidivism) may well outweigh the costs (minimal negative wage and employment effects on other unskilled workers). However, firms may be reluctant to use prison labor because of the low productivity of inmates and the high costs of producing in a prison environment.

EYES ONLY

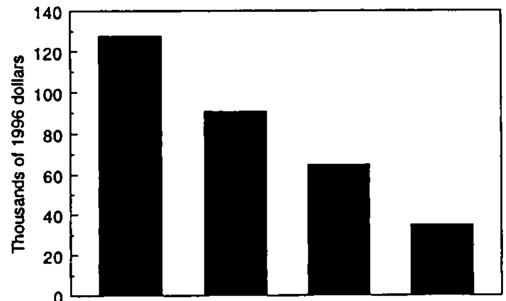
ARTICLE

Health and Wealth

Health and socioeconomic status (SES) are strongly associated in industrialized countries. While debate among medical scientists tends to focus on the linkages from low SES to poor health, a new economic study also examines more complex linkages, including how poor health affects SES.

The association. Median household wealth varies substantially by health status (see chart). This association shows up for all age groups and is not just a middle- or late-life pattern. *Changes* in health status are also associated with *changes* in wealth. The study finds, for example, that the median wealth of Americans who reported that they were in "very good" health in both 1984 and 1994 rose from $66,300 to $100,000, while the median wealth of those reporting that their health declined from "very good" to "fair" or "poor" fell by over 50 percent, to $31,000.

Median Wealth by Health Status in 1994



Note: Chart shows median household wealth by self-reported health status of head of household.

The effect of health on wealth. The study examines data from two national surveys of older Americans and finds that episodes of poor health can have potentially large impacts on household wealth. In a sample of those aged 51 to 61 in 1992, for example, the onset of a mild new health condition was associated with a decrease in wealth of $3,620, and the onset of a severe condition was associated with a decrease of $17,000 or 7 percent. Research indicates that increased out-of-pocket medical expenses and lower earnings from reduced work account for only part of these reductions in wealth, with the rest currently unexplained.

The effect of wealth on health. Much analysis of the link from wealth to health has stressed class differences in behavior. Smoking remains more prevalent among those with lower incomes, for example, even though all groups have seen a decline. Poor people also have less access to health care. While acknowledging these effects, the study finds that health disparities by economic status are only partially mitigated when researchers adjust for risky behaviors or access to medical care. More subtle effects of SES on health appear to be important.

One illustration is psychological stress. Studies of British civil servants, first begun in 1967 and still ongoing, suggest that factors such as work-related stress (often caused by monotonous work over which a worker has little control) and the absence of social support networks are important factors in the association between civil service employment grade and health. Other research has shown the cumulative negative effect of episodes of high and repeated stress—episodes that are likely to occur more frequently among lower socioeconomic groups. Studies showing the long-term impacts of early childhood or even intra-uterine environmental factors provide another example of the subtle effect of SES on health. Specifically, factors such as poor conditions at home and childhood health problems have been found to be independent predictors of cardiovascular, respiratory, and neurological health at mid-adulthood.

Implications. The new study provides evidence that the causality between socio-economic status and health runs in both directions. First, health affects wealth though out-of-pocket health care costs, especially for those lacking health insurance. Thus, policies like providing coverage for prescription drugs may help offset the decline in wealth resulting from illness, particularly for groups with substantially higher out-of-pocket drug expenses. Second, wealth affects health, implying that a strong economy and a high level of economic development have positive effects on health outcomes. The study also shows that being disadvantaged at an early age can have long-term health consequences into adulthood.

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

Benefits of Higher Quality Child Care Last into Elementary School. Children who attend higher quality child care centers perform better on measures of both cognitive and social skills not only while they are in child care but also through their transition into school, according to a new study. Second graders' math skills were postively related to good classroom practices during child care, and their classroom behavior was positively related to teacher-child closeness in child care. Children's language ability received a boost in kindergarten from high-quality care, but the difference largely faded by second grade. The study also found that quality child care may be especially important for at-risk children. Better quality child care was more strongly related to math skills and problem behaviors for children with less-educated mothers than for others.

