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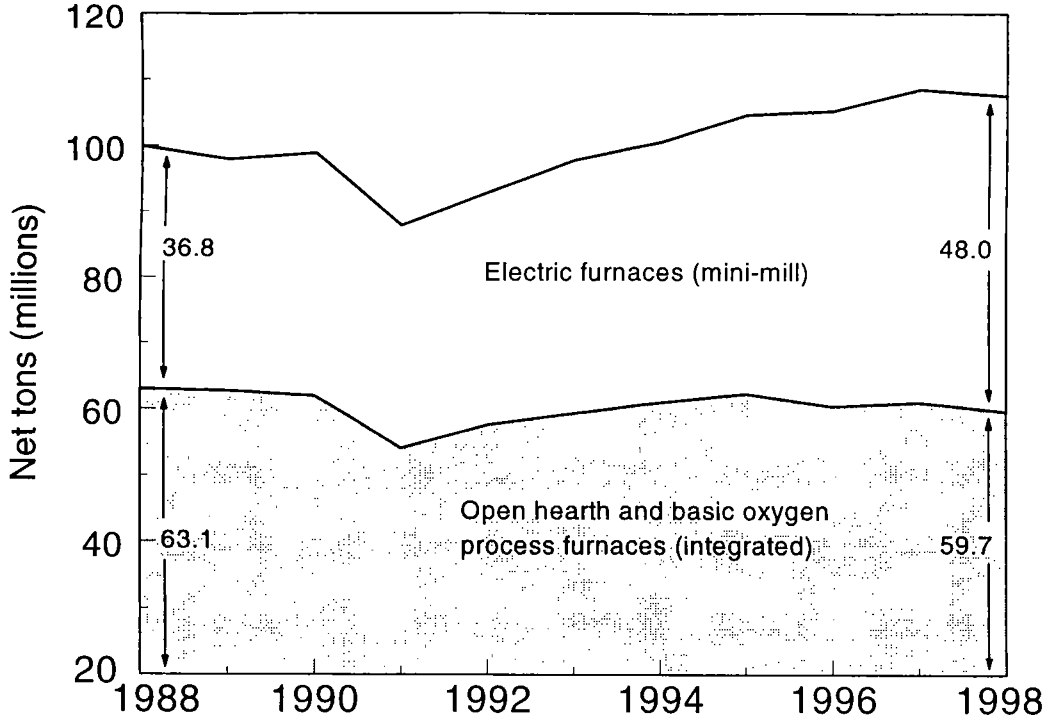
WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

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

May 28, 1999

CHART OF THE WEEK

Sources of Domestic Steel Production



Between 1988 and 1998, U.S. steel producers increased their annual production by about 8 million tons. However, production from large integrated mills using open hearth (prior to 1992) and basic oxygen process furnaces has actually declined. Thus, the increase in total steel production is more than accounted for by the 30 percent increase in production from electric furnaces used by mini-mills.

EYES ONLY

CONTENTS

"If you want to buy this, I'm afraid I'm going to need to see some justification."

EYES ONLY

SPECIAL ANALYSIS

First Evaluations Find Some Job Loss under ADA

The Americans with Disabilities Act (ADA) requires employers to accommodate disabled workers and outlaws discrimination against the disabled in hiring, firing, and pay. Initial evaluations suggest that, at least thus far, the ADA has had a modest negative impact on employment of disabled workers—though it does not appear to have affected the employment and earnings of other workers and may have raised the wages of some disabled workers.

Employment impacts in theory. Some aspects of the ADA raise the costs of *not hiring* disabled workers while others raise the costs of *hiring* them, hence the effect on employment could go either way. For example, hiring a non-disabled applicant over a disabled applicant exposes an employer to a charge of hiring discrimination under the ADA, but hiring the disabled applicant increases the employer's risk of subsequent charges over pay or firing. Also, to the extent that the requirements of accommodating disabled workers impose costs that are not offset by increased productivity, they tend to discourage employment of disabled workers.

Evidence on employment. The first studies that have tried to quantify employment outcomes under the ADA find that the act had a negative impact on the employment of all disabled men and of disabled women aged 21 to 39. Some evidence points to wage increases for disabled men (one study cites a 3 percent wage increase along with an 8 percent employment decrease for disabled men relative to nondisabled men). The wages and employment of nondisabled workers appear to have been unaffected by the ADA. Disaggregated findings show that employment effects for the disabled are strongest where the ADA is strongest. In particular, employment of the disabled appears to have fallen in medium-sized firms subject to the act relative to small firms that are exempt. Disemployment effects also appear to be stronger in states with higher ADA charge rates (the number of ADA-related complaints filed with the EEOC relative to the state's disabled population).

The balance of risks. Filings before the EEOC show that employers are much more likely to face ADA charges from people they have hired than from people they have not hired. Through September 1997, 63 percent of all charges brought under the ADA related to wrongful termination; 29 percent mentioned failure to accommodate; and only 9 percent were for discrimination in the hiring stage.

Implications. Over 10 percent of working-aged men in 1990 reported a disability and 53 percent of them worked (compared with 90 percent of their nondisabled counterparts). The ADA promises disabled workers benefits in the form of reduced discrimination, improved working conditions, and better accommodation of their disabilities in the workplace. Modest disemployment effects are perhaps to be expected, though they could diminish as employers gain more experience hiring and accommodating disabled workers.

SPECIAL ANALYSIS

Have Drug Companies Abandoned Critical R&D?

Tropical diseases long ago conquered in developed nations still kill and disable millions of people in the developing world—and some may be re-emerging in the United States and other advanced nations. Yet pharmaceutical companies appear to have abandoned R&D for these diseases. Can policymakers motivate profit-driven firms to invest in the development of drugs that primarily benefit the world's poor?

Malaria and market failure. The resurgence of diseases, increasing drug resistance, adverse effects, and the need for simpler treatment protocols point to the need for greater R&D in new drugs for diseases found in the developing world. For example, a resurgence of increasingly drug-resistant malaria around the world, including some cases in the United States, is afflicting up to 500 million people and killing up to 2.7 million each year. Yet in 1997 a consortium of leading pharmaceutical companies refused to support a proposed joint project to develop new treatments for the world's most threatening tropical diseases, particularly malaria.

A retreat to proven formulas. Other diseases besides malaria, including tuberculosis, dysentery, and meningitis, lack adequate treatment in poor countries. Instead of researching new treatments for these diseases, however, pharmaceutical companies have chosen to refine proven and profitable products. Of the more than 1,200 new pharmaceutical chemicals commercialized between 1975 and 1997, only about 30 percent were therapeutic innovations. Only 13 of these 1,200 were specifically for tropical diseases, and a mere 4 of these 13 resulted directly from R&D by the pharmaceutical industry rather than by the military or other organizations. This record stands in marked contrast to the pharmaceutical industry's crucial contributions to fighting endemic tropical diseases between 1910 and 1970.

Business as usual. Economic factors are a key explanation for the industry's current indifference to tropical diseases. A typical R&D program costs about $160 million and takes 8 to 12 years to complete. Profit-driven pharmaceutical companies will not undertake such costly research without the expectation of an adequate financial return to justify the risk and expense. In addition, heightened merger activity in the pharmaceutical industry in the late 1980s may have put pressure on management to focus on the proven profitable segments of the market, such as infectious diseases, cardiovascular conditions, and cancer—to the exclusion of even the most endemic of tropical diseases.

The attractiveness of the U.S. market. The sheer size of the U.S. market encourages profit-oriented pharmaceutical companies to develop drugs aimed at diseases that are more common here than elsewhere. But the United States is also a particularly lucrative market for international pharmaceutical companies because prices can be set freely in this country. By contrast, countries with a centralized health care system can exact price concessions from the companies. With the payoff to pharmaceutical R&D arising disproportionately from profits in the U.S. market, it is not surprising that companies' R&D programs are heavily weighted toward diseases that are prevalent here.

Intellectual property issues. Drug companies are among the most enthusiastic proponents of intellectual property protection. The importance of patents, which grant innovators a period during which they can exploit a new drug monopolistically, is well-known. Yet for diseases that afflict the very poor, even the guarantee of a temporary monopoly on the entire world market, enforced by an intellectual property regime, could be an inadequate incentive to incur the risk, research cost, and production cost of a vaccine or cure. In such cases, intellectual property protection would be only a partial solution.

The most cost-effective foreign aid? Some economists have recommended that leading governments guarantee an adequate market for an effective malaria vaccine, should it be discovered, by pledging to purchase the vaccine for mass distribution in needy areas. Under reasonable cost estimates, the vaccine could be provided for every child born in Africa for a very small fraction—between 1½ and 6 percent—of the current amount of all the foreign aid they receive.

Conclusion. The drought of industry research for tropical diseases endemic among the poorest nations may be reversible. Providing adequate economic incentive by guaranteeing a market for vaccines or cures may be one effective—and humane—government solution. Other solutions, such as demanding intellectual property protection from recipient countries, may be insufficient if those who need the treatment are simply too poor to afford it.

EYES ONLY

ARTICLE

USDA Finds Modest Impacts of Kyoto on U.S. Agriculture

The costs to U.S. agriculture arising from U.S. compliance with the Kyoto Protocol are estimated to be relatively modest, according to a new report from the U.S. Department of Agriculture. The USDA study plausibly refutes other analyses claiming that U.S. farm income would fall by half under Kyoto.

Planting the seeds. The USDA analysis builds on prior Administration analysis of the costs to the United States of meeting its Kyoto Protocol emissions target. The Administration's analysis included simulation results from a global economic model showing that effective implementation of the Protocol's market-based approaches—most importantly international emissions trading—would reduce the costs of meeting the U.S. emissions target by 80 percent relative to a no-trading scenario. This analysis found that if China, India, Mexico, and Korea adopted targets based on 2010 business-as-usual emissions levels and participated in trading with developed countries, the world price for a greenhouse gas permit would be about $23 per ton.

Reaping the harvest. Assuming a permit price of $23 per ton, the USDA analysis finds some impacts on energy-intensive agricultural practices such as irrigation and applying fertilizer. The key finding is that production, price, and income effects arising from meeting the Kyoto targets would be small—less than the variation farmers regularly experience on a year-to-year basis.

- Projected production declines for crops range from 0.1 percent for soybeans to 0.9 percent for rice. Livestock production would decline by 0.05 percent.
- Crop prices are projected to increase by less than 1 percent, while livestock prices would increase by 0.5 percent.
- Farmers' net cash returns would fall by about 0.5 percent, or about $370 million.

Comparison with other studies. These findings differ substantially from those of two studies sponsored by the American Farm Bureau Federation (AFBF), which estimate that farm income would fall by 46 to 48 percent under the Kyoto Protocol. The AFBF studies assume that the United States would meet its Kyoto obligations exclusively through domestic reductions, which would require energy price increases about 8 to 10 times greater than those corresponding to a $23 per ton permit price. Even correcting for the difference in assumed permit prices, however, the AFBF studies overestimate the costs of Kyoto to the agricultural sector, because they assume that farmers do not adapt to changing overall and relative input costs. The USDA study, by contrast, recognizes that farmers would respond to higher costs of energy-based inputs (such as nitrogen fertilizer) by economizing on their use and that some of the increase in overall production costs would be passed on to consumers in higher prices. At least one academic study has also reached conclusions similar to those of the USDA.

Further benefits. The USDA study discusses several other factors that could influence the effect of climate change policy on the agricultural sector. Because the Kyoto Protocol allows reductions through certain so-called "sink" activities—such as planting trees—that store or sequester carbon, institutions might be developed that would allow farmers to supplement their income through sequestration activities such as improved conservation practices or converting marginal agricultural lands to forests. Further, the study notes that if domestic emissions permits are auctioned, the auction revenues could be returned to the economy by reducing income, payroll, and corporate taxes, thereby offsetting some of the agricultural sector's costs. Finally, mitigating the risk of climate change over the long term could reduce the effects of extreme weather events and shifting growing zones on agriculture.

Conclusion. The USDA study reinforces the lessons of earlier Administration analyses of the costs of complying with the Kyoto Protocol. Effective implementation of the Protocol's market-based approaches and efficient response to market incentives by the private sector can reduce the costs of compliance to relatively modest levels.

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

Survey Finds Lower Job Insecurity. Recently available survey data show that perceived job insecurity was lower in 1996 and 1997 than in 1994 and 1995, but perceptions of job insecurity vary widely among workers. Although most workers see little or no risk of losing their jobs, a minority see moderate to high risk. The data come from a nationwide (although not nationally representative) survey of 3,600 workers in which respondents estimated their probability of job loss in the coming year and the probability that, if they lost their jobs, they would be able to find a comparable job in terms of wages and benefits. At least half of respondents saw no more than a 5 percent chance of losing their jobs, while a quarter of respondents saw their probability of job loss as 20 percent or more. Answers to the job search question were more varied. A quarter of respondents saw at least an 85 percent chance of finding a comparable job if they lost their current one, while another quarter saw the chance as 25 percent or less. An index of perceived job insecurity was negatively correlated with education, varied little with sex or age, and varied considerably by race—subjective probabilities of job loss among blacks tended to be nearly double those of whites.

Re-Examining "Bowling Alone." Education is usually the most important predictor of political and social engagement—from voting to chairing a local committee to hosting a dinner party to trusting others. But as Robert Putnam discussed in his 1995 article "Bowling Alone," levels of political and social participation in the United States have decreased over the past half century even though educational levels have risen sharply. One explanation that has been offered for this paradox is that people's participation is affected primarily by their relative education levels so that an increase in average education levels might not be expected to increase participation. However, a new study co-authored by Putnam finds empirical evidence that aggregate education levels matter. Using national data from 1972 to 1996 on social and political participation, social trust, and educational attainment, the study finds that increases in average education levels are associated with increased community engagement and that the overall decline in participation reflects other factors, including increased television watching.

State Drug-Control Spending Reduces Drug Use. A new study finds that drug-control spending by states and localities reduces illegal drug use, and that state and local expenditures on drug enforcement by police and drug treatment are the most effective methods of drug control. The study uses data from the 1990 and 1991 National Household Surveys on Drug Abuse and data on state and local spending on drug-related criminal justice and drug-related public health programs. The study finds that for marijuana use, the marginal cost of drug control exceeds the social benefits of drug control, although this may not be the case for other illegal drugs. It also finds that spending on correctional facilities had no effect on drug use. The study concludes that treatment rather than prison for drug offenders may be a more cost-effective approach.

EYES ONLY

INTERNATIONAL ROUNDUP

Australian Study Weighs Gains from Lower Trade Barriers. Cutting trade barriers in half in the next round of global trade talks would result in annual benefits of $400 billion, according to a new study commissioned by the Australian ministry of trade. The study estimates that a 50 percent reduction in trade barriers such as tariffs, quotas, and trade-distorting subsidies would trigger global growth of $250 billion in services, $90 billion in agriculture and $66 billion in manufactures. The biggest gainers in absolute terms would be the industrialized economies of East Asia, particularly Japan (a 50 percent drop in farm barriers alone would benefit Japan by $43 billion annually). Developing countries in Asia, Africa, the Middle East, and Latin America would gain the most in proportion to GDP. The study also finds that crisis-affected countries could gain more from trade reform than they could realistically expect to gain through financial assistance.

School and Work Prove Compatible for Bangladeshi Children. Critics of child labor often warn of a "poverty trap" in which extra income from child labor comes at the expense of the child's long-term chances of escaping poverty, as education is sacrificed for work. However, a new study of Bangladesh's Food-for-Education program finds that work and education can be compatible. Under the program, a stipend considerably less than the mean child wage was enough to ensure nearly full school attendance among participants. Furthermore, the enrollment subsidy led to only a small reduction in child labor. Just one-fourth of the increase in boys' school enrollment rate and one-eighth of the increase in girls' was attributed to the reduction in the incidence of child labor. Parents are finding uses of their children's time other than labor to give up in order to enroll them in the program, hence the impact on family earnings is modest. The authors point out, however, that work may well displace time for doing homework or attending after-school programs—effects not captured in the study.

Financial Crisis Is Less-Than-Traumatic for the World's Wealthiest. Despite global financial turmoil in 1998, the wealth of the world's nearly 6 million high net worth individuals (HNWIs) continued to grow, according to a recent estimate. The study defines HNWIs as people with financial assets exceeding $1 million and estimates the impact of aggregate changes on the distribution of wealth. Key defensive measures—including a move from equity to cash and fixed-income bonds and from local currency to U.S. dollars—protected HNWIs from last year's sharp decline in emerging countries' stock markets and allowed their wealth to grow by 12 percent over the year, to approximately $21.6 trillion. Although Latin American and Asia-Pacific HNWIs did not fare as well as their European and U.S. counterparts, they did manage to increase their wealth by 8 to 10 percent by moving much of their assets offshore into U.S. dollars. The report predicts that HNWIs' wealth will continue to grow at about 9 percent per year over the next few years.

EYES ONLY

RELEASES THIS WEEK

Gross Domestic Product

According to revised estimates, real gross domestic product grew at an annual rate of 4.1 percent in the first quarter.

Advance Durable Orders

Advance estimates show that new orders for durable goods fell 2.3 percent in April, following an increase of 2.7 percent in March.

Consumer Confidence

Consumer confidence, as measured by The Conference Board, rose 0.3 index point in May, to 135.8 (1985=100).

MAJOR RELEASES NEXT WEEK

NAPM Report on Business (Tuesday)
Leading Indicators (Tuesday)
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	**4.1**
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	Feb. 1999	March 1999	April 1999
Unemployment Rate (percent)	6.7**	4.5**	4.4	4.2	4.3
Payroll employment (thousands)					
increase per month			335	7	234
increase since Jan. 1993					18409
Inflation (percent per period)					
CPI	5.8	1.6	0.1	0.2	0.7
PPI-Finished goods	5.0	0.0	-0.4	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	March 1999	April 1999	May 27, 1999
Dow-Jones Industrial Average	7441	8626	9754	10444	10467
Interest Rates (percent per annum)					
3-month T-bill	5.06	4.78	4.44	4.29	4.52
10-year T-bond	6.35	5.26	5.23	5.18	5.62
Mortgage rate, 30-year fixed	7.60	6.94	7.04	6.92	7.23
Prime rate	8.44	8.35	7.75	7.75	7.75

INTERNATIONAL STATISTICS

Exchange Rates	**Current level May 27, 1999**	**Percent Change from**	
		Week ago	**Year ago**
Euro (in U.S. dollars)	1.044	-1.8	N.A.
Yen (per U.S. dollar)	121.3	-2.3	-11.7
Major currencies index (Mar. 1973=100) (trade-weighted value of the U.S. $)	96.65	0.3	-1.1

International Comparisons [1/]	**Real GDP growth** (percent change last 4 quarters)	**Unemployment rate** (percent)	**CPI inflation** (percent change in index last 12 months)
United States	3.9 (Q1)	4.3 (Apr)	2.3 (Apr)
Canada	2.8 (Q4)	7.8 (Mar)	1.0 (Mar)
Japan	-3.0 (Q4)	4.8 (Mar)	-0.4 (Mar)
France	2.2 (Q1)	11.4 (Mar)	0.6 (Mar)
Germany	1.8 (Q4)	[2/] 7.2 (Mar)	0.4 (Mar)
Italy	0.9 (Q4)	12.3 (Jan)	1.3 (Mar)
United Kingdom	0.6 (Q1)	6.3 (Jan)	2.1 (Mar)

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.

EYES ONLY

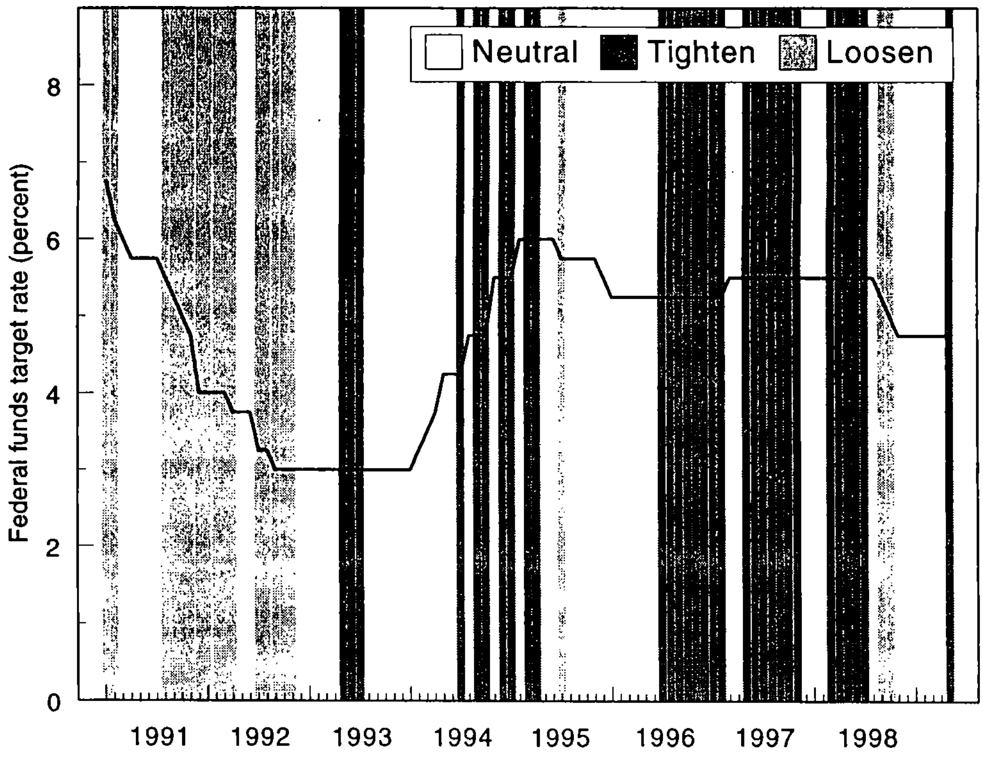
WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

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

May 21, 1999

CHART OF THE WEEK

Intermeeting Tilt and the Federal Funds Target Rate



The Federal Open Market Committee did not change its target for the Federal funds rate at this week's meeting, but it did adopt a "tilt" toward tightening. History suggests that such a move is not tantamount to an intention to raise rates at the next meeting. In 1998, for example, the tilt was toward tightening from March to August, but the next move was an easing.