Foreign Spending to Acquire or Establish U.S. Businesses Triples. Foreign investors' spending to acquire or establish businesses in the United States surged to a record $201.0 billion in 1998 from $69.7 billion in 1997, according to the most recent estimates by the Department of Commerce. This spending, which includes both outlays made directly by foreign investors and outlays made through their existing U.S. affiliates, almost tripled in 1998, following a decrease of 13 percent in 1997 and an increase of 40 percent in 1996. The 1998 outlays were boosted by two exceptionally large acquisitions (Chrysler by Daimler and Amoco by BP) and reflect trends toward greater global consolidation in the automobile and oil industries. Many of the other investments were in telecommunication- and information-related businesses and reflect a desire by foreign investors to gain access to advanced U.S. technological capability, to integrate operations vertically, and to enter new markets. Even without the two large acquisitions, 1998 outlays would have been 40 percent higher than the previous record, set in 1996.

How Do Lottery Winnings Affect Economic Behavior? A new study surveying 237 winners of the Massachusetts lottery in the mid-1980s found reductions in hours worked, labor force participation, and earnings for a group winning large prizes (averaging $80,000 per year for 20 years). Expenditures on cars and homes increased, as did savings, although savings in retirement accounts were not affected. In a group winning a smaller prize (averaging $15,000 per year for 20 years), the study found no substantial effect on labor supply or earnings, although winning the prize seems to have increased work effort among those with no earnings prior to winning the lottery. Yet, savings were sharply reduced after winning a smaller prize, suggesting to the authors that winning the lottery had reduced winners' perceived need to hold precautionary savings.

Prices of Non-Petroleum Imports Rise Slightly in May. After falling in March and April, non-petroleum import prices rose 0.1 percent in May. Nevertheless, over the 12 months ending in May, non-oil import prices fell 2 percent, after falling 3.2 percent over the comparable months in 1997-98. Prices of imports from Asian newly industrialized countries fell 5.8 percent over the 12 months ending in May.

EYES ONLY

INTERNATIONAL ROUNDUP

Basel Committee Releases New Capital Adequacy Proposal. The Basel Committee on Banking Supervision last week issued its proposal for a new capital adequacy standard to replace the 1988 Capital Accord. The proposed capital framework consists of three pillars: minimum capital requirements, supervisory review, and effective use of market discipline. External credit ratings would be used where feasible to determine risk weights on different assets, and the result will be to reduce risk weights for high-quality corporate credits and to introduce a higher-than-100-percent risk weight for certain low-quality exposures. For some sophisticated banks, the Committee suggests that banks could use their own internal credit ratings to determine the capital requirement. It is hoped that the improved weighting system will remove some of the perverse incentives, inherent in the current rules, to make riskier loans. The Committee will seek comments on its current proposals and set forth more definitive proposals during the year 2000.

Presidents Spend Less than Parliaments. Public spending as a percent of GDP in countries run by presidents is about 10 percentage points less than it is in those with a parliamentary system, according to a recent study. The authors argue that presidential systems may encourage thrift because a president is held directly and separately accountable to voters, whereas lines of responsibility are more blurred in parliamentary systems. Furthermore, a president needs only to assemble ad hoc majorities to pass laws, while parliamentary leaders may need to distribute more pork to maintain a stable majority. However, the study certainly is not definitive. For example, the preponderance of parliamentary systems in Europe, where voters seem especially supportive of public spending, may bias the results.

IMF's Outlook for South Korea Improves. South Korea's economy could expand by 4 to 4½ percent on a year-over-year basis in 1999, according to the IMF's chief representative in Seoul. GDP in the first quarter was 4.6 percent higher than a year ago and was led by strong private consumption, but the IMF official said that 4 to 4½ percent GDP growth was possible even if consumption slows. The prediction is a significant improvement from the forecast of 2.0 percent growth the IMF made in its May *World Economic Outlook.* The official noted that South Korea's unemployment rate (currently 6.7 percent) would likely be helped by GDP growth; however, continued corporate restructuring would prevent a rapid decline in unemployment, which will probably remain at historically high levels.

Slovenia on the Right Track for EU Accession. A new World Bank report finds that Slovenia's economic performance makes it a strong candidate for EU accession, though room for improvement remains. Slovenia's growth has been stable at around 4 percent per year for the last 6 years; its GDP per capita was the highest among the 10 Central and Eastern European countries seeking accession and just $100 below that of Greece. The report found need for improvement in areas that include attracting more foreign direct investment, reforming the pension system and making the banking sector more competitive.

EYES ONLY

RELEASES THIS WEEK

Producer Price Index

****Embargoed until 8:30 a.m., Friday, June 11, 1999****

The producer price index for finished goods rose 0.2 percent in May. Excluding food and energy, producer prices rose 0.1 percent.