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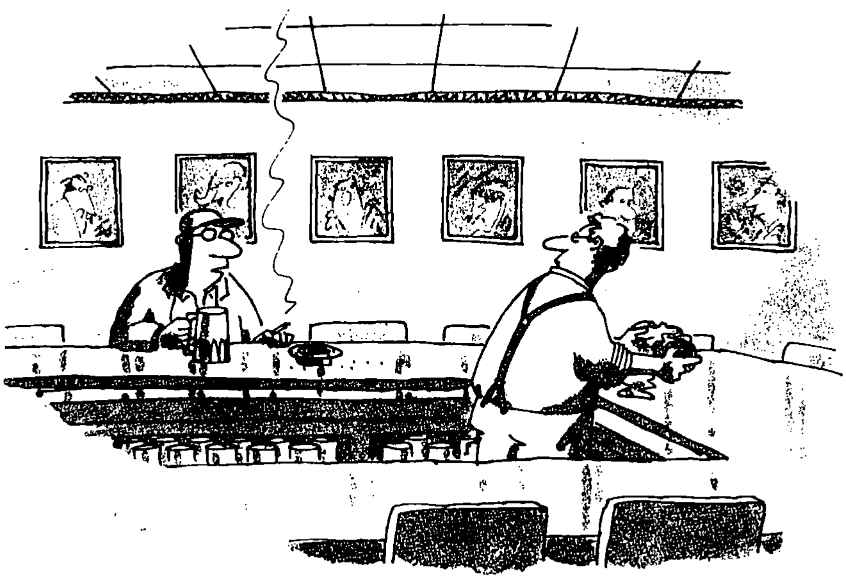
CONTENTS



"Forgive me, Eddie, if I'm unable to contain the occasional squeal of anticipatory glee over the new 'Star Wars' movie."

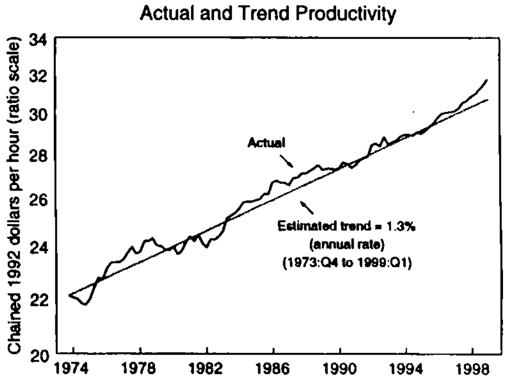
EYES ONLY

MACROECONOMIC UPDATE

Near-Term Growth Prospects Remain Strong

Over the past 4 months, forecasters have revised upward their estimates for U.S. economic growth. These revisions most likely reflect strong productivity growth and continued good news on inflation.

Actual and Trend Productivity



Productivity. While trend productivity has been thought to be growing at about 1.3 percent per year, actual productivity is well above that trend following last year's 2.8 percent growth (see chart). Forecasters are trying to assess whether the data are reliable, whether recent behavior is a temporary shock, or whether they need to revise upward their estimates of trend productivity growth.

Inflation. The 12-month rate of inflation as measured by the core CPI is little changed from a year ago. April's 0.7 percent increase in the overall CPI seemed to take markets by surprise. But it was accounted for by a surge in energy prices that is not likely to be repeated and a jump in core inflation that followed several months of tiny increases. Growth in ECI hourly compensation for the 12 months ending in March slowed to 3.0 percent from 3.5 percent during the year-earlier period. At the current rate, real wages can rise without putting upward pressure on price inflation.

Bumping against constraints? The economy seems to be making solid gains—though the rapid growth rate of the past two quarters may have sown the seeds of a slowdown as some sectors reach limits of either capacity or consumer satiation. For example, seasonally adjusted housing starts tumbled in April. The construction industry may already have been near its capacity in March, making the normal seasonal increase in April unattainable. Home builders now rank labor availability as their major problem. Similarly, a jump in motor vehicle production accounted for a sizable part of GDP growth in the fourth quarter. But capacity utilization in motor vehicles is now at the high end of its historical range and further gains may be hard to achieve. On the demand side, sales of new motor vehicles surged to a 16¼ million unit annual rate in the fourth quarter, a level that is so high relative to its recent trend that further increases are unlikely.

Indications of further growth. Despite these reservations, the forward-looking indicators point to more near-term growth. Order backlogs for investment goods have been increasing for the past 4 months; inventories are now so lean in relation to sales that a pickup in stock building is likely; and initial claims for unemployment insurance through the second week in May indicate that the labor market continues to be red-hot.

EYES ONLY

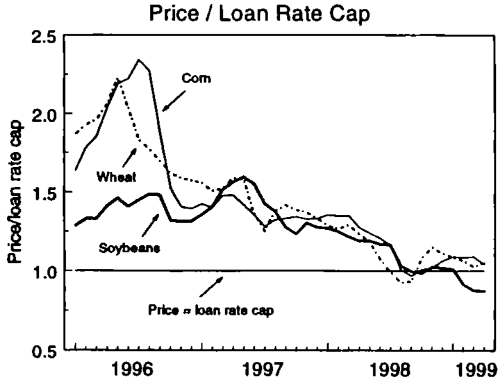
SPECIAL ANALYSIS

Farmers' Planting Intentions Are Full of (Soy)beans

U.S. soybean prices hit a 12-year low this spring, falling below the soybean loan rate cap (see chart). Prices are projected to show another steep drop over the coming year. Nevertheless, the USDA reports that farmers intend to plant a record 73.1 million acres of soybeans in 1999. Why?

Shouldn't low prices mean less production? The Farm Act of 1996 gave farmers participating in Federal commodity programs nearly full planting flexibility, and it might have been expected that farmers would reduce their soybean plantings in the face of falling prices. According to estimates by the USDA's Economic Research Service (ERS), the expected decline in soybean prices this year, all other things equal, would have *reduced* soybean planting intentions by about 5 million acres from last year's level.

Price / Loan Rate Cap



Offsetting factors. ERS has identified three offsetting factors that explain why soybean planting intentions in fact *increased* by approximately 1 million acres.

- Changes in relative prices. Prices of other crops farmers might plant—such as wheat, sorghum, and cotton—have also fallen, reducing their attractiveness relative to soybeans. ERS estimates that these price changes alone would have encouraged farmers to plant roughly an additional 3 million acres of soybeans.

- Changes in relative costs. Soybeans are an attractive alternative to winter wheat. ERS estimates that favorable relative cost savings for biotech soybeans and changes in the costs and returns to winter wheat would have increased soybean planting intentions by roughly 1½ million acres, other things equal.

- A favorable soybean loan rate. The soybean loan program guarantees farmers at least $5.26 per bushel, which means that farmers are insulated from the full decline in market prices. ERS estimates that without the loan program, farmers' soybean planting intentions would have been more than 1½ million acres lower.

Conclusion. For the first few years under the 1996 Farm Act, crop prices were sufficiently high that the loan rate was not a factor skewing planting decisions away from those warranted by market prices. But the current situation in soybeans is a reminder why price-guarantee mechanisms like the loan rate need to be accompanied by acreage restrictions to discourage excessive planting that can drive prices even lower.

SPECIAL ANALYSIS

EU Proposes Limits on Kyoto Flexibility Mechanisms

This week the European Union provided details on its proposal for quantitative restrictions on the use of international emissions trading and other flexibility mechanisms under the Kyoto Protocol. The EU proposal would significantly increase the costs to the United States without providing any climate benefits.

Kyoto flexibility mechanisms and cost effectiveness. A ton of greenhouse gas reduction provides the same climate benefit no matter where it is achieved. Mechanisms that encourage flexibility regarding where reductions occur encourage businesses and governments to find the least-cost methods of achieving targeted reductions. The Kyoto Protocol fosters cost-effective emissions reductions through the following flexibility mechanisms: international emissions trading, joint implementation (JI), and the Clean Development Mechanism (CDM). JI and CDM are project-oriented mechanisms that promote investment in emissions-abating projects in other industrialized countries (JI) and in developing countries (CDM). Previous Administration analysis found that efficient implementation of flexibility mechanisms could reduce compliance costs by 80 percent.

The EU proposal. The EU proposed a set of formulas that put quantitative limits on the number of emissions permits a country can purchase or sell through these three flexibility mechanisms. Preliminary analysis of these formulas indicates that the United States could purchase permits representing no more than 40 percent of the emissions reductions necessary to comply with its target. These formulas do allow for adjustment conditioned on domestic abatement efforts, but the United States would never be able to make purchases representing more than 50 percent of its necessary reductions. In addition, this proposal would effectively provide countries like Russia with fewer permits to sell for purposes of participating in the flexibility mechanisms. However, Russia could simply bank its untraded permits and either use them or trade them in subsequent periods. In such a case, the reduction in cost-saving opportunities for the United States and other countries would have no offsetting climate benefit.

Higher energy prices. By restricting buyers and sellers in the international emissions market, the EU proposal would significantly increase energy prices in the United States. Assuming that industrialized countries engage in international trading as envisioned in the Protocol, the increase in U.S. energy prices could be 3½ times greater under the EU proposal than in an unrestricted trading system. For example, gasoline prices are estimated to be as much as 30 cents per gallon higher in the restricted system than in the unrestricted market. These high energy costs would result if Russia and other selling countries could not comply with the proposal's burdensome information requirements. Indeed, if the selling countries cannot meet these requirements, permit prices in the international market would be so high that the United States would effectively be a non-participant in international trading.

Further, limiting the benefits associated with international trading could weaken the economic incentive for developing countries to adopt emissions targets.

Conclusion. Contrary to other international efforts to liberalize trade, the EU proposal would place costly restrictions on the United States and other countries in their participation in flexibility mechanisms under the Kyoto Protocol. This effort could eliminate virtually all of the economic benefits to the United States associated with international trading and the other mechanisms.

ARTICLE

Economics and Mental Health

The health care system often treats mental illness and substance abuse differently from other illnesses. To some extent this special treatment may reflect discrimination or prejudice, but it also reflects economic fundamentals that should be taken into account in formulating public policies aimed at more equal treatment.

Mental illness is common and costly. According to one estimate, roughly 30 percent of the U.S. population experiences some diagnosable mental or addictive disorder in a 12-month period. The most severe mental disorders—schizophrenia, manic depression, and some forms of major depression—affect about 4 percent of the population each year. Spending on care for mental health and substance abuse (MH/SA) was an estimated $75 billion in 1995 (8.3 percent of personal health care expenditures). Trends in the rate of growth of mental health expenditures have been similar to those of overall health care expenditures. Costs also tend to be concentrated. For example, one study found that nearly 30 percent of MH/SA spending on care was accounted for by 5 percent of the users. In addition, people with a history of mental health care tend to incur higher levels of general health expenditures than do others.

Indirect costs. More so than physical illnesses, mental and addictive disorders impose costs that go beyond direct spending on treatment. These indirect costs may amount to twice the direct costs of care. Studies have found earnings losses for men of between 20 and 25 percent associated with severe conditions such as psychotic disorders and major depression. Earnings losses associated with neuroses and other less severe mental disorders were found to be smaller but still significant at 5 to 15 percent. Mental illness and substance abuse have also been found to be associated with reduced employment, crime, violence, automobile accidents, unsafe sexual practices, child abuse and neglect, and homelessness.

Who pays? Because mental illness can be accompanied by a range of social pathologies that are costly both to the affected individuals and to society generally, the role of government (including protection of public safety) has been larger in the mental health care system than in health care generally. According to one estimate, direct government funding pays for about 23 percent of MH/SA expenditures, compared with about 12 percent of overall health care spending. State and local government spending (including Medicaid and Federal block grants) represents 42 percent of MH/SA spending but only 26 percent of overall health spending. By contrast, the Federal government pays a smaller fraction of total MH/SA spending (less than 20 percent) than it does of overall health care spending (more than 25 percent). Private organizations have taken over the care and treatment of those with insurance, leaving state mental hospitals to serve the most impaired, dangerous, and indigent people with mental illness.

Insurance. The mental health and substance abuse insurance market appears to be incomplete and inefficient. It tends to provide some coverage for low ranges of spending but leaves households unprotected against more expensive and potentially financially ruinous outcomes. Undertreatment and overtreatment appear to coexist. By one estimate, only about 25 percent of those with a diagnosable condition get some form of treatment over a 12-month period, while nearly 38 percent of all users and 28 percent of all visits for mental health care are not associated with a diagnosable disorder.

Barriers to efficiency. Moral hazard and adverse selection are not unique to mental health insurance, but they do appear to apply with special force. Some forms of mental health treatment (such as psychotherapy) appear to be discretionary and much more responsive to price than health care generally. This suggests that efficient insurance coverage might require greater cost sharing for mental health care than for other health care (which could be a burden on some beneficiaries). In addition, the persistence of many mental disorders and the fact that people most likely to suffer from mental disorders are likely to choose health plans with generous mental health coverage suggest that insurers have strong incentives to limit mental health coverage and discourage enrollment of those likely to make mental health claims.

Implications. Designing an optimal mental health policy involves coming to grips with the difficult issues posed by externalities, moral hazard, and adverse selection. These considerations may sometimes weigh in favor of special treatment for mental illness in designing optimal insurance and delivery arrangements. Optimal policy design is also complicated by the emergence of managed care and behavioral health "carve-outs" that separate MH/SA care from other health care. While such arrangements can potentially increase efficiency, they may also be harder to regulate than traditional fee-for-service plans, and they may add to the perception of discrimination against mental illness.

EYES ONLY

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

BLS Reports on Gender Differences in Teen Employment. Girls aged 14 and 15 are about as likely to work as boys of the same age, but they are less likely to hold an "employee" job (an ongoing relationship with a particular employer) and more likely to do "freelance" work (such as babysitting), according to new analysis by the Bureau of Labor Statistics. The BLS reports that 63 percent of 15 year-old boys held jobs in 1994-97, and that almost two-thirds of these young male workers held an employee job. A slightly larger 64 percent of 15 year-old girls held jobs, but only a little over half held employee jobs. Youths were found to move toward more formal work arrangements between age 14 and age 15—24 percent of 14 year-olds held an employee job, compared with 38 percent of 15 year-olds.

SEC Chairman Worries about Advertising for Online Brokerages. Arthur Levitt, the Chairman of the Securities and Exchange Commission, recently expressed concern about irresponsible advertising for online brokerages. Speaking before the National Press Club, Levitt worried that when firms repeatedly tell investors that online trading can make them rich, they create grandiose, unrealistic expectations. Levitt noted that more than 7 million Americans trade on-line (compared with none just 5 years ago), and many are relatively inexperienced and may never have been active investors during a down market. Levitt and the SEC are working with the National Association of Securities Dealers (NASD) to bolster NASD efforts to improve fairness in advertising.

Unlimited Substance Abuse Benefits May Be Cheap for Insurers. Providing unlimited substance-abuse benefits under managed care plans offered by large employers is likely to have a small effect on overall insurance costs, according to a new study by RAND. The study finds that adding an unlimited substance-abuse-care benefit under managed care would raise insurance payments by $5.11 per member per year. Putting a $10,000 limit on annual substance-abuse-care benefits could reduce costs by just 6 cents per member per year, to $5.05.

Do Market Conditions Affect Art? Changes in the nature of the demand for modern art at mid-century produced a substantial decline in the age at which modern American painters produced their most valuable work, according to a new study. Over the 1950s and 1960s, popular and critical demand emphasized novelty and innovation over technique and expression, and new artists were drawn away from the Abstract Expressionism that had been dominant in earlier years. The deemphasis of craftsmanship and the growing importance of conceptual innovation would be expected to lower the age at which artists produce their best work: psychologists note that mathematicians, physicists and poets typically make their most important contributions at younger ages than do astronomers, biologists and novelists, whose fields deal with complex and concrete ideas rather than abstract and conceptual ones. The paper finds that such a shift did occur: artists born between 1900 and 1920 produced their most valuable work (measured by the price of a painting at auction) at about age 50, while artists born between 1921 and 1940 peaked at around age 29.

INTERNATIONAL ROUNDUP

Japan's Trade Surplus Falls Again. Japan's current account surplus fell for the second consecutive month in March, providing further evidence that it has passed its peak. According to Japan's Ministry of Finance, the current account fell to just under $9 billion, a 3.5 percent drop from February and 25.5 percent below its level last March. The smaller-than-expected surplus was largely the result of a substantial increase in the current transfers deficit, which jumped to $4.3 billion in March, a 258 percent increase over the previous year.

Poorer Nations Starting More Anti-Dumping Cases. A record 26 countries opened anti-dumping investigations in 1998, up from 22 the year before and just 7 a decade ago, according to a new study based on World Trade Organization data. The United States, the EU, Australia, and Canada—traditionally the most active users of anti-dumping measures—accounted for just a third of the 225 cases opened last year. These four accounted for over 80 percent of cases in the late 1980s. (The EU has a single trade policy and is therefore treated as a single entity.) Developing countries have become relatively more active: South Africa opened the most cases, 41, and India opened 30, compared with 34 cases initiated by the United States and 22 by the EU. The EU was the target of the most anti-dumping cases, 42, followed by China with 23. Anti-dumping activity was most intense in the steel sector, which accounted for almost 40 percent of all cases opened last year.

World Bank Speaks Out Against Tobacco. Developing countries can prevent millions of premature deaths and much disability if they adopt measures to reduce the demand for tobacco, according to a new study from the World Bank. The study found that increasing the price of cigarettes is the most effective way to reduce demand. It estimates that increasing the price by 10 percent would reduce demand by about 8 percent in low- to middle-income countries and 4 percent in high-income countries. The Bank estimates that such an increase in price worldwide would cause 40 million current smokers to quit. The study found that advertising bans, dissemination of research on the health consequences of smoking, and nicotine replacement therapy are effective in reducing demand. Supply restrictions, by contrast, were judged to be ineffective ways to reduce smoking. The bank noted, for example, that attempts to restrict cigarette sales to minors have been largely unsuccessful, even in developed countries with substantial enforcement capacity.

Brazil Stays on Target. Brazil's government announced this week that it had hit two targets established by the IMF as part of the $41.5 billion aid package announced in November. Brazil's primary budget surplus exceeded 9 billion reals ($5.6 billion) in the first quarter of 1999, easily surpassing the goal of 6 billion reals set in the IMF agreement. Brazil also met all the foreign-debt targets specified in the agreement, with short-term foreign debt of $3.6 billion at the end of March, compared with the IMF ceiling of $5.3 billion.

EYES ONLY

RELEASES THIS WEEK

U.S. International Trade in Goods and Services

The goods and services trade deficit increased to $19.7 billion in March from $19.1 billion in February.

Housing Starts

Housing starts fell 10 percent in April to 1.574 million units at an annual rate.

MAJOR RELEASES NEXT WEEK

Consumer Confidence—The Conference Board (Tuesday)
Advance Durable Shipments and Orders (Wednesday)
Gross Domestic Product (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	4.5
GDP chain-type price index	5.4	0.9	1.0	0.8	1.4
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	10.8
Imports	9.2	13.0	12.9	13.1	13.1
Personal saving	5.2	0.3	0.1	-0.0	-0.4
Federal surplus	-2.7	0.9	1.1	0.8	N.A.

	1970-1993	1998	Feb. 1999	March 1999	April 1999
Unemployment Rate (percent)	6.7**	4.5**	4.4	4.2	4.3
Payroll employment (thousands)					
increase per month			335	7	234
increase since Jan. 1993					18409
Inflation (percent per period)					
CPI	5.8	1.6	0.1	0.2	0.7
PPI-Finished goods	5.0	0.0	-0.4	0.2	0.5

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

EYES ONLY

FINANCIAL STATISTICS

	1997	1998	March 1999	April 1999	May 20, 1999
Dow-Jones Industrial Average	7441	8626	9754	10444	10867
Interest Rates (percent per annum)					
3-month T-bill	5.06	4.78	4.44	4.29	4.48
10-year T-bond	6.35	5.26	5.23	5.18	5.60
Mortgage rate, 30-year fixed	7.60	6.94	7.04	6.92	7.23
Prime rate	8.44	8.35	7.75	7.75	7.75

INTERNATIONAL STATISTICS

Exchange Rates	**Current level May 20, 1999**	**Percent Change from** Week ago	Year ago
Euro (in U.S. dollars)	1.063	0.0	N.A.
Yen (per U.S. dollar)	124.2	2.0	-8.7
Major currencies index (Mar. 1973=100) (trade-weighted value of the U.S. $)	96.34	0.6	-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	4.0 (Q1)	4.3 (Apr)	2.3 (Apr)
Canada	2.8 (Q4)	7.8 (Mar)	1.0 (Mar)
Japan	-3.0 (Q4)	4.8 (Mar)	-0.4 (Mar)
France	2.8 (Q4)	11.4 (Mar)	0.6 (Mar)
Germany	1.8 (Q4)	[2/] 7.2 (Mar)	0.4 (Mar)
Italy	0.9 (Q4)	12.3 (Jan)	1.3 (Mar)
United Kingdom	0.7 (Q1)	6.3 (Jan)	2.1 (Mar)

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.

EYES ONLY

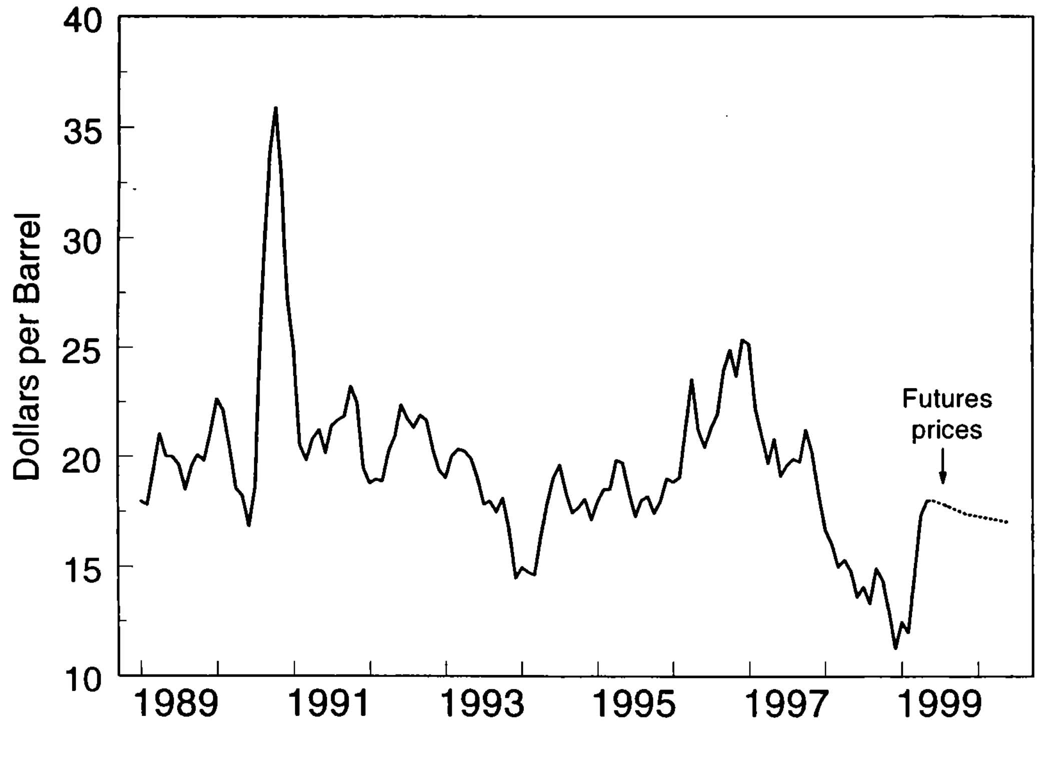
WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

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

May 14, 1999

CHART OF THE WEEK

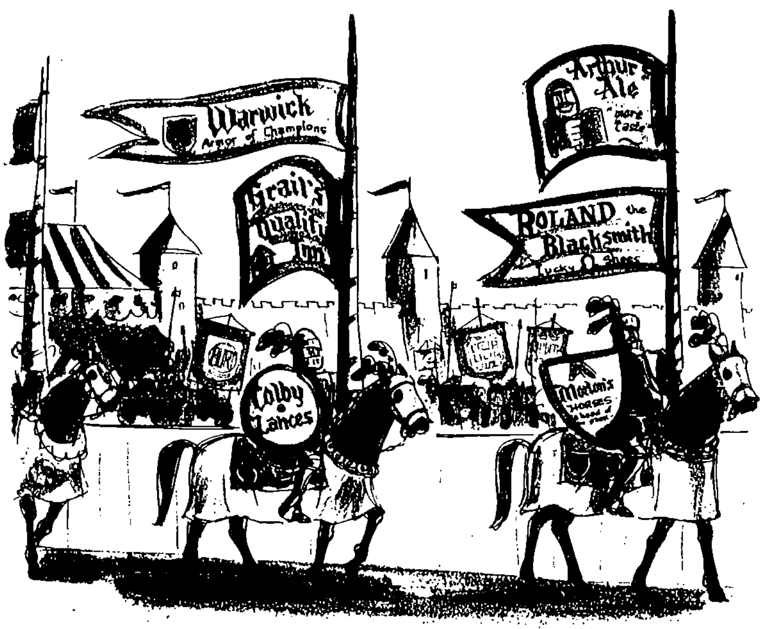
Crude Oil Prices



Declining oil prices in 1997 and 1998 helped keep inflation tame. However, oil prices have risen sharply in recent months, and these increases have shown up in the April consumer and producer price indexes. These are probably temporary spikes in CPI and PPI inflation. Futures markets are predicting that oil prices will remain at roughly current levels, however, suggesting that the role of energy prices in contributing to disinflation may be over.

EYES ONLY

CONTENTS



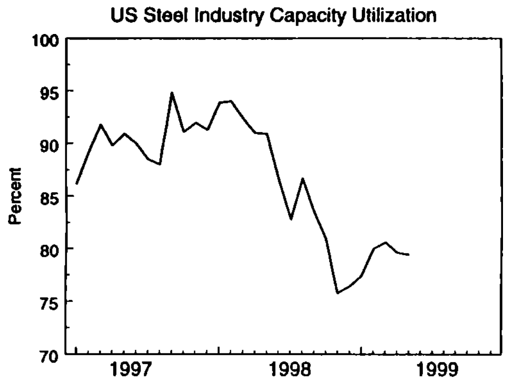
CURRENT DEVELOPMENT

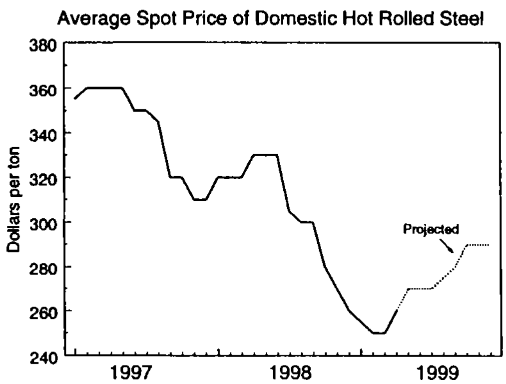
Is Steel Showing Some Strength?

Steel imports subsided to levels very close to those of a year ago in the first quarter of 1999, after surging in the second half of last year. While the steel industry continues to struggle, there are hopeful signs that recovery is imminent.

Imports. In March, imports of all steel products were down 37 percent from their peak in August 1998, and hot-rolled steel imports—a category heavily affected by anti-dumping measures—were down 73 percent from their peak in November. (Total steel imports from Japan were down 67 percent below their peak in October, but remained 36 percent above levels in March 1997.)

Domestic production. Although industrial production of iron and steel was 3.2 percent higher in March than in November, it remained 11.4 percent lower than a year earlier. Signs of weakness include flat employment, slack capacity utilization (80 percent compared with over 90 percent a year ago, see upper chart), and continued downward pressure on prices and profits. Domestic prices fell 5.8 percent last year and an additional 2.6 percent through April. The three largest integrated steel producers all reported losses for the first quarter, and while the top four mini-mill producers remained profitable, their earnings were down from the fourth quarter.

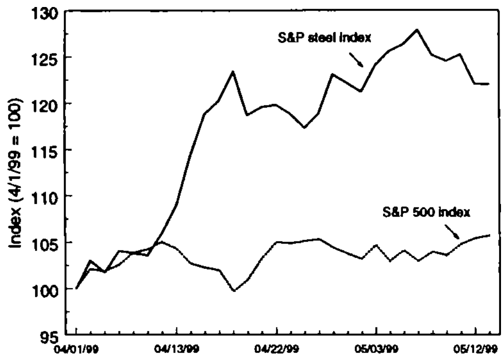




In part, the industry's current plight reflects relatively slow growth in U.S. manufacturing in the second half of 1998. In addition, spurred by low import prices and perhaps fears of future import protection, steel purchasers went on a buying spree in the second half of last year and built up their stocks. These inventories will have to be worked off before recovery can take place.

Signs of recovery? The latest purchasing managers survey and recent data on new orders reveal greater manufacturing strength in April. Construction and autos, which account for nearly 30 percent of mill shipments, also appear robust. And forecasts for growth abroad have improved. This improved situation can be seen in analysts' projections of price hikes planned for the second quarter (see lower chart), and in

Relative Performance of Steel Stocks in S&P Indices



surging stock prices for steel companies over the past month both in the United States (see chart) and around the world.

Bucking a trend? Nonetheless, based on historical trends in the industry, even if imports retain a constant share of the market and steel production grows, the prospects are for a continued decline in employment over the medium term—particularly in the large unionized integrated mills. Between 1991 and 1997, for example, steel production increased 29 percent—with mini-mills accounting for almost all of the growth. Yet because of productivity growth, employment in blast furnaces and basic steel products fell from 262,000 to 235,000.

EYES ONLY

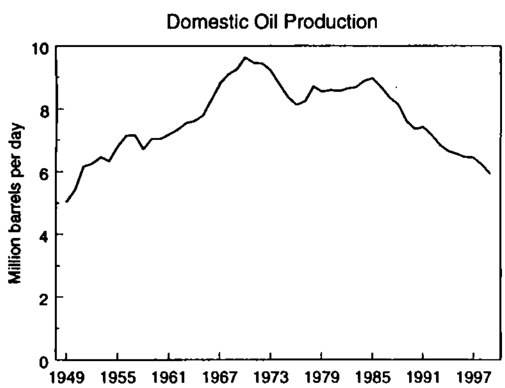
SPECIAL ANALYSIS

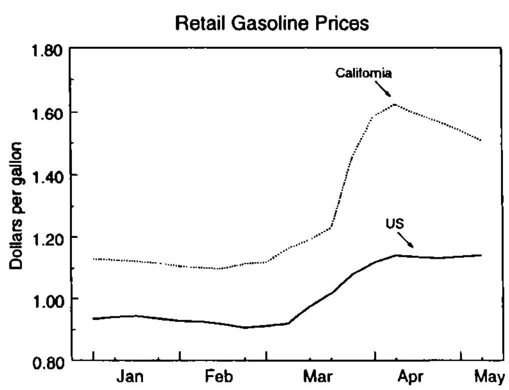
Oil Prices: The Crude and the Refined

Before its recent rebound, the real price of crude oil had sunk to an historic low in December 1998. While consumers benefited from lower oil prices, domestic producers were hurt. The recent rebound in prices means a reversal of fortunes.

Crude oil prices. Crude oil prices spiked to over $35 per barrel in 1990 prior to the Gulf War, and plunged to about $10 per barrel last December, but they have tended to be in the $15 to $20 per barrel range in the 1990s (see the Chart of the Week). The recent price increase back into this range occurred after an agreement by members of OPEC and several prominent non-OPEC oil producers (Mexico, Norway, Oman and Russia) to curtail production. Reviving economic activity in Asia has also probably contributed to the increase.

Domestic production. Domestic oil production has been declining for some time (see upper chart) as the discovery and development of new fields has not been sufficient to offset the decline in production rates in older fields as they are depleted. Imports have filled the gap between domestic demand and domestic production. Faced with very low prices last year, some marginal wells ceased operating, and, given large fixed costs to resume operation, it may not be economical to start them up again even with the recent price increases. New drilling activity remains depressed, auguring poorly for new supplies coming on line rapidly as older fields continue to be depleted.





Gasoline refiners and consumers. Changes in crude oil prices are an important determinant of changes in gasoline prices, but recent events show that conditions at refineries matter as well. Domestic refineries have been running close to capacity for several years, and temporary shutdowns can create local shortages of refined products. For example, in California, explosions at two refineries in February and March led to a significant shortage of refinery capacity in the state. As a result, average prices for gasoline in California rose from $1.12 to $1.62 per gallon between the beginning of March and mid-April—more than double the increase for the United States as a whole (see lower chart).

Distance and California environmental rules for reformulated and low sulfur gasoline probably limited the extent to which shipments from other regions could arbitrage away this price difference—though California prices have fallen more than 10 cents per gallon from their peak. Recently proposed standards would require low sulfur gasoline nationwide, thus making gasoline requirements similar to current California standards. Meeting these standards will require refiners to make large capital expenditures, which may make some small refineries uneconomical to operate. This could further tighten potential bottlenecks at the refinery stage unless imports of refined product can readily fill the gap.

Implications. Oil prices have recently moved up sharply from very low levels. These low oil prices, while bad for producers, were good for consumers. Because the United States consumes far more oil than it produces, low oil prices result in net gains for the economy as a whole. Changes in crude oil prices are a major source of changes in prices consumers pay for gasoline at the pump. But as the recent experience in California shows, factors such as refinery bottlenecks can also be important.

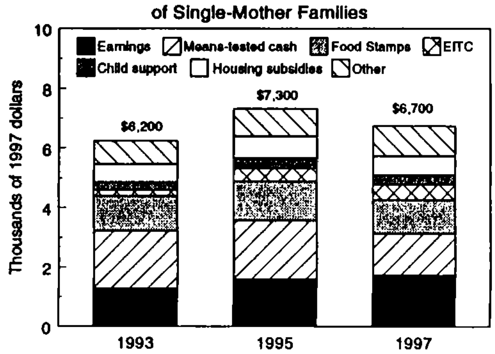
<u>ARTICLE</u>

Changes in the Income of Single Mothers

The dramatic decline in welfare rolls is a salient feature of welfare reform, but researchers are beginning to examine other indicators as well. Preliminary CEA analysis of changes in the distribution of income of single mothers suggests that these indicators will reveal a more complicated story.

The big picture... The CEA analysis is based on a broad measure of disposable income composed of labor market earnings, means-tested cash assistance, social insurance, child support, other cash income, the EITC, the cash value of housing subsidies, food stamps, and school lunches, all net of taxes. The average disposable income of single-mother families increased by 10 percent between 1993 and 1997. Income in the bottom fifth of the distribution rose 8 percent over the entire period. However, all of the gains were achieved between 1993 and 1995 (see chart). In fact, the average income of the poorest fifth of single-mother families fell by 8 percent between 1995 and 1997, and only the top quintile showed gains after 1995.

Income Composition of Poorest 20 Percent of Single-Mother Families



...and what is behind it. Labor market earnings of single mothers increased at all income levels between 1993 and 1995, with the largest improvement at the lower income levels. Much of this gain was due to more women entering the labor force, in part as a result of EITC expansions. Since 1995, single mothers' earnings continued to increase. However, the gains were much smaller than in the earlier period, and they were more than offset by declines in government transfers for the poorest quintile. In the bottom fifth of the distribution, average earnings increased by $134 between 1995 and 1997, while means-tested cash (TANF and SSI) decreased by $572 and food stamps decreased by $179.

Single-mother families relative to other families. Changes in the income of families headed by a single mother have been fairly similar to the changes among all other families at the same income level. In fact, the share of all poor families containing a single mother changed very little between 1993 and 1997. However, single-mother families are disproportionately concentrated at low income levels, with 85 percent having income less than the median income for all other families.

Interpret with caution. Outside analysts are likely to report results similar to those found in the CEA analysis, and it is important to understand some inherent limitations in the data and analysis. First, the only data that can be used to provide a recent national picture come from the Current Population Survey (CPS), which is not a longitudinal survey and hence does not track the experiences of the same people over time. In addition, welfare income has historically been under-reported in the CPS, and some evidence indicates that under-reporting has become worse in recent years. Second, the available measure of disposable income does not include the value to single mothers of growing levels of child care transfers, but it also does not net out work-related expenses. Third, in many states implementation of the Personal Responsibility and Work Opportunity Reconciliation Act (PRWORA) was just getting underway in 1997, so the results may be too preliminary to give an accurate assessment of the impact of welfare reform.

Conclusion. As analysts begin to look at indicators of welfare reform beyond caseload reduction, we are likely to see a more complex picture emerge. Some analysts are likely to interpret the evidence on changes in the income of single mothers in recent years as a sign of the weakness of PRWORA and state reform policies. The CEA analysis suggests reasons why such a conclusion might be overstated, but the Administration should expect to see some less-than-rosy assessments of welfare reform in the near future. As more states complete studies of those who have left the welfare rolls, and as longitudinal data become available on former welfare recipients, we should have a richer understanding of the experiences of those directly affected by welfare reform.

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

Non-Oil Import Prices Start Falling Again. Over the past few years falling non-oil import prices have been an important contributor to keeping inflation tame. Beginning last fall, it appeared that non-oil import prices had stabilized, but data released this week show renewed declines in March and April. For the 12 months ending in April, the price index for all imports excluding petroleum declined 2.4 percent. This decline was led by a drop in the price index for imported capital goods, as computer prices continued to move lower. Prices for goods imported from Asian newly industrialized economies showed a decline of nearly 7 percent over the 12 months ending in April.

Motivating Front-line Workers the Marine Way. The motivational techniques used so successfully by the Marine Corps could provide lessons for businesses in motivating their rank and file, according to a recent article in the *Harvard Business Review*. The article is based on a study of 30 companies (plus the Marines) with a reputation for emotionally engaging their front-line workers. The techniques used by the Corps include a substantial investment at the outset in inculcating core values; preparation of every member of the Corps to lead; clearly distinguishing when a work group is a team (with decisionmaking contributions from all members) and when it has a single leader with sole decisionmaking authority; attention to poor and mediocre performers, making sure that foundering Marines are caught before they hit bottom; and use of discipline to build pride. The article cites businesses that effectively use similar techniques. For example, Marriott focuses much of its orientation for new employees on company values and has ongoing programs for those at risk of failure. GE encourages front-line supervisors to attend to underperformers by evaluating supervisors on that dimension of their jobs. And Southwest Airlines encourages self-discipline among employees and work groups, which has been credited with cutting turn-around time of its planes.

Corporate Insider Trading Yields Moderate Profits. Although corporate insiders may realize better-than-market returns from trading their company's stock, these gains do not appear to disadvantage outsiders substantially, according to a recent study. The authors used a comprehensive sample of insider transactions drawn from legally required filings with the Securities and Exchange Commission over the period 1975-96. In effect, they analyzed the returns to two shadow mutual funds: a "purchase portfolio" composed at any one time of all the shares purchased by insiders in the past year, and a "sale portfolio" composed of all the shares sold by insiders in the past year. The study found that the purchase portfolio outperformed the market by about 5 percent on a risk-adjusted basis, with about a third of this extra gain coming in the first month after purchase. The authors argue that this shows that insider buyers have a good feel for near-term developments within their firm or that actions by others who follow their trades move the market. The study found no abnormal returns associated with insider sales. In other words, the people who buy the shares that insiders sell do not suffer losses relative to the market over the next year.

INTERNATIONAL ROUNDUP

Africa Off Target in War on Poverty. International goals to cut African poverty in half by 2015 are unlikely to be achieved, the UN's Economic Commission for Africa (ECA) warned last week. According to the organization's 1999 economic report, if sub-Saharan Africa is to achieve the annual growth of 7 percent that the ECA considers necessary to achieve the poverty reduction target it will have to find additional financing equal to almost 14 percent of GDP. Although Africa's aggregate GDP (including north Africa) grew 3.3 percent in 1998, up from 2.9 percent in 1997, growth in sub-Saharan Africa remains below the continent's average at just 2.6 percent. Export revenues fell by 17 percent, and the balance of trade was negative for the first time in nearly a decade. The cost of servicing Africa's debt rose to $35 billion, or 31 percent of goods and services exports. Debt reduction initiatives did not significantly reduce the burden, according to the ECA.

Malaysia to Press for Regulation of Speculators. Malaysia will push to keep the focus of next weekend's meeting of APEC finance ministers on regulating the activities of hedge funds and currency speculators, Malaysia's junior finance minister told the press this week. The Malaysian government, which sees predatory currency speculation as the main cause of the Asian crisis, will renew calls for greater transparency of hedge fund operations and demand the regulation of short-term capital flows. Malaysia also plans to return to the international bond market in the next few weeks, with a new $1 to $3 billion bond issue that could provide further evidence of Asia's recovery.

OPEC Production Cuts Fall Short of Target. Members of OPEC sharply reduced their oil output in April, but the cuts fell short of the promises they made each other in March, the International Energy Agency reported. With total production of 23.6 million barrels per day, the 10 participating OPEC nations would have to make additional cuts of about 600,000 barrels per day to achieve their target reduction of 4.3 million barrels per day. That put OPEC's compliance rate at about 85 percent of its pledges, according to the IEA.

EYES ONLY

RELEASES THIS WEEK

Consumer Price Index

****Embargoed until 8:30 a.m., Friday, May 14, 1999****

The consumer price index rose 0.7 percent in April. Excluding food and energy, consumer prices rose 0.4 percent.

Industrial Production and Capacity Utilization

****Embargoed until 9:15 a.m., Friday, May 14, 1999****

The Federal Reserve's index of industrial production increased 0.6 percent in April. Capacity utilization rose 0.2 percentage point to 80.6 percent.

Producer Price Index

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

Retail Sales

Advance estimates show that retail sales rose 0.1 percent in April. Excluding sales in the automotive group, retail sales rose 0.4 percent.

Productivity

Nonfarm business productivity rose 4.0 percent at an annual rate in the first quarter of 1999. Manufacturing productivity rose 5.8 percent.

MAJOR RELEASES NEXT WEEK

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

EYES ONLY

U.S. ECONOMIC STATISTICS

	1970-1993	1998	1998:3	1998:4	1999:1
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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	10.8
Imports	9.2	13.0	12.9	13.1	13.1
Personal saving	5.2	0.3	0.1	-0.0	-0.4
Federal surplus	-2.7	0.9	1.1	0.8	N.A.