Retail Sales

****Embargoed until 8:30 a.m., Friday, June 11, 1999****

Advance estimates show that retail sales rose 1.0 percent in May. Excluding sales in the automotive group, retail sales rose 0.5 percent.

Productivity

Nonfarm business productivity rose 3.5 percent at an annual rate in the first quarter of 1999. Manufacturing productivity rose 6.2 percent.

MAJOR RELEASES NEXT WEEK

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

EYES ONLY

U.S. ECONOMIC STATISTICS

	1970-1993	1998	1998:3	1998:4	1999:1
Percent growth (annual rate)					
Real GDP (chain-type)	2.7	4.3	3.7	6.0	4.1
GDP chain-type price index	5.4	0.9	1.0	0.8	1.5
Nonfarm business (NFB) sector:					
Productivity (chain-type)	1.5	2.7	2.5	4.3	**3.5**
Real compensation per hour:					
Using CPI	0.6	2.6	2.3	2.2	**2.6**
Using NFB deflator	1.3	3.8	3.4	3.8	**2.6**
Shares of Nominal GDP (percent)					
Business fixed investment	10.9	11.0	10.9	11.0	11.0
Residential investment	4.5	4.3	4.4	4.5	4.6
Exports	8.2	11.3	11.0	11.3	10.9
Imports	9.2	13.0	12.9	13.1	13.2
Personal saving	5.2	0.3	0.1	-0.0	-0.4
Federal surplus	-2.7	0.9	1.1	0.8	1.3

	1970-1993	1998	March 1999	April 1999	May 1999
Unemployment Rate (percent)	6.7**	4.5**	4.2	4.3	4.2
Payroll employment (thousands)					
increase per month			83	343	11
increase since Jan. 1993					18665
Inflation (percent per period)					
CPI	5.8	1.6	0.2	0.7	N.A.
PPI-Finished goods	5.0	0.0	0.2	0.5	**0.2**

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

New or revised data in **boldface**.
PPI data **embargoed until 8:30 a.m., Friday, June 11, 1999.**

EYES ONLY

FINANCIAL STATISTICS

	1997	1998	April 1999	May 1999	June 10, 1999
Dow-Jones Industrial Average	7441	8626	10444	10854	10621
Interest Rates (percent per annum)					
3-month T-bill	5.06	4.78	4.29	4.50	4.54
10-year T-bond	6.35	5.26	5.18	5.54	5.92
Mortgage rate, 30-year fixed	7.60	6.94	6.92	7.15	7.51
Prime rate	8.44	8.35	7.75	7.75	7.75

INTERNATIONAL STATISTICS

Exchange Rates	**Current level June 10, 1999**	**Percent Change from Week ago**	**Percent Change from Year ago**
Euro (in U.S. dollars)	1.048	1.2	N.A.
Yen (per U.S. dollar)	118.9	-2.2	-16.0
Major currencies index (Mar. 1973=100) (trade-weighted value of the U.S. $)	95.68	-1.3	-3.5

International Comparisons [1/]	**Real GDP growth** (percent change last 4 quarters)	**Unemployment rate** (percent)	**CPI inflation** (percent change in index last 12 months)
United States	3.9 (Q1)	4.2 (May)	2.3 (Apr)
Canada	3.2 (Q1)	8.3 (Apr)	1.7 (Apr)
Japan	0.1 (Q1)	4.9 (Apr)	-0.1 (Apr)
France	2.3 (Q1)	11.4 (Mar)	0.5 (Apr)
Germany	0.8 (Q1)	[2/] 7.2 (Apr)	0.6 (Apr)
Italy	0.9 (Q4)	12.3 (Jan)	1.5 (Apr)
United Kingdom	0.6 (Q1)	6.3 (Feb)	1.6 (Apr)