	1970-1993	1998	Feb. 1999	March 1999	April 1999
Unemployment Rate (percent)	6.7**	4.5**	4.4	4.2	4.3
Payroll employment (thousands)					
increase per month			335	7	234
increase since Jan. 1993					18409
Inflation (percent per period)					
CPI	5.8	1.6	0.1	0.2	**0.7**
PPI-Finished goods	5.0	**0.0**	-0.4	0.2	**0.5**

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

New or revised data in **boldface**.
CPI data **embargoed until 8:30 a.m., Friday, May 14, 1999.**

EYES ONLY

FINANCIAL STATISTICS

	1997	1998	March 1999	April 1999	May 13, 1999
Dow-Jones Industrial Average	7441	8626	9754	10444	11107
Interest Rates (percent per annum)					
3-month T-bill	5.06	4.78	4.44	4.29	4.46
10-year T-bond	6.35	5.26	5.23	5.18	5.41
Mortgage rate, 30-year fixed	7.60	6.94	7.04	6.92	7.10
Prime rate	8.44	8.35	7.75	7.75	7.75

INTERNATIONAL STATISTICS

Exchange Rates	**Current level May 13, 1999**	**Percent Change from Week ago**	**Percent Change from Year ago**
Euro (in U.S. dollars)	1.063	-1.4	N.A.
Yen (per U.S. dollar)	121.7	0.7	-9.3
Major currencies index (Mar. 1973=100) (trade-weighted value of the U.S. $)	95.72	0.9	-1.2

International Comparisons [1]	**Real GDP growth** (percent change last 4 quarters)	**Unemployment rate** (percent)	**CPI inflation** (percent change in index last 12 months)
United States	4.0 (Q1)	4.3 (Apr)	**2.3** (Apr)
Canada	2.8 (Q4)	7.8 (Mar)	1.0 (Mar)
Japan	-3.0 (Q4)	4.8 (Mar)	-0.4 (Mar)
France	2.8 (Q4)	11.4 (Mar)	0.6 (Mar)
Germany	1.8 (Q4)	[2] 7.2 (Mar)	0.4 (Mar)
Italy	0.9 (Q4)	12.3 (Jan)	1.3 (Mar)
United Kingdom	0.7 (Q1)	6.3 (Jan)	2.1 (Mar)

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

EYES ONLY

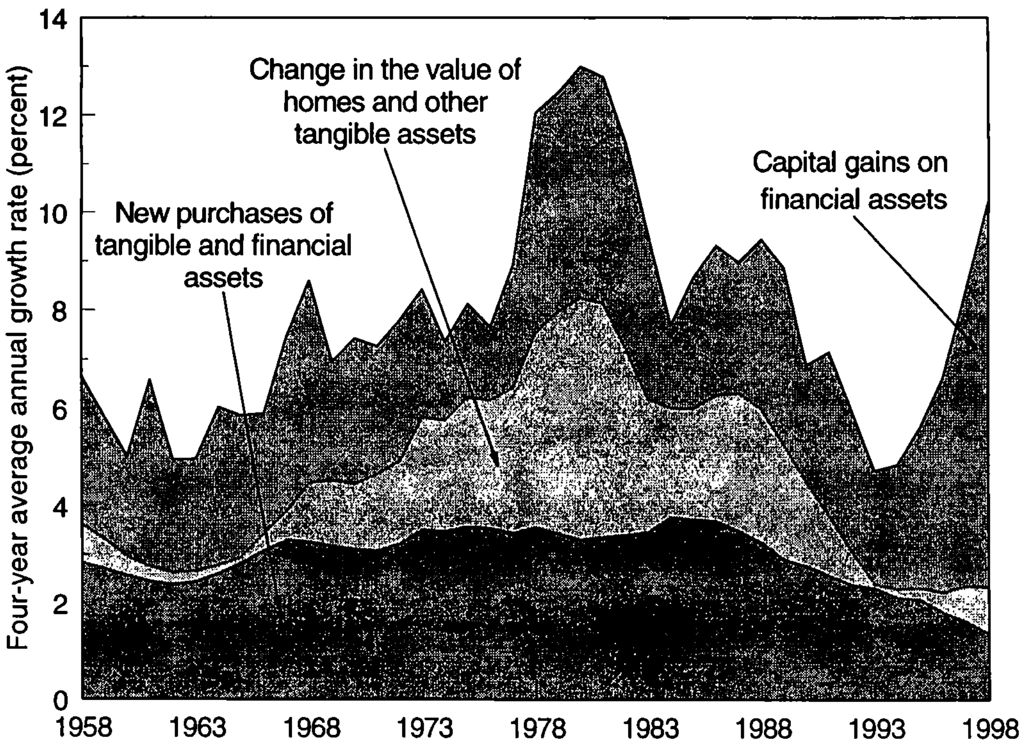
WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

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

May 7, 1999

CHART OF THE WEEK

Contributions to Changes in Household Net Worth



Sharp increases in capital gains on financial assets have been the main contributor to increases in household net worth in recent years. In the 1994-98 period, for example, (the last data point) this component contributed about 8 percentage points to the average annual growth in net worth of 10 percent per year. Increases in the value of housing and other tangible assets have been much less important than financial gains. Saving (purchases of tangible and financial assets) has also been relatively unimportant.

EYES ONLY

CONTENTS

"Special assignment, Chaswick. I need you to test our severance package."

EYES ONLY

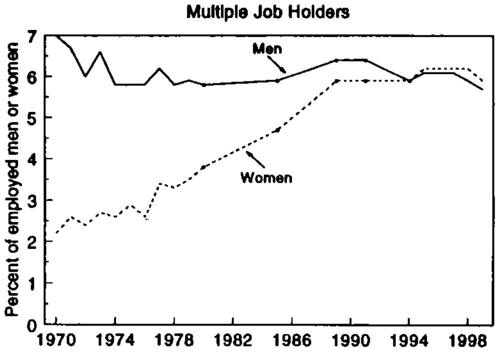
SPECIAL ANALYSIS

Moonlighting

Many people view multiple job holding as a problem, on the assumption that workers would prefer to work longer hours at their primary job rather than to hold two jobs—or that workers are forced to moonlight because of low wages in their primary job. (Thus the joke, "The expansion has created millions of new jobs and I've got three of them.") If these assumptions were true, one would expect moonlighting to decrease in an expansion, as job opportunities and wages increased. But multiple job holding has remained fairly steady in the 1990s, suggesting that many moonlighters hold second jobs by choice. This view is supported by the demographics of moonlighters, as well as by new evidence on why people moonlight.

Trends. Women's increasing attachment to the labor market resulted in a steady rise in their multiple job holding during the 1970s and 1980s—so much so that rates are now similar among men and women. Among all workers, moonlighting has remained fairly constant since 1994. About 6 percent of employed men (4.0 million) and 6 percent of women (3.6 million) worked multiple jobs in April 1999.

Multiple Job Holders



Note: Data for 1999 is for April. Data unavailable for some years.

Demographics. Census data from 1995 (the most recent data on moonlighters' characteristics) show that the percentage of workers holding multiple jobs increases with education. For example, 3 percent of workers with less than a high school education had multiple jobs, compared with 10 percent of those with a Ph.D. Also, moonlighting decreases only slightly among higher earners, contrary to the idea that most workers hold second jobs to meet basic living expenses. Finally, those holding primary jobs in professional specialty, technician, and well-paid service occupations (such as police and firefighters) were most likely to hold multiple jobs.

New evidence. A recent study uses 1984 data from the Survey of Income and Program Participation (SIPP) to investigate whether workers moonlight because of constraints on working hours in their primary jobs (due to workweek restrictions, economic conditions, or other institutional factors) or because they prefer to have multiple jobs. The study finds that many workers, but not all, face constraints in their primary jobs, and it concludes that both explanations for moonlighting are probably true: some would prefer having only one job, while others would not.

Implications. These results may explain why, during the current expansion, the trend in moonlighting has held steady. While some workers with greater constraints may have been able to quit their second jobs as employment opportunities expanded, others may have taken advantage of the strong economy and chosen to moonlight.

EYES ONLY

SPECIAL ANALYSIS

Do Firms Pay Women Less for the Same Job?

Past research on gender pay differences found that the gap between men's and women's wages is reduced to about 12 percent once a variety of factors are taken into account—education, labor market experience, broad industry and occupation, and union status. Some evidence suggested that the remaining gap mostly reflects job segregation (women tending to work in lower paying firms and occupations within firms). But a new study, using better data, finds that a significant share of women may still get paid less than men in the *same* occupation in the *same* firm.

New data... The new study uses confidential Bureau of the Census data to link characteristics of workers to characteristics of the establishments where they work. The sample is not random, however; manufacturing plants are over-represented and retail stores are under-represented. Nevertheless, it covers a much broader range of industries and occupations nationwide than the data used in previous studies.

...lead to new findings. Previous efforts to estimate within-job, within-establishment wage gaps found that most of the difference between women's and men's wages was explained by gender segregation within and across firms. The new study, while finding an unadjusted gap of roughly the same size as in previous studies, finds a 9 to 10 percent gap even within similar jobs at the same firm, after controlling for a number of firm and individual characteristics. In other words a significant amount of the within-job, within-firm difference remains unexplained.

Why the difference in results? The sizable within-job, within-establishment wage gap persists no matter how the data are analyzed. The authors conclude that their findings may differ from the earlier studies because they use the Census household survey instead of an employer survey. They observe that employers might be unlikely to report data showing gender pay differences within jobs, since that could be a violation of the Equal Pay Act. Alternatively, employers may classify similar "male" and "female" jobs as separate "occupations," but the Census may combine them into a single occupational category.

Implications. If, as the earlier studies had found, virtually all of the male-female pay difference arises from job segregation, the Equal Pay Act could not have much effect. However, the new study suggests that Equal Pay Act enforcement can play an important role in reducing the gender pay gap. It also demonstrates the importance of having pay data for narrowly defined occupations, as well as information about workers' education and experience, when measuring the gender pay gap within firm and occupation. In the new study, for example, this gap was twice as large when occupations were broadly defined and "human capital" differences were not taken into account as it was with more narrowly defined occupations and controls for education and experience.

ARTICLE

The Economics of Urban Sprawl

The General Accounting Office has just released a study of "urban sprawl" focusing on the role of Federal policies in contributing to the suburbanization of America since the end of World War II. Those hoping for decisive findings will be disappointed with the report's conclusion that the Federal influence is unclear. But such a finding reflects the fact that the overall causes and consequences of sprawling, low-density, fragmented, and automobile-dependent development are very complicated and only imperfectly understood. Even when the problems are clearly identified, the policy coordination necessary to effect a solution may be difficult to achieve.

Sprawl's private attraction... Research cited by GAO points to the advantages gained by moving out of the city, including increased home ownership and new, sometimes lower-cost locations for businesses. Suburbanites are likely to breathe cleaner air, have more space, live in housing that is newer (with lower risk of exposure to lead and asbestos), have better schools, and experience less crime. As roads and highways have improved and cars have become less costly to operate, people are able to live farther away from cities. (Automobile operating costs have fallen from 21.3 cents per mile in 1950 to 10.1 cents per mile in 1996.) In general, sprawl is encouraged to the extent that people can enjoy the benefits of cities while escaping their major disadvantages.

...and public failure. But these private benefits involve social costs as well. Suburban development consumes open space and farm land, poses challenges to central city finances, can increase pollution, and can be aesthetically unpleasing. An economic analysis of urban sprawl sees sprawl as emerging from classic market failures in which households and firms do not receive all the benefits or incur all the costs of their locational decisions. For example, researchers estimate that the full social cost of vehicle travel could be as high as a dollar per mile (compared with total private costs of about 66 cents per mile). Similarly, private developers and new home buyers may not bear the full social costs of developing unused land, including building access roads, utility connections, and schools, and providing for police and fire protection. People might put a higher premium on reducing the amount of driving they do or making more intensive use of already developed land if they faced the full costs of sprawl.

Coordination and federalism issues. Appropriate government action can, in principle, bring private and social costs more closely into alignment. However, many of the market failures associated with sprawl cut across jurisdictions, and difficult coordination problems may stand in the way of effective government solutions. For example, open land in a particular community may provide substantial benefits to that community, but many of the environmental, recreational, and aesthetic services of open land accrue to people outside the community. Decisions about providing and maintaining mass transportation networks are probably best made by regional authorities that must coordinate among different local jurisdictions and sometimes different states.

One approach to addressing these coordination issues is to encourage more voluntary co-operation. Unfortunately, the incentives that give rise to uncoordinated sprawl in the first place are likely to work against the long-run success of such efforts. More formal regional arrangements have the advantage of spelling out responsibilities more clearly, but local governments may be reluctant to cede the necessary power to make them effective. The Federal government may have a role to play in encouraging the development of regional arrangements, and in some cases Federal regulations might be the appropriate policy response. But many of the policies thought to influence sprawl, in particular land-use planning, have traditionally been considered a state and local responsibility.

Conclusion. The economic approach to analyzing urban sprawl focuses on incentives and market failures arising from divergences between private and social costs and benefits. An economically efficient response to the challenges of sprawl requires ensuring that households and firms face the true costs of their actions. While government policies can be useful in this regard, the challenge of coordinating appropriate responses across political jurisdictions is substantial.

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

Beige Book Sees Economy Expanding at a Moderate Pace. Reports from Federal Reserve districts indicate that the economy continues to operate at generally strong levels and to expand at a moderate pace. Consumer spending remains healthy, led by strong motor vehicle sales. Most districts noted improvements in manufacturing activity; however, weak foreign demand is a problem for some industries in some regions. Both residential and commercial construction remain at high levels, although some slowing in the rate of expansion was noted in several districts. Reports on agriculture have been mixed, while the outlook in the energy sector has improved. Loan demand is generally described as strong in many areas of the country. Most districts continue to report tight labor markets, but these conditions are apparently not often translating into higher wages; however, there are reports that non-wage compensation is increasing. Prices generally remain stable, with the exception of oil and gas, and some building materials, which are in short supply.

Class Size Appears to Boost College Aspirations of STAR Pupils. Students in small classes in grades K-3 are more likely, on average, to take either the ACT or SAT in high school, according to new results from the Tennessee class-size experiment, Project STAR. The experiment, which began in 1985, assigned kindergarten students and teachers randomly to one of three types of classes: small (13-17 students), regular-size (22-25 students), and regular-size with a full-time teacher's aide. After 4 years, all students were returned to regular-size classes. Previous results showed that students assigned to small classes had higher standardized test scores in elementary school. The new results show that attending a smaller class in K-3 boosted the rate of taking the ACT or SAT in high school to 43.7 percent, compared with 40.0 percent for those who attended regular-size classes. Average test scores were the same for both groups. The effect of smaller classes was particularly strong for minorities: the probability of taking one of the tests was 40.2 percent for black students who had attended small classes, compared with 31.7 percent for blacks in regular-size classes. The gap between test-taking probabilities of blacks and whites was 13.3 percentage points for those who had been in regular-size classes but only 6.1 percentage points for those who had been in small classes.

Social Security Is Just That for the Elderly. Without Social Security income, the number of Americans living in poverty in 1997 would have been 15.3 million instead of the official figure of 3.8 million, according to a recent report from the Center for Budget and Policy Priorities. The study estimates that 48 percent of elderly Americans would have been poor in 1997 if they had not received any Social Security income. Of course, the existence of Social Security has affected people's work, saving, and family support decisions—and hence the amount of their non-Social Security income—so these results should not be interpreted as what would have happened with no Social Security program. Still, Social Security constituted at least 50 percent of the total income of more than half of all elderly people in 1997, and at least 90 percent of the income of one-fourth of them. It was more than half the income of two-thirds of elderly women and more than 90 percent for a third of them.

INTERNATIONAL ROUNDUP

Higher Oil Prices Could Boost Some Economies. Crude-oil futures prices continued their steady climb from December's 12-year low of $10.35 per barrel to reach $19 per barrel this week. Analysts have attributed the increase to reduced U.S. and European production, recent cutbacks by OPEC, and an anticipated economic recovery in Asia. Higher oil prices could be good news for several developing countries. Russia, Mexico, and Venezuela in particular have suffered low export revenues associated with low oil prices. Mexico, where oil accounts for one-third of all government revenues, had projected a price of just $9.25 per barrel in its 1999 budget but may see a revenue windfall—the price of Mexican crude recently topped $14 per barrel. The price increase should also provide relief to the U.S. oil belt, though as a net importer the United States tends to benefit from lower oil prices.

Crisis in Indonesia May Have Peaked. Indonesia's economy grew 1.3 percent in the first 3 months of 1999 compared with 1998's fourth quarter, marking the first quarterly expansion since the financial crisis began in 1997. Reaction to the news was mixed: some analysts saw the figure as evidence that the recession has bottomed out, while others noted that a lack of seasonal adjustment left it unclear whether the first quarter marked real growth. Although the first quarter's GDP marked a 10.3 percent contraction from 1 year ago, the government maintained its forecast that the economy will contract just 1 percent this year.

Malaysia's Capital Controls: Not as Bad as They Could Have Been. Although Malaysia's capital controls have been controversial since they were imposed in September 1998, IMF official Stanley Fischer offered a relatively kind assessment in an interview this week. Malaysia has avoided the most deleterious effects of capital controls, according to Fischer, because the controls were not used to shield the banking sector from urgently needed reform, as was feared when the controls were imposed. In fact, Fischer said, Malaysia has made significant progress in attacking problems in the financial sector and with corporate debt. He also noted that Malaysia has softened the reaction to the controls by indicating that they are a temporary measure and that the country will gradually return to the global financial markets.

EU Claims to Find Carcinogenic Effects of Beef Hormone. Citing a new report by its scientific committee, the European Commission this week hardened its stance in the ongoing beef-hormone dispute with the U.S. The Commission declared that "there can no longer be any question of lifting the ban" on hormone-treated beef in the wake of the study, which labels one of the six growth-promoting hormones fed to cattle in the United States as a "complete carcinogen" and describes the other five as suspect. The study did not establish threshold levels of exposure for any of the six hormones, nor did it quantify the risks associated with them. The USDA and the USTR issued a joint statement dismissing the study as a reiteration of the same arguments that the EU has already made and that the WTO has already rejected. Further European Commission-sponsored reports on beef hormones are anticipated.

EYES ONLY

RELEASES THIS WEEK

Employment and Unemployment

****Embargoed until 8:30 a.m., Friday, May 7, 1999****

In April, the unemployment rate was 4.3 percent; it was 4.2 percent in March. Nonfarm payroll employment rose by 234,000.

Leading Indicators

The composite index of leading indicators increased 0.1 percent in March, following an increase of 0.3 percent in February.

NAPM Report on Business

The Purchasing Managers' Index declined 1.5 percentage points to 52.8 percent in April. (A reading above 50 percent indicates that the manufacturing economy is generally expanding.)

MAJOR RELEASES NEXT WEEK

Productivity (Tuesday)
Producer Prices (Thursday)
Retail Sales (Thursday)
Industrial Production and Capacity Utilization (Friday)
Consumer 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	4.5
GDP chain-type price index	5.4	0.9	1.0	0.8	1.4
Nonfarm business (NFB) sector:					
Productivity (chain-type)	1.5	2.7	2.5	4.6	N.A.
Real compensation per hour:					
Using CPI	0.6	2.5	2.3	1.7	N.A.
Using NFB deflator	1.3	3.7	3.4	3.4	N.A.
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	10.8
Imports	9.2	13.0	12.9	13.1	13.1
Personal saving	5.2	0.3	0.1	-0.0	-0.4
Federal surplus	-2.7	0.9	1.1	0.8	N.A.

	1970-1993	1998	Feb. 1999	March 1999	April 1999
Unemployment Rate (percent)	6.7**	4.5**	4.4	4.2	**4.3**
Payroll employment (thousands)					
increase per month			**335**	**7**	**234**
increase since Jan. 1993					**18409**
Inflation (percent per period)					
CPI	5.8	1.6	0.1	0.2	N.A.
PPI-Finished goods	5.0	-0.1	-0.4	0.2	N.A.

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

New or revised data in **boldface**.
Employment and unemployment data **embargoed until 8:30 a.m., Friday, May 7, 1999.**

EYES ONLY

FINANCIAL STATISTICS

	1997	1998	March 1999	April 1999	May 6, 1999
Dow-Jones Industrial Average	7441	8626	9754	10444	10947
Interest Rates (percent per annum)					
3-month T-bill	5.06	4.78	4.44	4.29	4.49
10-year T-bond	6.35	5.26	5.23	5.18	5.52
Mortgage rate, 30-year fixed	7.60	6.94	7.04	6.92	7.02
Prime rate	8.44	8.35	7.75	7.75	7.75

INTERNATIONAL STATISTICS

Exchange Rates	**Current level May 6, 1999**	**Percent Change from Week ago**	**Percent Change from Year ago**
Euro (in U.S. dollars)	1.078	1.8	N.A.
Yen (per U.S. dollar)	120.8	1.3	-9.0
Major currencies index (Mar. 1973=100) (trade-weighted value of the U.S. $)	94.87	-0.7	-1.2

International Comparisons [1/]	**Real GDP growth** (percent change last 4 quarters)	**Unemployment rate** (percent)	**CPI inflation** (percent change in index last 12 months)
United States	4.0 (Q1)	**4.3** (Apr)	1.7 (Mar)
Canada	2.8 (Q4)	7.8 (Feb)	1.0 (Mar)
Japan	-3.0 (Q4)	4.7 (Feb)	-0.4 (Mar)
France	2.8 (Q4)	11.4 (Jan)	0.6 (Mar)
Germany	1.8 (Q4)	[2/] 7.2 (Feb)	0.4 (Mar)
Italy	0.9 (Q4)	12.3 (Jan)	1.3 (Mar)
United Kingdom	0.7 (Q1)	6.3 (Dec)	2.1 (Mar)

U.S. unemployment data **embargoed until 8:30 a.m., Friday, May 7, 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 February was 9.0 percent.

EYES ONLY

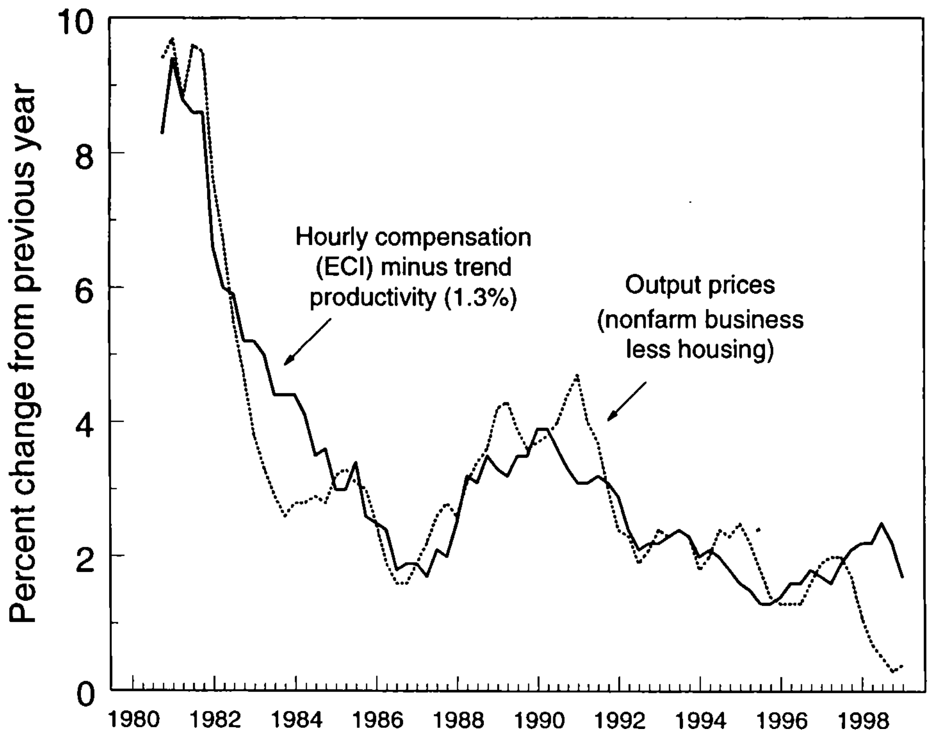
WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

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

April 30, 1999

CHART OF THE WEEK

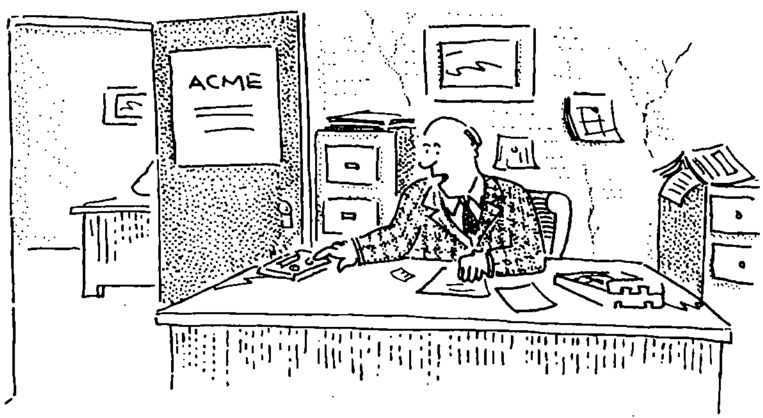
Inflation and Trend Unit Labor Costs



In the long run, the rate of business price inflation tends to gravitate toward the rate of increase in trend unit labor costs (measured in the chart using the employment cost index minus the estimated 1.3 percent trend rate of growth of productivity). Over the past year, however, a gap has existed between trend unit labor cost increases and price increases. Actual productivity growth has been strong recently, but unless trend productivity growth has risen substantially higher than 1.3 percent per year, the historical pattern suggests that some combination of higher inflation and slower wage growth will eventually narrow the gap between trend inflation and trend unit labor costs.