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

EYES ONLY

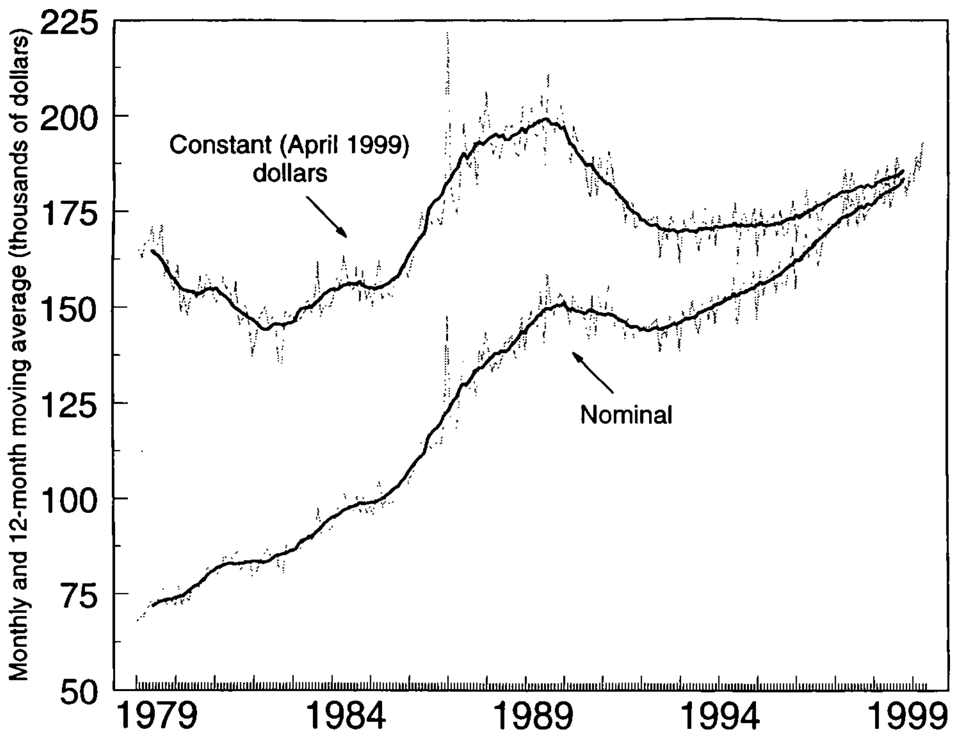
WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

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

June 4, 1999

CHART OF THE WEEK

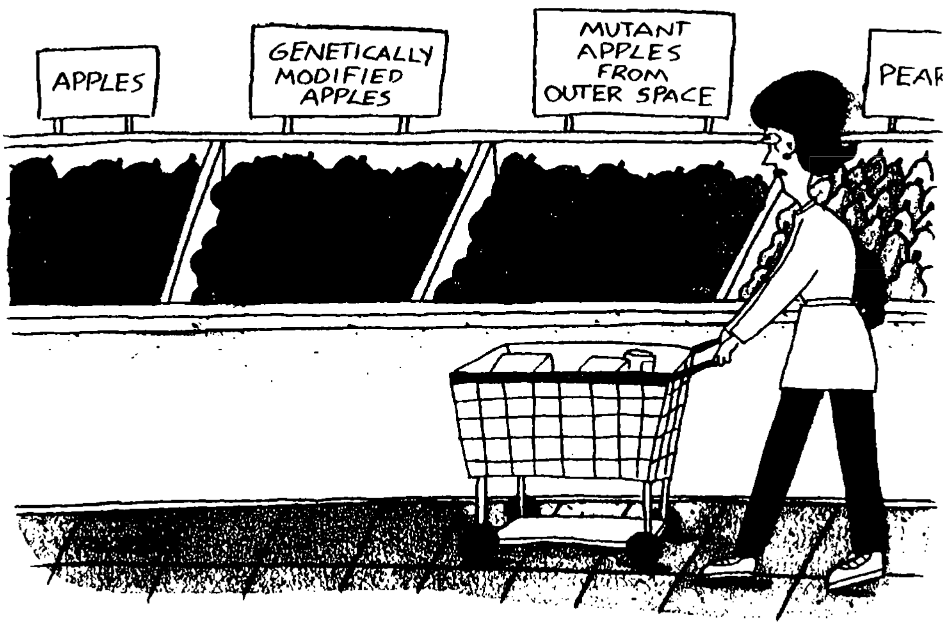
Real and Nominal New Home Prices



This week's report on new home sales showed strong growth in April and a rise in the average price of a new home to an all-time high. Adjusted for inflation, however, new home prices remain below the peak levels reached in the late 1980s and early 1990s.

EYES ONLY

CONTENTS



EYES ONLY

SPECIAL ANALYSIS

Agricultural Cooperatives Plow New Ground

Many small farmers worry that they are being put at a competitive disadvantage by structural changes in the farm economy such as vertical coordination, industry consolidation, and new contracting arrangements. A new form of agricultural cooperative may offer some a way to become more competitive.