EYES ONLY

CONTENTS



"Miss Davis, bring me everything we've got on turning a two-bit hole-in-the-wall operation into a multinational juggernaut."

EYES ONLY

CURRENT DEVELOPMENT

GDP Scorecard: First Quarter 1999

Real GDP is estimated to have increased at a 4.5 percent annual rate in the first quarter of 1999, about the same as the average pace during the four quarters of 1998. Large gains in personal consumption, homebuilding, and computer investment were only partly offset by a decline in net exports. Inflation remained subdued, with the GDP price index up just 1.0 percent from the same quarter a year ago.

Component	Growth*	Comments
Total consumer expenditures	6.7%	Perhaps reflecting continued stock market gains, consumption exceeded income and the saving rate fell to -0.5 percent.
Producers' durable equipment	10.5%	Almost all of the growth was in computer-related equipment. Purchases of industrial equipment have been flat during the past year.
Nonresidential structures	-0.1%	Declines in oil-well drilling have held down this category during the past year.
Residential Investment	15.6%	The sixth consecutive quarter of large increases in homebuilding reflects gains in real income and a decline in mortgage rates during most of the past 2 years.
Inventories (change, billions of 1992 dollars)	$45.2	Stockbuilding is estimated to have been about the same pace as in the fourth quarter. Inventories remain lean with respect to sales.
Federal purchases	-0.7%	Federal purchases have been stagnant for several years.
State & local purchases	7.3%	The jump reflects a huge increase in highway construction that is probably partly weather-related but may also reflect the 1997 transportation legislation.
Exports	-7.7%	Exports of aircraft, which had taken off in the fourth quarter, fell back.
Imports	11.7%	Some of the strong demand for consumer goods and equipment investment was met with imports.

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

SPECIAL ANALYSIS

Measuring the Benefits of Educational Grants

From 1965 to 1985, the Social Security student benefit program helped millions of students pay for college. A new study evaluating the program indicates the potential benefits of this kind of aid.

The program. The Social Security student benefit program provided benefit payments to children of deceased, disabled, or retired Social Security beneficiaries. Open to 18 to 22 year-olds who were attending college full time, the program was far-reaching and generous.

- Reach. About 850,000 or one in every 10 college students aged 18 to 22 received aid from the program at its peak in 1977.
- Generosity. The average annual payment in 1980 was $5,200 (1997 dollars), compared with $1,700 for the average Pell Grant at the time.
- Scale. When Congress voted to eliminate the program in 1981, outlays were $3.3 billion. (The Pell Grant's $3.8 billion was the largest among college-related grant programs.)

Getting there and staying in. The new study confirms earlier research showing that aid encourages students to start college in the first place, rather than merely subsidizing those who are already college-bound. Indeed, the new study finds a particularly strong response. Whereas other studies found that a grant of $1,000 raised the probability of attending college by 2.5 to 4 percentage points, the new study finds an increase of 5 percentage points. The new study is also one of the first to find that grant aid increases the number of years of college that a student will complete. In particular, reducing schooling costs by 10 percent increased educational attainment by the same 10 percent. That is, a grant of $5,000 raised the average number of years completed by 1 full year.

Are the results too optimistic? One explanation for the study's relatively strong findings may be that the Social Security student benefits were not means-tested. Previous estimates based on means-tested programs, such as Pell Grants, show weaker effects of grant aid on college attendance rates, possibly because the low-income students targeted by those programs have larger non-financial barriers to starting college than the more random selection of students served by the Social Security program.

Yet there is still Hope. Another reason for the study's strong results may be the relative generosity of the Social Security benefits, suggesting that the extra financial aid provided by the Hope Scholarship program during the early years of college can help risk-averse or borrowing-constrained students overcome the potentially high fixed costs of starting college.

EYES ONLY

ARTICLE

A Changing Market for Corporate Control in Japan?

Although the market for foreign direct investment in Japan has long been officially open, as a practical matter it has been exceedingly difficult and rare for foreign investors to acquire significant ownership or control of Japanese enterprises. Recent developments offer hopeful signs that this could change if the Japanese are serious about restructuring their economy.

Past barriers. Typically, foreign firms making direct investments in Japan have entered on their own rather than through acquisition of domestic companies, even though acquisition would generally have provided major benefits such as local contacts and established distribution networks. Japanese securities laws that are unfriendly to foreign acquisitions have been partly responsible. Other barriers have been tied to the *keiretsu* system in which groups of firms have substantial cross-holdings of each others' stock, making it hard for an investor outside the *keiretsu*—whether foreign or domestic—to purchase controlling shares.

A merger boom (by Japanese standards). One sign that the times may be changing is an increase in corporate merger activity. In 1998, there were about 900 mergers in Japan. This number is minuscule compared with over 11,000 in the United States last year, but it is more than double the figure for 1993 and 35 percent more than that in 1997. Merger growth in Japan is significant because it indicates that corporate managers are more willing than in the past to respond meaningfully to economic forces. This would mark a change in a corporate culture that has been characterized as one of inaction, driven by face-saving, the suppression of bad news, and consensus requirements. It also suggests that the cross-ownership of firms is becoming a less stringent constraint on corporate restructuring. Nevertheless, the obstacles the *keiretsu* pose to mergers and foreign direct investment in Japan remain substantial. More than 40 percent of corporate stock is in the hands of other companies, often friendly banks or suppliers, making it difficult for significant shares to be purchased by an outsider. But the restructuring of Japan's banks and changes in Japanese securities laws that make them more amenable to merger activity may help to reduce the barriers posed by such cross-ownership relations.

Significant acquisitions by foreign firms. Two recent events provide further examples of a liberalizing corporate system in Japan. The most significant is Renault's purchase of a substantial (but not controlling) 36.8 percent of the Japanese car manufacturer Nissan. Such a stake by a foreign owner in one of Japan's major companies, and in one of its most important industries, would previously have been virtually unthinkable. During the global merger boom of the late 1980s, for example, Japanese companies acquired foreign ones by the hundreds, while foreign firms acquired an average of only about 20 Japanese firms per year. Also, for the first time, a Japanese firm trying to acquire another Japanese firm is in a high-profile battle with a foreign firm. This challenge from Cable and Wireless to Nippon Telephone and

Telegraph's effort to acquire International Digital Communications may be further evidence that the old rules are becoming less binding on Japan's corporate culture.

Less refuge for underperforming firms. A third harbinger of Japanese corporate restructuring may be a more tough-minded approach by parent companies towards weak subsidiaries. Press reports have cited plans by the new CEO of NEC to spin off unnecessary businesses and a statement by the new president of Hitachi that he plans to divide the enterprise into 10 companies, each of which must post profits or be closed. A new emphasis on profitability, as opposed to market share, has been driven by the heavy losses suffered by Japanese industry in the past 2 years. It also suggests that the market for corporate control is likely to become more active and more open.

Conclusion. The anecdotal evidence of more openness toward corporate restructuring and toward foreign participation in Japanese companies is suggestive but not conclusive. Whether the events described above are an anomaly or a trend remains to be seen. But so far, the signs of change are substantial and suggest that, as Japanese firms continue to face economic pressure, more reform at the firm, *keiretsu*, and regulatory levels will follow.

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

Clark Medal Awarded to Shleifer. Andrei Shleifer, a Harvard University economist who immigrated to the United States from Russia as a teenager, was chosen this week as the winner of the American Economic Association's John Bates Clark Medal. The prize, considered by many the most prestigious in economics short of the Nobel, is awarded every 2 years to an outstanding economist under 40 years old. Schleifer, 38, was honored for his research into corporate and institutional finance and economic growth, particularly in countries making the transition from socialism to a market economy. Much of his recent work has sought to explain how strong legal protection for investors helps to determine the long-term development of securities markets. Past winners of the Clark Medal include Deputy Secretary of the Treasury Lawrence Summers and former CEA Chair Joseph Stiglitz.

Census Reports on Child Support. Nearly 30 percent of children (22.8 million) lived with only one of their parents in April 1996, 85 percent of those with their mother, according to a new study from the Bureau of the Census. Almost 60 percent (8.0 million) of custodial parents had child support awards, and roughly seven of every 10 of these parents received at least a portion of the amount they were owed in 1995. Average child support received was $3,700, and total child support payments amounted to $17.8 billion of the $28.3 billion due in 1995. The number of custodial parents who received the full amount of child support owed to them increased from 2.3 million (34 percent) in 1993 to 2.7 million (39 percent) in 1995. Custodial parents who received none of the payments they were owed had a poverty rate of 32 percent, compared with a poverty rate of 22 percent for those who received at least some payment. Overall, noncustodial parents who owed child support were much more likely to have made payments if they had joint custody or visitation rights.

In-School Teacher Training Gets Good Grade. Extra in-service teacher training improved children's reading and mathematics achievement in a set of Jerusalem elementary schools, according to a recent study. The training, given to teachers in 10 schools beginning in 1995, was in pedagogy, not subject content, and was based on widely used pedagogical strategies developed in the United States. The study tracked students in these schools for a year and a half, while also tracking outcomes in schools that did not receive the extra training. By 1996, teachers in the "treatment" schools were receiving considerably more hours of training than in "control" schools: 11 more hours per week in math and 8 more hours in reading. The result, according to the study, was an improvement in test scores among students in the treatment schools. The study estimated that, at least in this case, teacher training (which cost $12,000 per class) provided a less costly means of increasing test scores than reducing class size or adding school hours.

INTERNATIONAL ROUNDUP

World Trade Growth to Hold Steady, at Best. World merchandise exports in 1999 will grow no faster than 1998's 3.5 percent, according to a new report from the World Trade Organization. In fact, for trade growth in 1999 even to match that of 1998, recovery in Asia would have to offset slowing output growth in Western Europe and the United States. The volume of world merchandise exports grew 10.5 percent in 1997 after averaging 6.0 percent growth from 1990 to 1995. The sharp reduction in 1998 largely reflected continued economic contraction in Asia. Performance differed widely by region: imports into Asia fell by 8.5 percent, while expanding by 7.5 percent in Western Europe and by 10 percent in North America, Latin America, and the transition economies. Export growth was strongest in the transition economies (10 percent) and Latin America (6.5 percent), while increasing only marginally in Asia. Western Europe's export growth was 4.5 percent, while North America's was 3.0 percent.

Prospects for the World's Poor May Be Declining. After a generation of falling poverty, rising longevity, and better health for millions of the world's poorest people, efforts to improve key areas of human development are in danger of stalling, according to the World Bank's latest annual compilation, *World Development Indicators*. Although strong growth in developing countries (5.3 percent per year from 1991 to 1997 in countries excluding the former Soviet Union) encouraged expectations that living standards would continue to rise around the world, those expectations have not been realized in crucial regions. In Sub-Saharan Africa, for example, hard-won increases in life expectancy have been wiped out by HIV/AIDS, while foreign aid levels are at their lowest level in 50 years. In Eastern Europe and the countries of the former Soviet Union, millions have seen their living standards deteriorate sharply during the difficult transition toward market economies. In East Asia, the fallout from the 1997 financial crisis will likely prevent the region from reducing poverty by half by 2015, as had been expected as recently as a year ago.

"Grease Money" May Just Mean More Sand in the Gears. Some political scientists and economists have noted that, under certain circumstances, corruption may improve economic efficiency. One theory holds that bribery allows firms to bypass excessive red tape; another describes how bribes could function like an auction, allowing better firms to buy less red tape. If the "efficient grease" hypothesis is correct, then efforts against corruption could be counterproductive. However, this conclusion assumes that the burden of red tape is independent of the existence of bribery and corruption. Recent research suggests, to the contrary, that red tape distortions may in fact be created by or aggravated by opportunities for bribery. One new study using firm-level data consistently finds a positive correlation between bribery and measures of official harassment. Furthermore, it finds no evidence to support the notion of "Asian exceptionalism"—that the official corruption which has long been part of Asian culture does not hamper business there. Indeed, it finds that bribery induces corruption to at least the same extent in Asia as in the rest of the world.

EYES ONLY

RELEASES THIS WEEK

Gross Domestic Product
****Embargoed until 8:30 a.m., Friday, April 30, 1999****

According to advance estimates, real gross domestic product grew at an annual rate of 4.5 percent in the first quarter.

Employment Cost Index

The employment cost index for private industry workers rose 3.0 percent for the 12-month period ending in March.

Advance Durable Orders

Advance estimates show that new orders for durable goods rose 2.0 percent in March, following a decrease of 3.9 percent in February.

Consumer Confidence

Consumer confidence, as measured by The Conference Board, rose 0.9 index point in April, to 134.9 (1985=100).

MAJOR RELEASES NEXT WEEK

NAPM Report on Business (Monday)
Leading Indicators (Tuesday)
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	**4.5**
GDP chain-type price index	5.4	0.9	1.0	0.8	**1.4**
Nonfarm business (NFB) sector:					
Productivity (chain-type)	1.5	2.7	2.5	4.6	N.A.
Real compensation per hour:					
Using CPI	0.6	2.5	2.3	1.7	N.A.
Using NFB deflator	1.3	3.7	3.4	3.4	N.A.
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	**10.8**
Imports	9.2	13.0	12.9	13.1	**13.1**
Personal saving	5.2	0.3	0.1	-0.0	**-0.4**
Federal surplus	-2.7	0.9	1.1	0.8	N.A.

	1970-1993	1998	Jan. 1999	Feb. 1999	March 1999
Unemployment Rate (percent)	6.7**	4.5**	4.3	4.4	4.2
Payroll employment (thousands)					
increase per month			217	297	46
increase since Jan. 1993					18176
Inflation (percent per period)					
CPI	5.8	1.6	0.1	0.1	0.2
PPI-Finished goods	5.0	-0.1	0.5	-0.4	0.2

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

New or revised data in **boldface**.
GDP and related data for 1999:1 **embargoed until 8:30 a.m., Friday, April 30, 1999**.

EYES ONLY

FINANCIAL STATISTICS

	1997	1998	Feb. 1999	March 1999	April 29, 1999
Dow-Jones Industrial Average	7441	8626	9323	9754	10878
Interest Rates (percent per annum)					
3-month T-bill	5.06	4.78	4.44	4.44	4.39
10-year T-bond	6.35	5.26	5.00	5.23	5.22
Mortgage rate, 30-year fixed	7.60	6.94	6.81	7.04	6.93
Prime rate	8.44	8.35	7.75	7.75	7.75

INTERNATIONAL STATISTICS

Exchange Rates	**Current level April 29, 1999**	**Percent Change from** Week ago	Year ago
Euro (in U.S. dollars)	1.059	-0.1	N.A.
Yen (per U.S. dollar)	119.3	-0.5	-9.7
Major currencies index (Mar. 1973=100) (trade-weighted value of the U.S. $)	95.51	-0.4	-0.9

International Comparisons [1]	**Real GDP growth** (percent change last 4 quarters)	**Unemployment rate** (percent)	**CPI inflation** (percent change in index last 12 months)
United States	**4.0** (Q1)	4.2 (Mar)	1.7 (Mar)
Canada	2.8 (Q4)	7.8 (Feb)	0.8 (Feb)
Japan	-3.0 (Q4)	4.7 (Feb)	-0.1 (Feb)
France	2.8 (Q4)	11.4 (Jan)	0.3 (Feb)
Germany	1.8 (Q4)	[2] 7.2 (Feb)	0.2 (Feb)
Italy	0.9 (Q4)	12.3 (Jan)	1.4 (Feb)
United Kingdom	0.7 (Q1)	6.3 (Dec)	2.1 (Feb)

U.S. GDP data **embargoed until 8:30 a.m., Friday, April 30, 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 February was 9.0 percent.

EYES ONLY

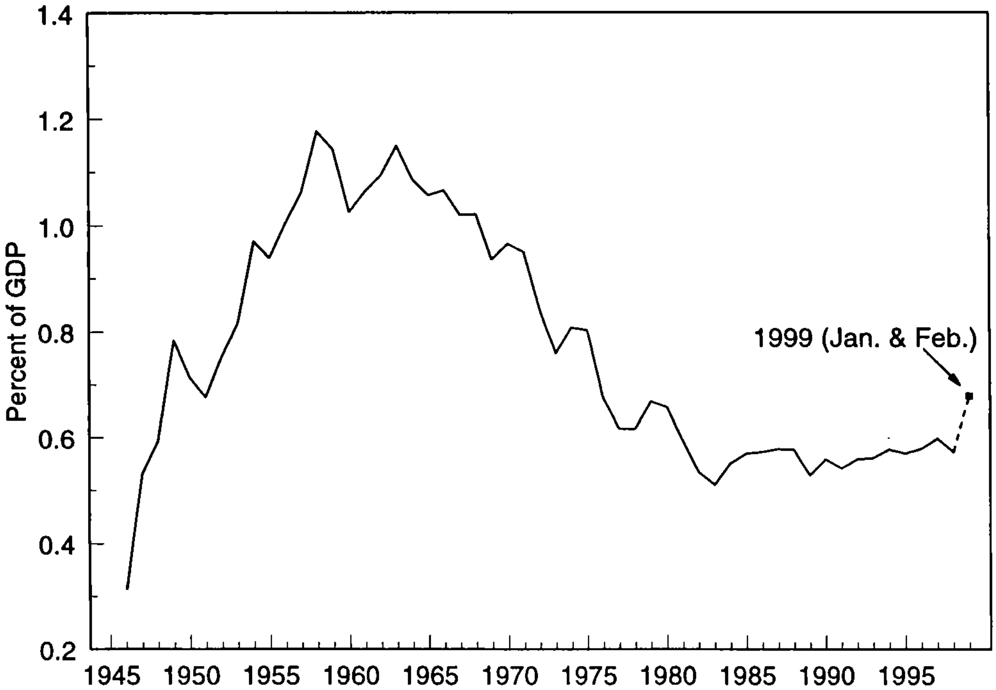
WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

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

April 23, 1999

CHART OF THE WEEK

Public Expenditure on Streets and Highways



Public expenditures on streets and highways jumped sharply in the first 2 months of 1999. Some of the increase appears to be due to unusually warm weather that allowed crews to work through the winter. In addition, state and local governments may be ramping up spending authorized in the 1997 transportation legislation. Even if the recent increase is sustained, however, this spending is much smaller as a share of GDP than it was when the country's highway infrastructure was being built in the 1950s and 1960s.

EYES ONLY

CONTENTS

EYES ONLY

TREND

CEO Pay: Rewarding Performance?

Business Week (BW) recently released its 49th annual compilation of executive compensation in 365 of the largest U.S. companies. In general, the findings are familiar: executive compensation is huge relative to that of the average worker and it has been growing rapidly, raising anew the question of whether such compensation levels make economic sense.

Trends in CEO pay. The average CEO in the *BW* survey received $10.6 million in 1998, 36 percent more than in 1997 and more than 5 times higher than in 1990. The highest paid executive, Disney's Michael Eisner, received almost $5.8 million in salary and bonus and almost $570 million in long-term compensation (mostly from exercising stock options). Interestingly, the average salary and bonus component of executive pay fell for the second year in a row, to $2.1 million, while the average value of long-term compensation (mainly exercised stock options) rose sharply. The average pay of the 47 executives cited in the first *BW* survey in 1950 was $217,000, or less than 100 times the average worker's pay. The comparable ratio in 1998 was over 400.

Analysis. In principle, current compensation packages with moderate base pay and extensive use of stock options could provide the right incentives for CEOs to act in the best interests of shareholders and maximize the value of the company. Thus, the trend toward increasing reliance on options should be an encouraging trend. In practice, however, boards of directors may not act as adequate watchdogs for the interests of shareholders and may compensate executives excessively. Skeptics argue that actual compensation packages may have weak performance incentives due to factors like repricing of options when the company's stock falls in value, generous severance packages, and the ability of executives to cash out their company stock. The fact that option values are rarely indexed to general market performance (which would make them valuable only when the company's stock outperforms a relevant index) is offered as further evidence that the link between pay and performance remains weak even as options grow in importance.

Evidence. Several studies have found only a modest link between company performance and CEO pay. A typical result is that a CEO whose company achieved a 20 percent rate of return would, other things equal, be paid only about 1 to 1½ percent more than one whose company achieved only a 10 percent return. But these studies typically look at *current compensation.* A recent study that tracks changes in executives' *wealth* over time (including changes in the value of holdings of company stock and unexercised stock options) finds a much closer correlation between company performance and executive compensation. While such a finding does not prove that compensation packages are ideally structured, it does call into question claims that they are wildly inefficient because they do not link pay to performance.

SPECIAL ANALYSIS

The Forest or the Trees?

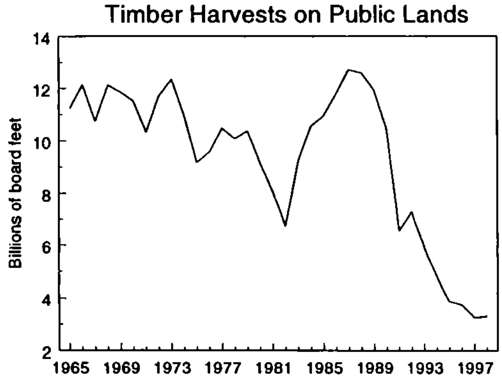
Recent policy debates over the Headwaters Forest in California and the Tongass National Forest in Alaska illustrate the need to reconcile competing visions of what makes forests valuable. Are they mainly commercial properties or are they more important as environmental systems with inherent value beyond their timber content?

Trees as capital. A traditional view in forestry is that the forest is a tree farm, with the unique feature that trees are very slow growing and are harvested only after decades of growth. Deciding when to harvest involves balancing the increased timber volume from letting the trees grow another year against the interest cost of waiting another year to receive the revenue and plant the next crop of trees.

The forest as capital. Increasingly, however, forests have come to be viewed as more than just tree farms. Standing forests produce valuable environmental services, such as habitat for endangered species, clean water, and carbon sequestration. They also provide recreational opportunities and scenic beauty. Taking these benefits of a standing forest into account shifts the optimal harvesting decision towards waiting longer or perhaps not harvesting at all.

Balancing the forest and the trees. Policymakers hoping to achieve an optimal balancing of the value of harvesting timber and the value of standing forests face a number of practical difficulties. First, private landowners generally do not appropriate much of the benefits of a standing forest, and without public policy intervention their decisions will mainly reflect the private benefits and costs of harvesting timber. Second, even on public lands, policies like below-cost timber sales conflict with the objective of recognizing the benefits of a standing forest. Third, valuation is problematical. While it is relatively straightforward to estimate the value of timber, economic valuation techniques are pushed to their limit (or beyond) when trying to answer questions like what is the value of preserving old growth redwoods in the Headwaters Forest or what is the value of preserving habitat for the spotted owl. Even when non-market valuation studies have been made, different interest groups may not agree that the resulting estimates of value are objective or accurate.

Timber Harvests on Public Lands



Division of labor. Faced with these difficulties, the United States seems to be moving toward specialization, with forests on public lands providing environmental services and forests on private land providing timber. While total U.S. domestic timber production has continued to grow, timber harvests from public lands have fallen dramatically over the past 10 years, from 12.6 billion board feet in 1988 to just 3.3 billion board feet in 1998 (see chart on previous page). Consistent with this trend, the Forest Service announced last week that it will put 234,000 acres of Alaska's Tongass National Forest in protected status and increase rotation times from 100 to 200 years on nearly half of the land that may be harvested.

Implications. Balancing the value of timber harvests against the value of standing forest is challenging. Management improvements can be made on public lands, for example, by eliminating below-cost timber harvests that are environmentally and economically harmful. Public policy intervention may also be necessary to protect forests on private lands that provide large environmental benefits. For example, the preservation of 10,000 acres of the Headwaters Forest was deemed to be sufficiently important to justify their purchase for $480 million. Another possible approach is to exchange public and private lands of equal commercial value in order to put the more environmentally valuable property under public management.

EYES ONLY

ARTICLE

Giving New Hope to the Working Poor

The New Hope Project—a voluntary, work-based anti-poverty initiative conducted in Milwaukee from 1994 to 1998—used a unique combination of benefits to ensure that a person who worked full time would not be poor. Recently released 2-year results show that New Hope modestly increased participants' employment, reduced poverty, and may have improved their children's classroom behavior.

The New Hope model. New Hope had unusually broad eligibility rules, extending to any adult with income at or below 150 percent of the poverty line who was willing to work full time. The program consisted of close to 700 participants and an equal number of control group members (the program was independently evaluated using a classical, random-assignment design). By working at least 30 hours per week, participants were eligible for the following benefits:

- Earnings supplement. Monthly supplements, designed to complement state and Federal EITCs, raised family incomes of most full-time workers to the poverty line.

- Affordable health insurance. Low-cost health insurance, with a co-payment based on income, was available to those unable to obtain other coverage.

- Child care. Participants were allowed to find their own licensed child care. Most of the costs were subsidized, subject to a co-payment based on income.

- Short-term community service jobs (CSJs). Participants unable to find full-time work could apply for paid community service jobs with nonprofit organizations. With satisfactory attendance and job performance, participants could hold CSJs for a total of 12 months, though after 6 consecutive months in any one CSJ, a participant was required to look for a private sector job.

Concentrated earnings and employment gains. The effects of New Hope on earnings and employment differed according to whether or not participants were working full time when they entered the program.

- Positive impacts on those who were not working full time. Participants who were not working full time when they entered the program had better employment and earnings outcomes than comparable members of the control group. A smaller proportion never worked during the entire 2 years of the study (6 percent compared with 13 percent in the control group). Participants' earnings were about $1,400 (13 percent) higher and their overall income (including things like the earnings supplement, welfare payments, and the EITC) was about $2,650 (also 13 percent) greater. CSJs appear to have been an important contributor to the positive impact on employment and earnings.

- Little impact on those who were already working full time. Average employment and earnings did not increase among those who were already working full time when they entered New Hope. In fact, these participants reduced their work hours somewhat, mostly by cutting back on overtime and second jobs. Tentative survey evidence does, however, show an increase in parental monitoring, possibly because these participants were better able to balance work and family life. Also, New Hope participants who were working full time when they entered the program had 30 percent lower welfare payments (AFDC/TANF and Food Stamps) than comparable members of the control group in the second year.

Other key results. Although New Hope did not raise employment and earnings for all groups, it did boost the resources available to all participants through its provision of affordable child care and health insurance. In addition, about 60 percent of CSJ users found unsubsidized employment following their CSJ. New Hope's experience with CSJs provides encouraging evidence that such a subsidized employment program can be operated successfully, at least on this scale. Finally, there is some indication that the program improved boys' classroom behavior, school performance, and social competence.

Conclusion. New Hope's appeal lay in its balanced mix of supports and requirements and its premise that working people should not be poor. While the magnitudes of the results are somewhat disappointing, it is important to recognize that employment rates in the control group were almost surely being raised at the same time by the Wisconsin Works (W-2) program (and its precursor), which required work and work-related activities of every welfare recipient.

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

SBA Reports on Minorities in Business. In 1997, an estimated 3¼ million minority-owned businesses in the United States generated almost $500 billion in revenues and employed nearly 4 million workers, according to a new study by the Small Business Administration. About 1.4 million of these firms were Hispanic-owned (up 232 percent from 1987 levels), about 1.1 million were Asian-owned (up 180 percent), and about 900,000 were black-owned (up 108 percent). Substantial differences were evident among the three groups in average revenue per business. Although they represented just one-third of all minority-owned businesses, Asian-owned businesses accounted for 56 percent of revenues generated by these businesses in 1997; in contrast, black-owned businesses accounted for 27 percent of the businesses but just 12 percent of the revenues. These differences reflect disparate growth over the previous decade, as real revenues for Asian- and Hispanic-owned businesses increased by over 400 percent, while those of black-owned businesses rose by just over 100 percent.

Philip Morris Ships Fewer Cigarettes but Increases Its Market Share. In November, cigarette makers raised prices about 45 cents per pack to finance the settlement of tobacco-related health claims with the states. This week, Philip Morris (PM) and RJR Nabisco reported declining shipments and lower profits on domestic tobacco sales in the first quarter. PM shipped 9.6 percent fewer cigarettes than in the first quarter of 1998—slightly less than the overall industry decline of 9.7 percent—while RJR saw shipments fall 14 percent. Profits on domestic tobacco sales fell 7.3 percent at PM and 19 percent at RJR. At the retail level, PM increased its market share to almost 54 percent while RJR's fell below 25 percent. Shipments of PM's Marlboro, the top-selling brand, declined just 4.6 percent and their market share rose 2.2 percentage points to 38.8 percent of retail sales. International profits were up 0.9 percent at PM despite an 11.2 percent decline in shipments, but RJR suffered a 31 percent decline on its international tobacco business, which it is planning to sell.

Do Higher Salaries Buy Better Teachers? Teacher salaries have only a modest impact on teacher mobility (decisions to change schools) and on student performance, according to a recent study using data for 1993 to 1996 from the University of Texas' Texas Schools Project. These data include teacher salaries, measures of teacher quality, and measures of student achievement. The study finds that teacher mobility is more affected by characteristics of students (income, race, and achievement) than by salary schedules. Also, teachers' salaries appear to be only weakly related to their performance on certification tests, which some evidence suggests are not an accurate measure of teacher quality in any case. The study's results are consistent with previous findings that teacher quality is more variable within schools (and thus within school districts) than among schools, suggesting that school and district-wide factors such as compensation may play only a minor role in determining teacher quality. The study concludes that salary policies, at least as currently implemented, do not offer much promise for improving student performance.

EYES ONLY

INTERNATIONAL ROUNDUP

IMF Breathes Easier over the State of the World Economy. For the first time since the beginning of the Asian financial crisis, the IMF has revised upward its forecast for world economic growth in 1999. Nevertheless, the newly released *World Economic Outlook* predicts that the world economy will expand by just 2.3 percent this year and 3.4 percent in 2000. This projected 1999 growth rate would still be the slowest since the last global slowdown in 1991. The Fund warns that the outlook for the world economy depends in part on whether the United States can move to more moderate growth rates without suffering a "hard landing" from increased inflation, a significant stock market correction, or a drop in domestic demand. It notes that world economic recovery would also be threatened if fiscal conditions in emerging market countries do not improve, if recent weakening of growth in the euro area is more than just transitory, or if Japan's recession worsens.

World Bank Study Warns of Increasing Poverty in Russia. Up to a fifth of Russians may be living in extreme poverty by next year as the effects of last year's financial crisis take their full effect on growth and household incomes, according to a forthcoming World Bank study. The study projects that Russia's economy will contract by 8.3 percent (significantly more than in other organizations' forecasts). Under one set of assumptions the number of people in extreme poverty would rise 29 percent above its 1996 baseline level. (Extreme poverty is defined as consumption less than half the official subsistence minimum.) Under a different set of assumptions, in which the poor bear disproportionately less of the burden of contraction, the number of people living in extreme poverty still rises by 14 percent. The report suggests that the worst-affected Russians will be families with many children, particularly those living in small towns and rural areas.

Ratings Agency Warns of Stress on Global Financial Systems. A growing number of countries' financial systems are showing deteriorating credit quality in the face of excessive credit growth, weakening external funding profiles, and falling asset prices, according to a new study by Standard and Poor's. Of the 61 economies regularly monitored by S&P, deteriorating credit quality was observed in 24. Visible signs of weakness are already evident in nine economies (those of China, Colombia, the Czech Republic, Hong Kong, Japan, Malaysia, the Philippines, Romania and the Slovak Republic), while the others (which include Brazil and the United States) were described as vulnerable in the event of a reasonable worst-case slowdown.

Taiwan Gives U.S. Firm a Taste of Its Own Medicine. Although Taiwan has long been the target of dumping accusations, the island's semiconductor industry has recently turned the tables, charging a U.S. firm with selling chips below cost. According to press reports, the Taiwanese government is investigating the complaint against Micron Technologies, which last year won a similar action against Taiwanese companies in the United States and which has another case pending.

EYES ONLY

RELEASES THIS WEEK

U.S. International Trade in Goods and Services

The goods and services trade deficit was $19.4 billion in February; it was $16.8 billion in January.

MAJOR RELEASES NEXT WEEK

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

EYES ONLY

U.S. ECONOMIC STATISTICS

	1970-1993	1998	1998:2	1998:3	1998:4
Percent growth (annual rate)					
Real GDP (chain-type)	2.7	4.3	1.8	3.7	6.0
GDP chain-type price index	5.4	0.9	0.9	1.0	0.8
Nonfarm business (NFB) sector:					
Productivity (chain-type)	1.5	2.7	0.3	2.5	4.6
Real compensation per hour:					
Using CPI	0.6	2.5	2.2	2.3	1.7
Using NFB deflator	1.3	3.7	3.5	3.4	3.4
Shares of Nominal GDP (percent)					
Business fixed investment	10.9	11.0	11.2	10.9	11.0
Residential investment	4.5	4.3	4.3	4.4	4.5
Exports	8.2	11.3	11.3	11.0	11.3
Imports	9.2	13.0	13.1	12.9	13.1
Personal saving	5.2	0.3	0.3	0.1	-0.0
Federal surplus	-2.7	0.9	0.9	1.1	0.8

	1970-1993	1998	Jan. 1999	Feb. 1999	March 1999
Unemployment Rate (percent)	6.7**	4.5**	4.3	4.4	4.2
Payroll employment (thousands)					
increase per month			217	297	46
increase since Jan. 1993					18176
Inflation (percent per period)					
CPI	5.8	1.6	0.1	0.1	0.2
PPI-Finished goods	5.0	-0.1	0.5	-0.4	0.2

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

EYES ONLY

FINANCIAL STATISTICS

	1997	1998	Feb. 1999	March 1999	April 22, 1999
Dow-Jones Industrial Average	7441	8626	9323	9754	10727
Interest Rates (percent per annum)					
3-month T-bill	5.06	4.78	4.44	4.44	4.28
10-year T-bond	6.35	5.26	5.00	5.23	5.25
Mortgage rate, 30-year fixed	7.60	6.94	6.81	7.04	6.88
Prime rate	8.44	8.35	7.75	7.75	7.75

INTERNATIONAL STATISTICS

Exchange Rates	**Current level April 22, 1999**	**Percent Change from** Week ago	Year ago
Euro (in U.S. dollars)	1.060	-1.1	N.A.
Yen (per U.S. dollar)	119.8	0.7	-8.4
Major currencies index (Mar. 1973=100) (trade-weighted value of the U.S. $)	95.89	0.3	-0.0

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	4.3 (Q4)	4.2 (Mar)	1.7 (Mar)
Canada	2.8 (Q4)	7.8 (Feb)	0.8 (Feb)
Japan	-3.0 (Q4)	4.7 (Feb)	-0.1 (Feb)
France	2.8 (Q4)	11.4 (Jan)	0.3 (Feb)
Germany	1.8 (Q4)	2/ 7.2 (Feb)	0.2 (Feb)
Italy	0.9 (Q4)	12.3 (Jan)	1.4 (Feb)
United Kingdom	1.1 (Q4)	6.3 (Dec)	2.1 (Feb)

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 February was 9.0 percent.

EYES ONLY

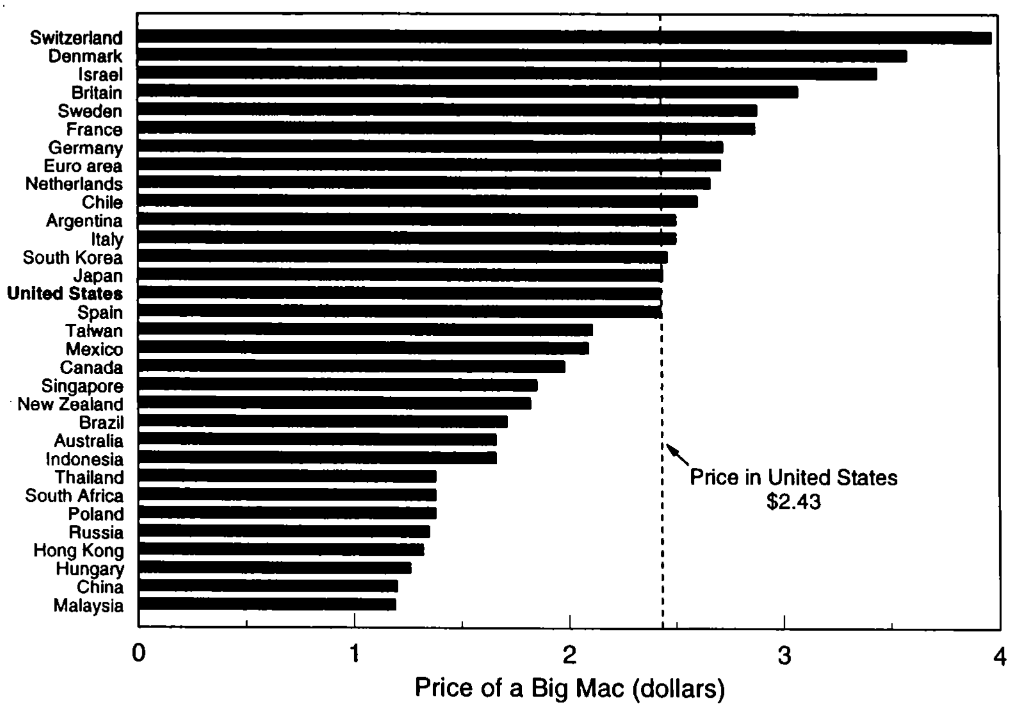
WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

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

April 9, 1999

CHART OF THE WEEK

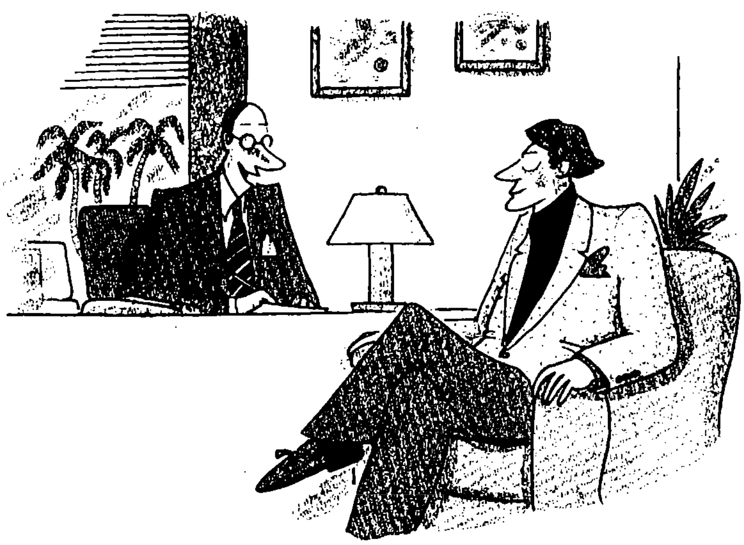
The 1999 Big Mac Index



The Big Mac index was devised 13 years ago by *The Economist* as a tongue-in-cheek test of whether exchange rates are "correct." The concept of purchasing power parity (PPP) says that exchange rates tend to move in the long run so as to equalize the prices of identical market baskets of goods across countries. According to this cheesy one-good index, the euro is overvalued relative to the dollar, while many Asian currencies are undervalued. Critics beef that PPP is a poor predictor of exchange rate movements.

EYES ONLY

CONTENTS



"There're no business deductions like show-business deductions."

EYES ONLY

CURRENT DEVELOPMENT

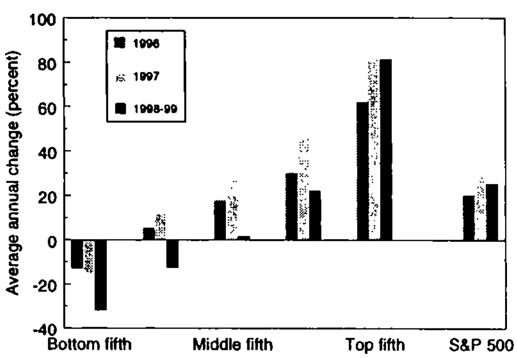
Is It Getting Harder to Pick Winners in the Stock Market?

As discussed in last week's financial market update, gains in the stock market are increasingly concentrated in a relatively small group of companies. As a result, the most successful stocks have outpaced the least successful stocks by a much wider margin in the past year or so than during the previous several years.

Indexes and individual stocks. Perhaps surprisingly, stock indexes can rise sharply even if most individual stocks in the index perform badly. This can happen in two ways. First, the larger companies' stocks may do well; because the S&P 500 weights stocks by their market value, the biggest 50 companies have more influence on the index than the remaining 450. Second, some companies' stocks may increase by exceptional amounts, offsetting much smaller increases or decreases by other stocks. Both of these effects have been at work recently.

How many stocks are winners? The growth rate of the S&P 500 index was similar in 1996, 1997, and (on an annualized basis) for 1998 through the first quarter of this year. But many more stocks have experienced losses over the last five quarters than previously (see chart). The difference has been especially striking this year: while the index as a whole was up 4.6 percent in the first quarter, about half of the stocks in the index actually declined over that period. Bigger stocks enjoyed significantly higher returns on average than smaller stocks. And of the 100 top-performing S&P 500 stocks in the first quarter, a third were either technology or communications stocks—though these stocks make up less than a sixth of the index. Companies involved with the Internet and the Web appear to have done especially well, although many of these are startup companies and not in the S&P 500.

Distribution of Price Changes in S&P 500 Stocks

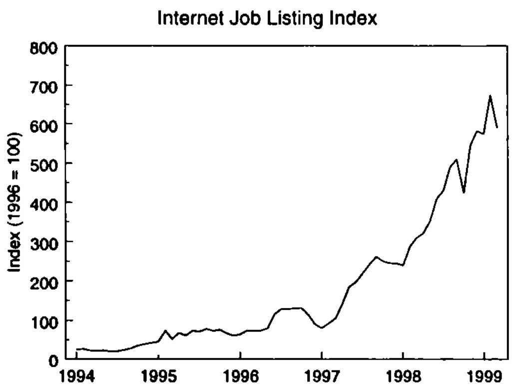


Implications. The growing disparity in stock performance may be felt at both the household and aggregate levels. Many owners of stocks or mutual funds may have lost money recently, as price gains accrued disproportionately to holders of technology stocks. Trying to "beat the market" by picking individual stocks is riskier if most stocks are doing badly. Indeed, the relatively poor first-quarter performance of many stock mutual funds may fuel the growing popularity of index funds. On the macroeconomic side, large gains within a narrow band of stocks may be more easily erased than moderate gains across a wider array, suggesting an aspect of fragility in the recent bull market.

SPECIAL ANALYSIS

Employment Online?

The Internet is not just a place to shop for books, music, airline tickets, or other consumer goods. It is also a burgeoning job market, with several job-posting sites and rapidly rising activity. At this stage, however, much of the information about usage is impressionistic and less well-developed than official job market data.



Explosive growth in listings. An index of Internet job listings (based on the JobOptions site, with offerings recently from about 11,000 companies) shows explosive growth since 1994 (see chart). For example, this index rose 90 percent in the last 12 months. To date, however, no one has compiled a comprehensive index based on multiple sites.