Background. An agricultural cooperative is a business organization, usually incorporated, that is owned and controlled by member agricultural producers. Cooperatives are non-profit and dividends on member capital are limited. Of the more than 3,800 U.S. farmer cooperatives in 1996, about 52 percent engaged primarily in marketing activities (chiefly grain, soybeans, dairy, fruits and vegetables, livestock, sugar, and rice); 36 percent in supply purchasing activities (chiefly seed, fertilizer, petroleum, farm chemicals, feed, and building materials); and about 12 percent in specialized services related to marketing or purchasing.

New generation cooperatives. So-called "new generation" cooperatives have been sweeping through the Great Plains, particularly North Dakota and Minnesota. These cooperatives focus on value-added processing (one example is the very successful Dakota Growers Pasta Company) and require grower and producer agreements as well as an up-front equity investment by members. Low prices seem to encourage farmers to look for alternatives to basic commodity production and may increase their motivation to participate in new generation cooperatives. For example, durum wheat was selling at only $2.20 per bushel at the time discussions began to form the Dakota Growers Pasta Company. Between 1990 and 1997, 28 new generation cooperatives were initiated with headquarters in North Dakota (seven have since disbanded or become inactive).

Vertical integration. Cooperatives increase small farmers' ability to negotiate favorable prices with large buyers. New generation cooperatives add the following additional advantages from vertical integration:

- Increased efficiency. Growers and producers sign up-front agreements that reduce the costs of writing and enforcing contracts. Cooperatives can also lower production risks by assuring a steady supply of inputs to the processing stage.

- Increased net income. To the extent that value-added production generates higher or steadier profits than crop production, cooperatives offer small farmers a share in those profits that could boost their net income.

Implications. Agricultural cooperatives offer the intriguing possibility of opening up opportunities for a new generation of farmer-entrepreneurs. They could also help the rural economy by keeping value-added activities local.

EYES ONLY

SPECIAL ANALYSIS

GAO Offers a Glimpse of Welfare Leavers' Outcomes

Last week the General Accounting Office released a compilation of state studies of post-1995 welfare leavers. The report shows that many former welfare recipients are working—though at low wages. It also is a reminder that the data necessary to evaluate important questions about the effects of welfare reform remain relatively meager.

Results from seven states. There are no Federal requirements for states to report on the status of former welfare recipients, but 17 states (some with Federal funding) thus far have undertaken studies of welfare leavers. The GAO determined that only the information from Indiana, Maryland, Oklahoma, South Carolina, Tennessee, Washington, and Wisconsin was comprehensive enough to generalize the findings to most families who had left welfare in the state at the time of the study. However, these seven states account for only about 8 percent of all leavers, and their studies do not provide a valid basis for drawing conclusions about the national population of welfare leavers. In addition, differences among the studies mean that the results are not completely comparable across the states.

Employment. The main consistent finding across studies was that most former welfare families had an adult who was or had been employed since leaving welfare. Studies measuring employment at the time of the follow-up (between 2 and 18 months after leaving the rolls) reported employment rates ranging from 61 to 71 percent. Those measuring whether an adult in a family had ever been employed after leaving welfare found employment rates ranging from 63 to 87 percent. However, the four studies that measured both found that the percentage ever employed was substantially higher than the percentage employed at the time of the follow-up. In addition, these employment rates generally exclude families who returned to welfare, and some evidence suggests their numbers are substantial (19 percent after 3 months in Maryland; 30 percent after 15 months in Wisconsin). Including such families would most likely produce lower employment rates, since many former recipients who return to the rolls are unemployed.

Income and earnings. All studies reported some information on former recipients' earnings or wages but far from a complete picture of hourly wages or number of hours worked—and certainly not enough information to draw strong conclusions about whether families were better or worse off after leaving the welfare rolls. The GAO reports average quarterly earnings ranging from $2,378 to $3,786, which would extrapolate to annual earned incomes of about $9,500 to $15,000—greater than the amount of cash assistance and food stamps a family of three would receive, but not enough to rise above the Federal poverty level. However, some welfare recipients also have earnings. The Wisconsin study found that during their first year off welfare, less than half of the families had cash incomes higher than their incomes had been while they were on AFDC, including both benefits and earnings.

EYES ONLY

Other findings. Data from five states show that many families who left welfare subsequently received noncash public assistance: between 44 and 83 percent received Medicaid benefits, between 31 and 60 percent received food stamps, and between 11 and 38 percent received SSI, WIC benefits, or child care subsidies. Lack of health insurance among children varied considerably (9 percent of children in families who left welfare in South Carolina were uninsured, compared with 20 percent in Oklahoma and 35 percent in Indiana).

Nonworking former recipients. Surveys in South Carolina and Wisconsin asked nonworking former recipients what stopped them from working for pay. The most frequent answers were their own physical or mental illness, followed by the inability to find a job, lack of transportation, and lack of child care. Wisconsin also attempted to determine how these families were supporting themselves. Among the approximately four-fifths that were not living with employed spouses or partners, 65 percent were receiving Social Security, state unemployment insurance, child support, or foster care payments; 23 percent were receiving noncash assistance such as free housing, rent subsidies, Medicaid, or food stamps.

Conclusion. Most states either are currently studying or plan to study former recipients. The GAO report compiles seven early studies of welfare leavers, showing that welfare recipients are taking jobs, often at low wages. This emphasizes the importance of income supports such as subsidized medical and child care and the EITC. As the report concludes, a broader picture of the status of this population will require state data that are more comprehensive and more comparable between states than what is currently available.

ARTICLE

Facing the Costs and Benefits of Cost-Benefit Analysis

Executive Order 12866 requires a cost-benefit analysis of all major new regulatory rules, and the Congress is considering legislation that would mandate wider use of cost-benefit analysis. However, effective use of cost-benefit analysis in regulatory rule-making remains hampered at one level by ongoing controversy about how to value environmental benefits, and, more deeply, by the inherent contradiction between the practical necessity of taking costs into account and the prohibition against doing so in some key environmental laws, especially the Clean Air Act.

Reducing vehicle emissions. EPA's proposed new emissions standards for passenger cars and light trucks (Tier II regulations) illustrate the issues that arise in carrying out a cost-benefit analysis of an environmental regulation. The new standards are designed to reduce vehicle emissions that contribute to the formation of ozone and particulate matter pollution. Meeting them will require changes to both vehicles and gasoline that will add an estimated $80 to the cost of a new car, up to $274 to the cost of a light-duty truck, and 1 to 2 cents per gallon to the price of gasoline. The estimated total costs are approximately $3.5 billion annually. The annual benefits of the proposed regulation—which include reductions in disease and premature mortality, improved visibility, and ecological benefits—have been estimated to be as low as $3.3 billion and as high as $19.5 billion. This extremely wide range reflects both uncertainty about the health impacts of exposure to pollutants and disagreements about the appropriate monetary value of premature mortality.

- Uncertainty about health impacts. It is unclear whether there is a relationship between ozone exposure and premature mortality. Some studies have found a statistical relationship between the daily mortality rate and ozone levels, but evidence on the long-term relationship between ozone exposure and premature mortality remains mixed. In the context of the Tier II regulations, estimates of the number of premature mortalities prevented by reducing ozone concentrations vary from none to 388 per year.

- Valuing life. Evidence on the "value of a statistical life," that is, the value of saving the life of a person from the general population (rather than any particular person), comes from studies of labor markets that observe the wage premium for risky jobs and from survey information. Such estimates range from $0.7 million to $16.6 million per life saved.

Can the process be improved? Unless standard procedures are used to address scientific uncertainty and to value a statistical life, the range of estimated benefits for environmental regulations is likely to remain large and the same debates concerning estimated benefits are certain to recur in the regulatory review process. One possibility would be to have an independent group of experts review existing evidence and establish best practices guidelines.

Can costs be ignored? Although few analysts would argue that regulatory rule-making can or should be based solely on the results of cost-benefit analysis, most economists defend it as a useful if imperfect tool to inform standard setting. However, the Clean Air Act requires standards to protect public health with an "adequate margin of safety" and explicitly forbids costs from being taken into account. This would seem to rule out the use of cost-benefit analysis. The recent decision overturning the 1997 National Ambient Air Quality Standards because the court could discern no "intelligible principles" for setting standards points out the difficulties of agency implementation of health-based standards under such circumstances.

The logical difficulty of assuring an adequate margin of safety without regard to costs is illustrated by ozone, a non-threshold pollutant for which any amount above zero may cause harm. Taken literally, the law requires that even if the incremental costs of eliminating the last trace of ozone are huge relative to any reasonable measure of benefits, those costs should be incurred. A practical solution requires some method of deciding how large a cost is too big to bear.