Are they a hit? Nearly all of the larger job-search sites were listed in a study that tried to identify the 500 Web sites attracting the largest numbers of "unique" visitors (that is, correcting for multiple hits by the same person). A survey in 1998 by the American Management Association found that only 13 percent of human resource managers had used online recruiting prior to January 1997, but that usage had swelled to 59 percent at the time of the survey, with an additional 13 percent expected to implement online recruiting by year-end. Increases in Internet usage since January 1997 have been over four times larger than those for any other recruiting medium.

DOL on AOL. The largest Internet job bank is run by the Department of Labor, which currently displays close to a million jobs and receives between 15 and 20 million hits per week. Usage is free, and services include America's Learning Exchange (which lists courses, seminars, and training programs); America's Talent Bank (which allows job hunters to create an electronic resume in a national database that can be searched by employers); America's Job Bank (which contains all employer-posted job listings); and America's Career InfoNet (which contains details on the job outlook for particular occupations and for individuals based on education).

Commercial sites. Some common job-search sites, containing between 150,000 and 350,000 job listings, also provide career advice and information and allow searchers to post resumes for free. Among these sites, Monster and CareerMosaic charge employers approximately $200 per job listing, CareerPath posts newspaper classifieds online, and HeadHunter is free.

Implications. Increased use of Internet job listings could lead to better job matching and reduced frictional unemployment—phenomena that probably have played a role in allowing the unemployment rate to reach such low levels in this expansion.

EYES ONLY

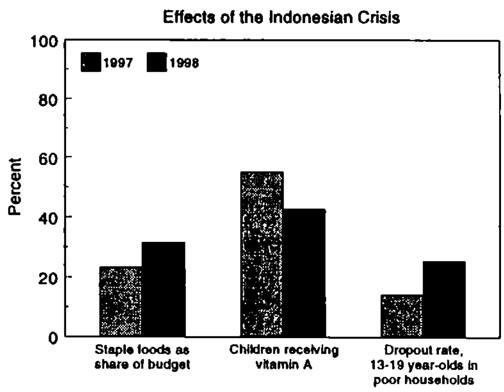
SPECIAL ANALYSIS

The Human Costs of the Asian Crisis in Indonesia

Since the outbreak of the Asian crisis in the summer of 1997, Indonesia has experienced both economic and political turmoil. An on-going longitudinal study of individuals, households, and communities documents the human costs. Interviews took place in the second half of 1997 (in the earliest stages of the crisis) and the second half of 1998 (after some of the most severe impacts had been experienced).

Income, poverty, and food expenditures. Real incomes collapsed between the two surveys, with the purchasing power of the average Indonesian falling by 25 percent. The share of Indonesian households in poverty rose from 11 percent to between 14 and 20 percent (depending on inflation assumptions). Although quite substantial, this increase was far smaller than the five-fold increase claimed by the Indonesian government.

A sharp increase in food prices is the most salient change affecting individual well-being, with almost 60 percent of those surveyed in 1998 reporting that they had been made significantly worse off by the rising price of rice. This large increase in food prices caused the share of the household budget spent on food, particularly staples like rice, to rise (see chart). In 1998, about one-quarter of households reported that they had recently taken advantage of programs distributing food at subsidized prices launched by the Indonesian government and international NGOs. However, the study argues that the subsidies need to be better targeted to the neediest households.



Health status and use of health care. While food shares increased, spending on health and education declined, especially among the poorest households. Use of primary preventive health care services by children declined sharply. For example, children's use of outpatient services fell by 38 percent, and the proportion receiving Vitamin A, which reduces children's vulnerability to infectious disease, dropped by 22 percent. Thus far, there is little evidence of significant effects on physical health status, which is likely to be fairly resilient in the short term. Some evidence suggests, however, that nutritional status among the poorest Indonesians may have worsened.

Education. Among 13- to 19-year olds, drop-out rates increased substantially in both rural and urban areas and across all income levels. Reduced enrollment among 7- to 12-year olds was concentrated in the poorest households. Prior to the crisis, Indonesia had achieved near-universal enrollment in primary school; today 1 out of every 10 children aged 7 to 12 in poor households is not in school.

Conclusion. The study provides evidence confirming that Indonesia's recent troubles have carried a high human cost, although poverty rates have risen by far less than the initial projections of the Indonesian government. Few people in Indonesia have been left untouched by the crisis, but children in the poorest households are the most likely to be affected in the long run as these households cut back on investments in education and health.

ARTICLE

Can Japan Keep Inequality at Bay?

How will Japanese workers fare as the country moves toward greater deregulation and other structural reforms? Some clues may be found by examining how employment practices specific to Japan, as well as globalization and domestic protection more generally, affected income distribution in the early 1990s.

Is a falling tide lowering all boats? In contrast to the United States, where the past two decades have seen rising inequality between high-skilled and low-skilled workers, Japan's economic problems during the early 1990s seem to have *reduced* inequality—or at least slowed its growth relative to the 1980s. The wage premium received by college graduates rose to nearly 50 percent relative to high school graduates during the 1980s but decreased slightly during the early 1990s. After growing in the 1980s, overall wage dispersion has become more compressed, both among industries and among individuals, and the Gini coefficient measuring inequality in household income among workers has subsided somewhat.

Stuck in middle management. One reason for this unusual phenomenon is Japan's convention of lifetime employment, along with its seniority-based pay scale. Japanese firms are expected to retain excess labor during a recession, and a firm that cannot lay off workers may choose to control costs instead by slowing the pace of promotions or of new hires. One observer finds lower odds for promotion among middle-aged managers in the 1990s relative to the 1980s, suggesting a slowing of pay increases for senior, college-educated workers.

Above and below, wages have nowhere to go. Meanwhile, a glut of new college graduates relative to employer demand has depressed the wages of college graduates at the entry level. A government survey found a placement rate for new graduates in 1998 of just under two-thirds—the lowest rate since 1951. Another survey found that over one-third of Japanese firms had frozen their starting salaries for new graduates between 1997 and 1998. At the same time, Japan's job market exhibits a "downward price rigidity" that prevents wage declines for unskilled workers at the lower end of the distribution. Together, these restrictions at the two ends of the pay scale may help compress the wage distribution.

Does globalization matter? Although globalization has been one of several forces driving income inequality in the United States, it seems to affect the Japanese labor market differently. Whereas American wages in tradable goods sectors (such as manufacturing) are generally high compared with wages in sectors less subject to international competition, the reverse appears to be true in Japan. One study finds that the shares of exports and imports in a given industry are negatively correlated with industry-specific wage premiums (the difference between actual wages and predicted wages based on workers' educational level, size of firm, and other background factors). Industries with substantial exports or imports, such as steel, metal products, and machinery, are generally characterized by low or negative wage premiums. Almost all positive wage premiums occur in domestically oriented industries—mainly those that are highly regulated (such as banking and insurance and public utilities) or highly unionized (such as public utilities, communications, and public services).

Implications. Many in Japan are apprehensive about changes in labor market practices associated with deregulation and other structural reform. The evidence suggests why, as there are likely to be many winners and losers. First, adjusting to the market will be disruptive to workers who benefit from lifetime employment arrangements and seniority-based wages. At the same time, however, greater openness to international competition should increase the demand for skilled workers in internationally competitive industries. Finally, if Japan is serious about deregulation, unionized and regulated sectors are likely to face particularly painful adjustment.

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

Grading the States. A new study by Syracuse University's Maxwell School and *Governing* magazine used in-depth surveys and interviews to evaluate state governments on financial management, capital management, human resources, managing for results, and information technology. The study found that many states may not fit the common wisdom about them; Kentucky's managerial reforms earned it good grades; Connecticut lags in its use of computers; Louisiana's government is a pioneer in the use of performance measures; Wisconsin seems less prepared than others for unforseen economic downturns; and West Virginia received high marks for financial reporting. The average state grade for financial management was a B. Encouragingly, some states are giving agencies more flexibility in their financial affairs, and legislatures are requesting and receiving more information about the future cost of current programs. Overall, states earned a B- for capital management, where insufficient funding for regular maintenance of structures is the biggest problem. The average grade was also a B- for human resources. Reform has been slow, but many states have removed the most constrictive elements of civil service codes, eased the hiring process, and reduced the number of job classifications. Although a growing number of states have begun experimenting in strategic planning, performance measurement, bench marking, and performance-based budgeting, the average grade for managing for results was a C+. States also received a C+ for information technology. Most states now have some kind of strategic IT planing process, but the quality varies.

Regulations Credited with Boosting Air Quality and Home Values. A recent study finds that the 1970 and 1977 Clean Air Act Amendments had positive impacts on both pollution and housing prices. The study uses property value data combined with EPA assessments (from 1970 to 1990) on whether a county was in attainment with federally determined air quality standards. It finds that much of the observed differences across counties in achieving reductions in suspended particulates can be attributed to differences in regulatory pressure. (Counties that were not in attainment faced greater Federal regulatory oversight.) Also, the regulations appear to have increased home values: housing prices in regulated, non-attainment counties rose by about 5 percent more in the 1970s and 4 percent more in the 1980s than housing prices in non-regulated counties, after controlling for changes in population density and other socio-economic characteristics of counties. According to one estimate, this translated into gains of $80 billion in the 1970s and $50 billion in the 1980s for homeowners in regulated counties.

INTERNATIONAL ROUNDUP

EIA Projects Slower Growth in Global Carbon Dioxide Emissions. The annual international energy forecast recently released by the Energy Information Administration contains projections of energy consumption and related carbon dioxide emissions through 2020, assuming no new policies, such as the Kyoto Protocol, are implemented. Global energy consumption is projected to be 4 percent lower than forecast last year, primarily because of slower economic growth in Russia and Asia. Emissions in 2010 from Eastern European and Former Soviet Union countries are expected to be nearly 30 percent below their Kyoto targets, and below previous forecasts. The forecast for carbon dioxide emissions for Japan and the European Union was reduced as well. While developing countries are projected to have slower emissions growth than previously forecast, their emissions are still expected to surpass industrialized countries' emissions by 2015. Further, China's carbon emissions are projected to surpass U.S. emissions in about 20 years. The slower emissions growth in industrialized countries could reduce the costs of complying with emissions targets established in the Kyoto Protocol.

World Bank Sees Slow Growth in Developing Countries. Although the risk of deep global recession has receded in recent months, depressed world trade and falling commodity prices will prolong the crisis in emerging markets, according to the new *Global Finance Development 1999* report from the World Bank. Compared with its December forecast, the Bank's growth forecast for developing countries in 1999 has been revised downward by 1 percentage point to 1.5 percent, the lowest rate since 1982. For developing countries as a group, a return to trend growth in the 4½ to 5 percent range is unlikely before 2001. The Bank noted that net private capital flows to the developing world dropped to $227 billion in 1998 from $299 billion in 1997. This decline was concentrated in loans and portfolio flows, while foreign direct investment (FDI) was relatively resilient. However, the Bank warned that FDI in developing countries is likely to slow over the next 2 years, in response to a slowing of world output and reduced corporate earnings in source countries. Nevertheless, as corporate restructuring accelerates, FDI flows to Asian crisis countries should pick up, and FDI is likely to remain the largest source of finance for developing countries in the foreseeable future.

Palestine Hopes to Offer First Bonds. The Palestinian Authority is currently projecting a budget deficit that it hopes to finance with the first Palestinian bonds, according to recent remarks to the press by the Authority's financial affairs chief. Thus far, the Authority's ambiguous status has prevented it from raising money in the sovereign debt market. The finance official said that foreign governments were prepared to provide backing for Palestinian bonds, although he did not name which. He also claimed that the size and pricing of the bond issue is being negotiated with major investment banks prepared to serve as underwriters, and that the bonds could be issued as early as June. A serious question remains, however, as to whether these bonds could indeed find a market.

EYES ONLY

RELEASES THIS WEEK

Producer Price Index

****Embargoed until 8:30 a.m., Friday, April 9, 1999****

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

Leading Indicators

The composite index of leading indicators increased 0.2 percent in February, following an increase of 0.5 percent in January.

MAJOR RELEASES NEXT WEEK

Consumer Prices (Tuesday)
Retail Sales (Tuesday)
Housing Starts (Friday)
Industrial Production and Capacity Utilization (Friday)

EYES ONLY

U.S. ECONOMIC STATISTICS

	1970-1993	1998	1998:2	1998:3	1998:4
Percent growth (annual rate)					
Real GDP (chain-type)	2.7	4.3	1.8	3.7	6.0
GDP chain-type price index	5.4	0.9	0.9	1.0	0.8
Nonfarm business (NFB) sector:					
Productivity (chain-type)	1.5	2.7	0.3	2.5	4.6
Real compensation per hour:					
Using CPI	0.6	2.5	2.2	2.3	1.7
Using NFB deflator	1.3	3.7	3.5	3.4	3.4
Shares of Nominal GDP (percent)					
Business fixed investment	10.9	11.0	11.2	10.9	11.0
Residential investment	4.5	4.3	4.3	4.4	4.5
Exports	8.2	11.3	11.3	11.0	11.3
Imports	9.2	13.0	13.1	12.9	13.1
Personal saving	5.2	0.3	0.3	0.1	-0.0
Federal surplus	-2.7	0.9	0.9	1.1	0.8

	1970-1993	1998	Jan. 1999	Feb. 1999	March 1999
Unemployment Rate (percent)	6.7**	4.5**	4.3	4.4	4.2
Payroll employment (thousands)					
increase per month			217	297	46
increase since Jan. 1993					18176
Inflation (percent per period)					
CPI	5.8	1.6	0.1	0.1	N.A.
PPI-Finished goods	5.0	-0.1	0.5	-0.4	**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, April 9, 1999**.

EYES ONLY

FINANCIAL STATISTICS

	1997	1998	Feb. 1999	March 1999	April 8, 1999
Dow-Jones Industrial Average	7441	8626	9323	9754	10198
Interest Rates (percent per annum)					
3-month T-bill	5.06	4.78	4.44	4.44	4.28
10-year T-bond	6.35	5.26	5.00	5.23	5.03
Mortgage rate, 30-year fixed	7.60	6.94	6.81	7.04	6.92
Prime rate	8.44	8.35	7.75	7.75	7.75

INTERNATIONAL STATISTICS

Exchange Rates	**Current level April 8, 1999**	**Percent Change from Week ago**	**Percent Change from Year ago**
Euro (in U.S. dollars)	1.084	0.5	N.A.
Yen (per U.S. dollar)	120.9	0.5	-8.9
Major currencies index (Mar. 1973=100) (trade-weighted value of the U.S. $)	95.84	-0.1	-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	4.3 (Q4)	4.2 (Mar)	1.6 (Feb)
Canada	2.8 (Q4)	7.8 (Feb)	0.8 (Feb)
Japan	-3.0 (Q4)	4.7 (Feb)	-0.1 (Feb)
France	2.8 (Q4)	11.4 (Jan)	0.3 (Feb)
Germany	1.8 (Q4)	2/ 7.2 (Jan)	0.2 (Feb)
Italy	0.9 (Q4)	12.3 (Jan)	1.4 (Feb)
United Kingdom	1.1 (Q4)	6.3 (Dec)	2.1 (Feb)

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 January was 9.1 percent.

EYES ONLY

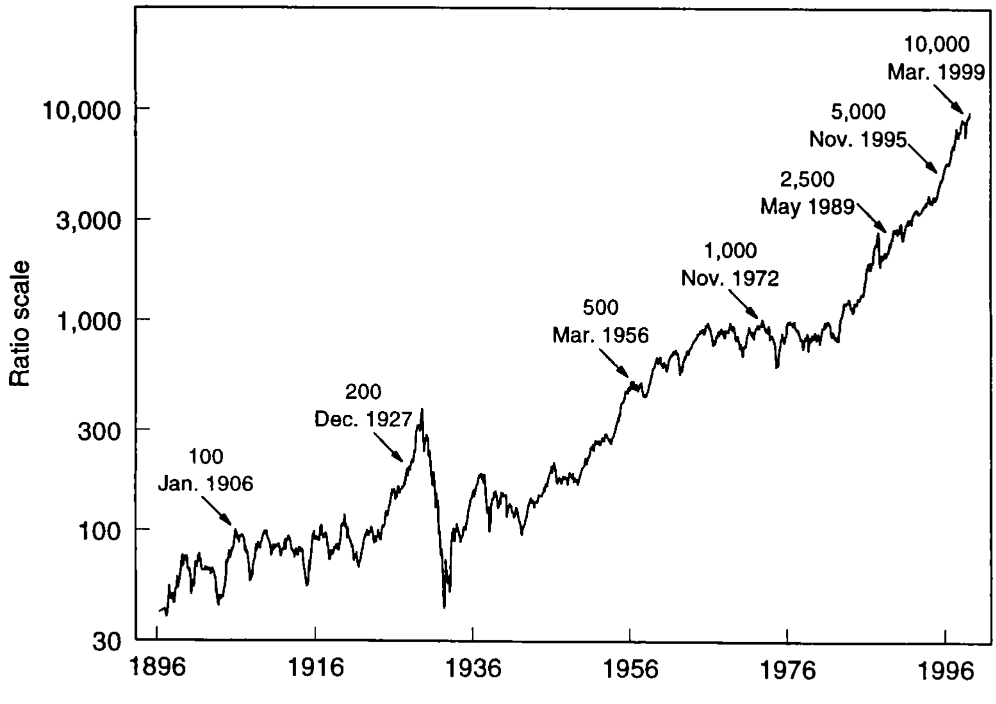
WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

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

April 2, 1999

CHART OF THE WEEK

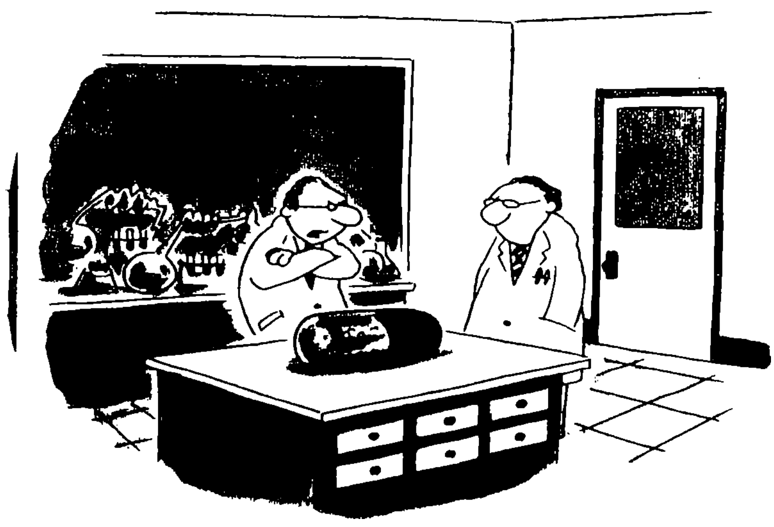
Dow 10,000



Monday the Dow Jones Industrial Average achieved a symbolic benchmark by closing above 10,000, before falling back over the next few days. The chart plots the history of the Dow on a logarithmic (ratio) scale that emphasizes percentage changes rather than absolute point gains. Thus the 10-fold increases from 100 to 1,000 and from 1,000 to 10,000 are the same distance on the vertical axis—though the first took almost 67 years while the second took less than 27.

EYES ONLY

CONTENTS



"That's just great. I discover the cure for the common cold and all you can do is criticize."

EYES ONLY

CURRENT DEVELOPMENT

What's Behind the Trustees' New Estimates?

The new reports from the Social Security and Medicare trustees show an improved financial outlook for both programs since last year. However, both programs remain seriously underfunded in the long run.

The key numbers. The last year of Social Security solvency was moved from 2032 to 2034; that of Medicare from 2008 to 2015. The actuarial balance improved to -2.07 percent of taxable payroll for Social Security and -1.46 percent for Medicare. This means that payroll tax rates would have to be increased immediately by 2.07 percentage points for Social Security and 1.46 percentage points for Medicare to achieve 75-year solvency.

Change in Actuarial Balances
(percent of taxable payroll)

Social Security	
1998 actuarial balance	*-2.19*
short-term economic assumptions	+.03
long-term economic assumptions	+.12
extension of horizon to 2073	-.08
other	+.05
1999 actuarial balance	*-2.07*
Medicare	
1998 actuarial balance	*-2.10*
economic assumptions	+.06
improved base period conditions	+.38
provider reimbursement assumptions	+.26
other	-.06
1999 actuarial balance	*-1.46*

Social Security. Most of the extension of Social Security solvency reflects the recent strength of the economy. By contrast, most of the small improvement in the 75-year balance reflects changes in long-run economic assumptions (see table). In particular, the Bureau of Labor Statistics' recent change in the formula for calculating the consumer price index translates in the trustees' forecast into a higher real rate of return on accumulated trust fund balances.

The 75th year. Because the gap between Social Security's revenues and costs is larger in later years, moving the 75-year forecast period forward to include 2073 creates an increased imbalance that offsets over half of the improvement due to economic changes. Reforming Social Security in a way that puts the system on a sustainable path beyond 75 years would require larger changes in tax and benefit rules or more pre-funding than would be required to achieve 75-year balance.

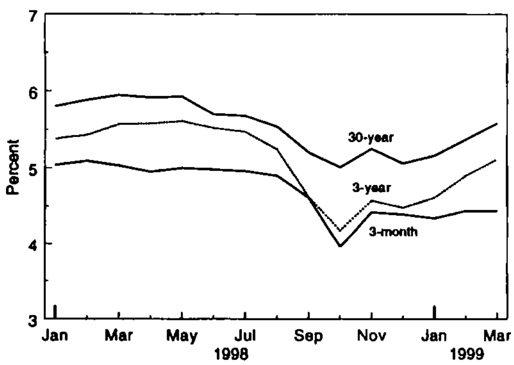
Medicare. Most of the extension of Medicare solvency comes from recent economic strength and lower-than-expected Medicare spending under the Balanced Budget Act of 1997. These more favorable base period conditions also contribute to the improved 75-year balance. The other important factor is more optimistic assumptions about future growth in the cost of hospital services. The Medicare spending projections implicitly assume either significant structural reform of the program or changes in the basic dynamic of U.S. health care spending.