Conclusion. Cost-benefit analysis of health and environmental issues is hard to live with, because it involves difficult philosophical and practical issues about how to value the benefits of reduced morbidity and mortality. But it is also hard to live without, because it provides a useful framework for addressing inevitable trade-offs between the benefits of a cleaner environment and the costs of achieving those benefits. Both improving cost-benefit analysis and clarifying the way it should be used in the rule-making process would appear to offer clear benefits in better informing environmental and health policy decisions.

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

Study Finds Health Benefits of SO_2 Trading. Allowing electric utilities to bank and trade sulfur dioxide emissions has led to health-related benefits nationally, over and above those arising from reduced aggregate SO_2 emissions, according to a recent study. The study uses a computer model of the utility industry to evaluate the health effects of the trading and banking provisions of the 1990 Clean Air Act. Geographic shifts in emissions caused by these provisions have been the subject of considerable concern, especially in the Northeast, which is widely thought to be the recipient of pollution emitted by power plants in the Midwest. The study finds, however, that trading shifted emissions away from more populated areas (the East and Northeast) and toward less populated areas (the Midwest), and that this shift resulted in health benefits for the East and Northeast arising from decreased exposure to harmful particulates. The shift could have gone the other way, however, so health or environmental effects of trading remain legitimate issues of concern. In September 1998, the EPA announced another substantial trading program for nitrogen oxide emissions by electric utilities in 22 eastern states based on the SO_2 program.

Texas Banks Are Less Vulnerable to Low Oil Prices. The precipitous drop in oil prices in early 1986 led to severe financial distress in Texas, but the state's banks are much less vulnerable to low oil prices today, according to a recent study by a Dallas Federal Reserve Bank economist. The study notes that the 1991 FDIC Improvement Act provides much stronger incentives for banks to avoid excessive risks—although the regime has only been in effect during "good times" and therefore has never been subject to actual stress. Furthermore, many of Texas' larger banks have diversified their risks geographically by becoming part of large, multistate branching networks, whereas such diversification was impossible before 1987, when bank branching was first allowed in Texas. Finally, the study notes that banks have been more cautious than they were prior to 1986; hence, today's prosperity seems more solidly grounded than the earlier boom.

Evaluating the Economic Turnaround of Upstate New York. After registering poor performance through most of the 1990s, several important economic indicators for upstate New York improved in 1997 and 1998. Perhaps most notably, job growth was 1.2 percent in 1998, the highest since 1990 and a clear turnaround from the net decline of 1.3 percent between 1990 and 1996. In addition, unemployment rates were low and home sales rose dramatically. However, a recent analysis by the Federal Reserve Bank of New York suggests a cautious interpretation, noting that job growth in the region in 1998 was just half that of the nation as a whole. Furthermore, record-low unemployment rates in some parts of upstate New York in 1998 are more closely related to the continuation of decade-long declines in population (down 0.4 percent in 1998) and labor force (down 0.5 percent) than to job growth. Finally, although single-family home sales were up almost 32 percent in 1998, the declining population suggests that many of the sales were to people who already lived in the region, such as renters taking advantage of low mortgage rates.

INTERNATIONAL ROUNDUP

How Likely Is a "Race to the Bottom" in Environmental Policy? Critics of international trade agreements often argue that lowering trade barriers will lead to a race to the bottom in environmental standards. The argument is that as companies move to countries with the most permissive environmental regulations, other nations will have to reduce the stringency of their own regulations to remain competitive. This scenario carries with it the assumption that foreign direct investment (FDI) responds significantly to international differences in regulatory stringency. However, a new study comparing regulatory stringency across U.S. states found that stringent environmental regulation had at most a very small effect on inward FDI. The authors recognize that the stringency of environmental legislation differs much more across countries than across U.S. states; however, other determinants of FDI (such as factor costs, market access, and transportation costs) also vary more across countries, so the relative importance of environmental regulation is likely to remain small.

Update on Effects of Asian Crisis on Poverty. This week, the World Bank released its latest estimates of the effects of the East Asia crisis on poverty rates in the region. Early results from the Bank's surveys confirm that the impact of the crisis was severe: in urban Korea, the average standard of living dropped 22 percent between 1997 and 1998, and the poverty rate jumped from 9 percent to 19 percent. In Indonesia, the average standard of living fell 24 percent, and the poverty rate rose from 11 percent to 20 percent, with the implication that about 20 million people—the equivalent of a medium-sized country—fell into poverty in Indonesia alone.

Mexico Cuts Deposit Insurance. Landmark measures designed to reduce government-sponsored deposit insurance came into effect this week in Mexico, as the new Institute for the Protection of Bank Savings introduced a 7-year plan to drop insurance levels to a maximum amount equivalent to about $100,000 per account. Mexico's current system, with no limit on the amount covered, is widely considered responsible for weaknesses in the banking sector, since depositors have little reason to choose their bank carefully. An initial cap equivalent to roughly $2.5 million will be introduced in January of 2003, with the tighter $100,000 cap being imposed on January 1, 2005. The program aims to protect the savings of small and medium-sized depositors and would help to bring Mexico's financial system more in line with those of its closest trading partners.

EYES ONLY

RELEASES THIS WEEK

Employment and Unemployment

****Embargoed until 8:30 a.m., Friday, June 4, 1999****

In May, the unemployment rate was 4.2 percent; it was 4.3 percent in April. Nonfarm payroll employment rose by 11,000.

Leading Indicators

The composite index of leading indicators decreased 0.1 percent in April, following no change in March.

NAPM Report on Business

The Purchasing Managers' Index increased 2.4 percentage points to 55.2 percent in May. (A reading above 50 percent indicates that the manufacturing economy is generally expanding.)

MAJOR RELEASES NEXT WEEK

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

EYES ONLY

U.S. ECONOMIC STATISTICS

	1970-1993	1998	1998:3	1998:4	1999:1
Percent growth (annual rate)					
Real GDP (chain-type)	2.7	4.3	3.7	6.0	4.1
GDP chain-type price index	5.4	0.9	1.0	0.8	1.5
Nonfarm business (NFB) sector:					
Productivity (chain-type)	1.5	2.7	2.5	4.3	4.0
Real compensation per hour:					
Using CPI	0.6	2.6	2.3	2.2	2.8
Using NFB deflator	1.3	3.8	3.4	3.8	3.0
Shares of Nominal GDP (percent)					
Business fixed investment	10.9	11.0	10.9	11.0	11.0
Residential investment	4.5	4.3	4.4	4.5	4.6
Exports	8.2	11.3	11.0	11.3	10.9
Imports	9.2	13.0	12.9	13.1	13.2
Personal saving	5.2	0.3	0.1	-0.0	-0.4
Federal surplus	-2.7	0.9	1.1	0.8	1.3

	1970-1993	1998	March 1999	April 1999	May 1999
Unemployment Rate (percent)	6.7**	4.5**	4.2	4.3	**4.2**
Payroll employment (thousands)					
increase per month			**83**	**343**	**11**
increase since Jan. 1993					**18665**
Inflation (percent per period)					
CPI	5.8	1.6	0.2	0.7	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, June 4, 1999.**

EYES ONLY

FINANCIAL STATISTICS

	1997	1998	April 1999	May 1999	June 3, 1999
Dow-Jones Industrial Average	7441	8626	10444	10854	10664
Interest Rates (percent per annum)					
3-month T-bill	5.06	4.78	4.29	4.50	4.52
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Mortgage rate, 30-year fixed	7.60	6.94	6.92	7.15	7.41
Prime rate	8.44	8.35	7.75	7.75	7.75

INTERNATIONAL STATISTICS

Exchange Rates	**Current level June 3, 1999**	**Percent Change from Week ago**	**Percent Change from Year ago**
Euro (in U.S. dollars)	1.036	-0.8	N.A.
Yen (per U.S. dollar)	121.5	0.2	-12.2
Major currencies index (Mar. 1973=100) (trade-weighted value of the U.S. $)	96.93	0.3	-0.8

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	3.9 (Q1)	**4.2** (May)	2.3 (Apr)
Canada	2.8 (Q4)	7.8 (Mar)	1.7 (Apr)
Japan	-3.0 (Q4)	4.8 (Mar)	-0.1 (Apr)
France	2.2 (Q1)	11.4 (Mar)	0.5 (Apr)
Germany	1.8 (Q4)	[2] 7.2 (Mar)	0.6 (Apr)
Italy	0.9 (Q4)	12.3 (Jan)	1.5 (Apr)
United Kingdom	0.6 (Q1)	6.3 (Jan)	1.6 (Apr)

U.S. unemployment data **embargoed until 8:30 a.m., Friday, June 4, 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 March was 9.0 percent.