FINANCIAL MARKET UPDATE

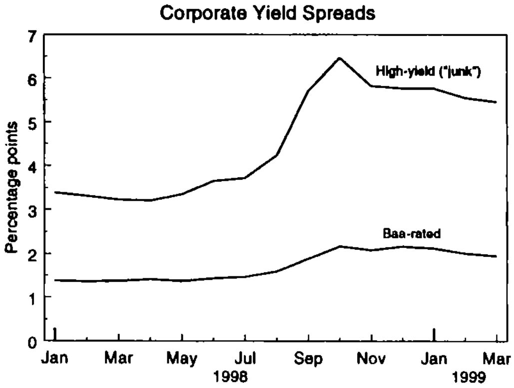
First Quarter Developments

This week the Dow Jones closed above 10,000 for a day, and the Federal Reserve left its interest rate target unchanged. These events symbolize a quarter marked by rising stock market indexes and relatively tranquil interest rates. A closer look at the stock market suggests that while the technology sector has moved up sharply, many stocks have languished.

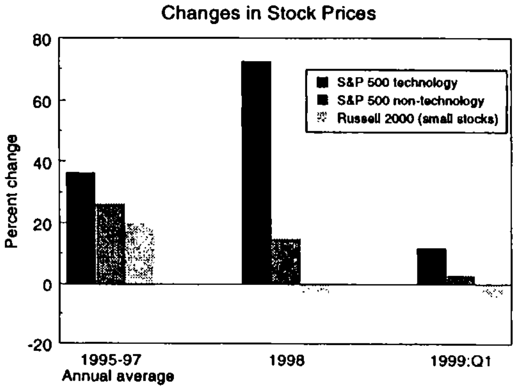
Treasury Yields



Corporate Yield Spreads



Changes in Stock Prices



Interest rates. With unemployment low but inflation tame, the Fed has neither tightened nor eased. Yields on longer term Treasury securities have increased this year, reversing much of their decline during 1998 (see upper chart). Spreads between yields on private and Treasury debt have continued to narrow, but they have not returned to the low levels seen prior to last year's flight to safety and liquidity (see middle chart). Apparently, lingering uncertainty is keeping risk premia elevated, or the price of risk had fallen too low earlier. Corporate debt issuance, which revived late last year after a sharp decline in the third quarter, has continued at a robust pace this year.

Stock prices. Most major indexes have soared to record highs. However, the changes among economic sectors have become more disparate since early 1998, with the technology sector (now about a fifth of the S&P 500) significantly outperforming the rest (see lower chart). Smaller stocks have done much worse than larger stocks, with the Russell 2000 index down 9 percent since the beginning of last year, compared with a 33 percent gain for the S&P 500.

EYES ONLY

SPECIAL ANALYSIS

Children and *Women's Figures*

Women's Figures, a new book from the American Enterprise Institute, draws attention to the shrinking gap between men's and women's wages. The book offers a benign interpretation of one of the major reasons for the remaining gap, the "child penalty" imposed on working mothers. But is this the right interpretation?

Just the facts. The central argument of *Women's Figures* is that women are doing very well in the labor market and there is no problem for government to address. For example, the authors cite a study showing that among 27 to 33 year-olds who have never had children, women earn 98 cents on the male dollar. This is a much smaller gender gap than the commonly cited 74 cents for the entire population. The CEA has also estimated how the raw gender gap is reduced once factors such as education and experience are taken into account. The remaining gap estimated by CEA is about 9 cents, but the real controversy is over interpretation.

Parenthood effects. The small gender gap among the young and the childless suggests that motherhood is more important than femaleness in generating an overall gender gap. Childless women's wages are an estimated 10 to 15 percent higher than their peers who are mothers. And while parenthood hurts women's wages, it does not hurt men's. In fact, men receive a "marriage premium"—married men earn an estimated 10 to 15 percent more than unmarried men, controlling for other factors. *Women's Figures* argues that women have chosen their career paths freely and rationally, picking jobs with the right combination of compensation, benefits, and flexibility for their needs. What the authors do not address is whether women's options are unduly socially circumscribed and whether innovative work arrangements could work better for many women, while still meeting employers' needs.

Can discrimination persist? Many economists would argue that discriminatory wage differences cannot persist for long in a competitive labor market: firms would have an incentive to pay a bit more to the workers experiencing discrimination, wooing the most productive workers and still making a profit. Once started, such wage-setting behavior would snowball until pure discrimination was eliminated. This argument loses some force in a world where social norms and institutions underlie the entire market, making it difficult for employers to innovate on their own. For example, a firm's willingness to offer greater flexibility might not be worth much if day care centers are geared to standard work arrangements. In the longer run, strong demand for new arrangements would be expected to overcome such inertia, but in the short run, neither firms nor day care centers might want to move first.

Implications. Carefully selected statistics may look good for gender parity, but these same numbers confirm that motherhood lowers wages. Family leave and child care policies may thus be more relevant to helping working women than narrow approaches that focus on gender pay equity but miss the key link of parenting.

ARTICLE

The Economic Rationale for Antidumping Policies

Trade liberalization under the GATT and the World Trade Organization has successfully reduced tariffs and circumscribed many forms of protection. However, countries appear to be turning increasingly to antidumping enforcement as a substitute for these other forms of protection.

Trends. Data compiled by the Congressional Budget Office show that the United States is the most active user of antidumping laws, even after adjusting for import quantities and economic size. But the study also finds that U.S. exporters face significant foreign antidumping actions—sometimes in retaliation for U.S. actions. For example, Mexico and Canada initiated cases against the U.S. steel industry in response to cases filed against them in June 1992. U.S. firms accounted for 23 percent of Canadian antidumping cases brought between 1985 and 1991 and 18 percent of the cases brought by the EU between 1980 and 1997. The CBO study found no increasing trend in antidumping actions among most developed countries, though it noted that as a group their use of such actions was relatively high. It did, however, find a rising trend among developing countries such as Mexico, Brazil, India, and South Korea.

Efficiency considerations. Under perfectly competitive conditions, foreigners' willingness to sell at low prices provides benefits to consumers that outweigh the costs to domestic producers. But this result will not hold in the following situations:

- Predatory pricing. If foreigners use their pricing strategy to drive U.S. firms out of the market and then to raise prices, the short-term benefits from low prices could be offset by higher prices in the future.

- Strategic trade. In industries where markets are not perfectly competitive, firms may earn premium profits and pay premium wages. If countries use a protected home market to achieve lower costs through economies of scale, they may be able to take advantage of the more open U.S. market to undercut domestic producers and capture some of these premium profits and wages for themselves and their workers.

The rules. Thus, antidumping laws can contribute to greater economic efficiency if they are able to discriminate between beneficial and harmful situations. Most U.S. antidumping cases are brought under the Tariff Act of 1930, as amended, which requires evidence of below-cost pricing and material harm to the affected U.S. industry, but does not inquire into predatory intent. This approach has been criticized as encompassing numerous instances of dumping that economists would regard as characteristic of vigorous and socially beneficial competition. Examples include "market expansion dumping," in which firms find it profitable to expand exports even if they do not have or expect to have monopoly power; "cyclical dumping," which takes place during periods of weak demand and excess production capacity; and "state trading dumping," which refers to exporting at low prices by state-owned enterprises, particularly when hard currency is needed. These are instances in which the harm to domestic producers can be offset by gains to consumers.

The evidence. A recent set of studies has examined antidumping enforcement in Canada, the United States, and the European Union. To be successful, predatory dumping requires a reasonable expectation of securing market power. This suggests that predatory intent is unlikely in industries that do not meet certain threshold conditions such as being highly concentrated. Studies applying such criteria to the United States, Canada, and the EU typically find that only about 10 percent or fewer of dumping cases could plausibly be cases of predation. According to these studies, antidumping enforcement protects domestic firms against actions that would not be found to be anticompetitive under antitrust laws.

Other abuses? Economists have pointed out that antidumping actions may have other effects as well. They may permit domestic firms to harass their foreign competitors by bringing suits that are costly to defend. They may also restrain domestic competition by facilitating collusion by domestic firms to raise prices and by inhibiting foreign firms from pricing aggressively. On the other hand, the rules may be a blunt but effective way to deal with circumstances in which relief may be justified but other instruments are not available.

Implications. Markets are not all perfectly competitive and efficient. Domestically, antitrust enforcement is the main policy to protect competition. Internationally, anti-dumping policies provide a second set of tools that appear to be less well-targeted. The coexistence of these two sets of policies may result in foreign firms being singled out for behavior that is acceptable for domestic firms. The EU has already achieved uniform treatment for its members by replacing anti-dumping rules with a single competition policy. A challenge for future international negotiations is to demonstrate whether effective competition policies could achieve a single set of rules so that what is fair for trade is the same as what is fair for domestic competition.

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

Own-Race Policing Found to be Associated with Fewer Arrests. A new study examines the relationship between the racial composition of a city's police force and the racial patterns of arrests and crime. The study uses FBI data for 134 cities, combined with EEOC data on the racial composition of municipal police departments compiled over the past 20 years. It finds evidence across a wide range of crime categories that own-race policing is associated with lower numbers of arrests than cross-race policing. It also finds that the addition of officers of a given race is associated with an increase in the number of arrests of suspects of a different race, but has little impact on same-race arrests. The impact of own-race policing on crime (as opposed to arrests) is less clear, although own-race policing appears to be more effective in lowering property crime. The results imply either that deterrence is greater with own-race policing (perhaps because of greater community cooperation) or that fewer false arrests are made. The study concludes that increasing minority representation on a police force so as to mirror the makeup of a city, coupled with reallocation of police patrols to maximize own-race policing, would be expected to increase the efficiency of policing, at least for property crime.

Managers Are Taking Ownership. A new study finds that the ownership stakes of directors and officers of publicly traded U.S. companies rose from an average of 12.9 percent of their company's stock in 1935 to 21.1 percent in 1995, while the average value of their holdings soared from $17.9 million to $73 million (in 1995 dollars.) The authors suggest that recent financial innovations that help reduce volatility and hedge risk have made insiders more willing to hold larger stakes in their companies. While past research had found that corporate performance tended to decline once holdings of officers and directors rose above 5 percent, this study found no significant impact of ownership above the 5 percent level.

UCLA Forecast is Generally Sunny for California and U.S. Economies. Both California and the national economy are likely to keep growing over the next 2 years, according to the latest forecast from the Anderson Business School at UCLA. The forecast sees the national economy heading for a "soft landing," with growth in real GDP falling from 3.9 percent in 1998 to 3.5 percent in 1999 and 2.1 percent in 2000. While most indicators will remain strong, the report forecasts lower consumption growth and flat corporate profits, and sees deflation as a possible problem. As for California, it predicts a slowdown, but not until 2000. Job growth is forecast to drop from 3.6 percent in 1998 to 3.4 percent in 1999 and to 2.3 percent in 2000. The state has good regional and industry diversity, according to the study, and the housing and real estate expansion will continue. However, the prevalence of high-flying Internet companies in California may be why the report warns that the state could be vulnerable to a major stock market sell-off.

INTERNATIONAL ROUNDUP

Indonesia and Foreign Banks Agree to Debt Restructuring. The Indonesian government and foreign bank creditors have reached an agreement in principle to restructure about $3.8 billion in debt owed by Indonesian banks. Much as in other recent debt restructurings in Southeast Asia, international banks will roll over the cross-border interbank liabilities of Indonesian banks in exchange for government guarantees of these new loans. Last October's G-22 report on international financial crises warned against such guarantees, since they cushion the effects of bad risk assessment and create moral hazard.

China's Economic Growth: Incredible, or Just Unbelievable? A recent IMF study has pointed out an interesting disparity in official Chinese economic statistics: GDP growth, though slowing from its sky-high levels of the early 1990s, remains strong. The Chinese government targeted 8 percent growth in 1998; however, low growth in electricity consumption and a decline in freight traffic—two useful indicators of economic activity—seem incompatible with such robust GDP growth. How, then, should this disparity be interpreted? On the positive side, increased energy efficiency could explain some of the gap: the share of output from industry and state-owned enterprises, both heavy energy users, has declined in recent years as a substantial increase in the relative price of electricity has increased incentives for conservation. Furthermore, coal output, which accounts for around 40 percent of freight traffic, is declining, and freight carried by the private sector may not be fully counted. However, the study points out another, less favorable interpretation. China's economic data is widely regarded as suspect—one World Bank study found that the actual GDP growth rate from 1978 to 1995 may have been 1¼ percentage points lower than the official rate—and it may be that China's growth has in fact slowed more than official figures suggest.

EU Adjusts Its CAP. Last Friday EU members reached agreement on package of budget and farm subsidy programs for the years 2000-2006. The final "Agenda 2000" reforms to the EU's Common Agricultural Policy (CAP) include reductions in grain and dairy price supports of 15 percent; an equalization of per-acre payments for oilseeds and grains to reduce the incentive to overproduce oilseeds; and a cap on agricultural spending. No immediate changes were made to beef price supports. These reforms fall short of those proposed by the EU farm ministers on March 11 but nevertheless represent a small step toward a more market-oriented farm policy.

Chrétien Calls for More Debt Relief. Canadian Prime Minister Jean Chrétien recently joined the chorus of calls from G-7 leaders for more generous debt relief for the world's poorest countries. Chrétien urged industrialized countries to join Canada in pledging to forgive all commercial debt owed them by the "poorest of the poor" heavily indebted countries, and to convert all new development assistance into grants instead of loans. He also proposed that the Heavily Indebted Poor Countries Initiative be enhanced so as to provide deeper, faster-paced debt reduction to a larger number of countries.

EYES ONLY

RELEASES THIS WEEK

Employment and Unemployment

****Embargoed until 8:30 a.m., Friday, April 2, 1999****

In March, the unemployment rate fell to 4.2 percent from 4.4 percent in February. Nonfarm payroll employment rose by 46,000.

NAPM Report on Business

The Purchasing Managers' Index rose to 54.3 percent in March from 52.4 percent in February.

Gross Domestic Product

According to revised estimates, real gross domestic product grew at an annual rate of 6.0 percent in the fourth quarter.

Consumer Confidence

Consumer confidence, as measured by The Conference Board, rose 0.8 percentage point in March, to 133.9 (1985=100).

MAJOR RELEASES NEXT WEEK

Leading Indicators (Tuesday)
Producer Prices (Friday)

EYES ONLY

U.S. ECONOMIC STATISTICS

	1970-1993	1998	1998:2	1998:3	1998:4
Percent growth (annual rate)					
Real GDP (chain-type)	2.7	4.3	1.8	3.7	**6.0**
GDP chain-type price index	5.4	0.9	0.9	1.0	**0.8**
Nonfarm business (NFB) sector:					
Productivity (chain-type)	1.5	2.7	0.3	2.5	4.6
Real compensation per hour:					
Using CPI	0.6	2.5	2.2	2.3	1.7
Using NFB deflator	1.3	3.7	3.5	3.4	3.4
Shares of Nominal GDP (percent)					
Business fixed investment	10.9	11.0	11.2	10.9	**11.0**
Residential investment	4.5	4.3	4.3	4.4	4.5
Exports	8.2	11.3	11.3	11.0	11.3
Imports	9.2	13.0	13.1	12.9	13.1
Personal saving	5.2	0.3	0.3	0.1	**-0.0**
Federal surplus	-2.7	**0.9**	0.9	1.1	**0.8**

	1970-1993	1998	Jan. 1999	Feb. 1999	March 1999
Unemployment Rate (percent)	6.7**	4.5**	4.3	4.4	**4.2**
Payroll employment (thousands)					
increase per month			**217**	**297**	**46**
increase since Jan. 1993					**18176**
Inflation (percent per period)					
CPI	5.8	1.6	0.1	0.1	N.A.
PPI-Finished goods	5.0	-0.1	0.5	-0.4	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, April 2, 1999.**

EYES ONLY

FINANCIAL STATISTICS

	1997	1998	Feb. 1999	March 1999	April 1, 1999
Dow-Jones Industrial Average	7441	8626	9323	9754	9833
Interest Rates (percent per annum)					
3-month T-bill	5.06	4.78	4.44	4.44	4.32
10-year T-bond	6.35	5.26	5.00	5.23	5.27
Mortgage rate, 30-year fixed	7.60	6.94	6.81	7.04	6.98
Prime rate	8.44	8.35	7.75	7.75	7.75

INTERNATIONAL STATISTICS

Exchange Rates	**Current level April 1, 1999**	**Percent Change from**	
		Week ago	**Year ago**
Euro (in U.S. dollars)	1.078	-0.8	N.A.
Yen (per U.S. dollar)	120.2	1.8	-10.1
Major currencies index (Mar. 1973=100) (trade-weighted value of the U.S. $)	95.90	0.7	-1.3

International Comparisons [1]	**Real GDP growth** (percent change last 4 quarters)	**Unemployment rate** (percent)	**CPI inflation** (percent change in index last 12 months)
United States	4.3 (Q4)	**4.2** (Mar)	1.6 (Feb)
Canada	2.8 (Q4)	7.8 (Jan)	0.8 (Feb)
Japan	-3.0 (Q4)	4.5 (Jan)	-0.1 (Feb)
France	2.8 (Q4)	11.4 (Jan)	0.3 (Feb)
Germany	1.8 (Q4)	[2] 7.2 (Jan)	0.2 (Feb)
Italy	0.9 (Q4)	12.4 (Oct)	1.4 (Feb)
United Kingdom	1.0 (Q4)	6.2 (Nov)	2.1 (Feb)

U.S. unemployment data **embargoed until 8:30 a.m., Friday, April 2, 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 January was 9.1 percent.

EYES ONLY

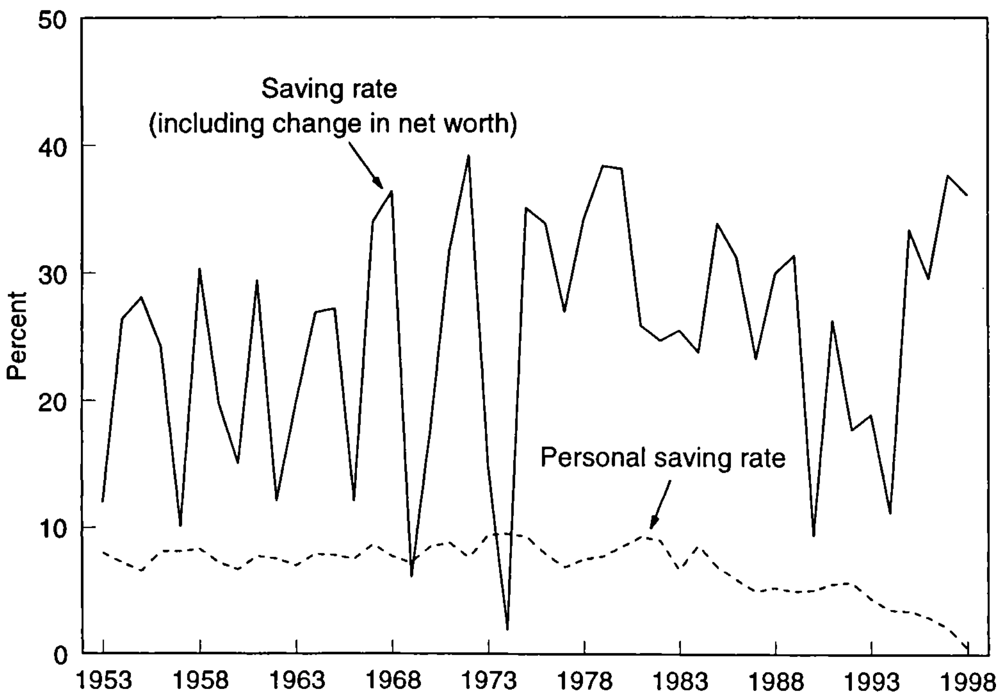
WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

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

March 26, 1999

CHART OF THE WEEK

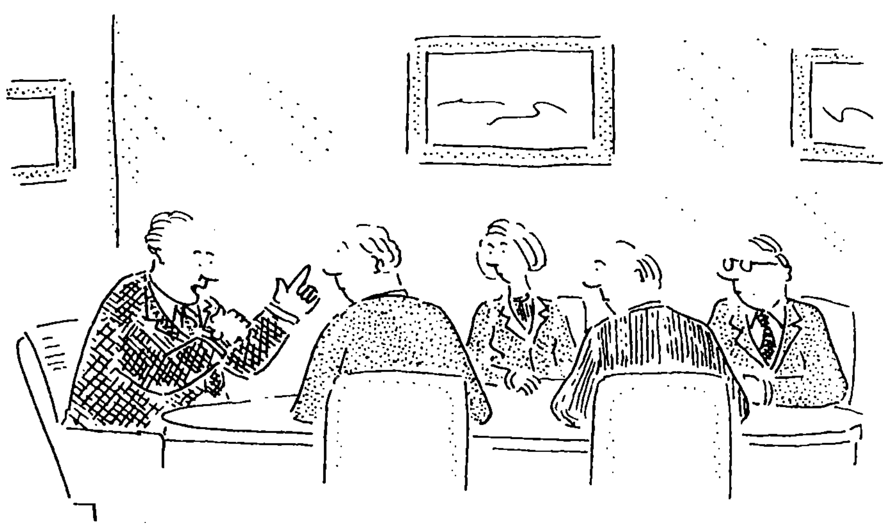
Personal Saving and Changes in Net Worth



The personal saving rate, which measures how much people save out of disposable personal income, does not reflect capital gains and has shown a precipitous decline in recent years. By contrast, the saving rate based on an expanded definition of income that includes capital gains and other changes in household net worth has remained high. The historical record shows, however, that changes in net worth are highly volatile.

EYES ONLY

CONTENTS



"O.K., on my signal we're going to shift from pre-millennial to post-millennial thinking."

EYES ONLY

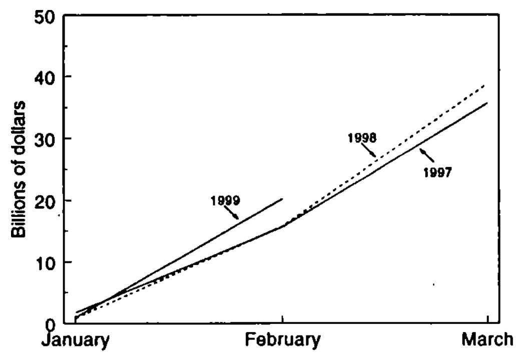
CURRENT DEVELOPMENT

Will Tax Refunds Boost Consumption or Saving?

Income tax refunds so far this year are running ahead of last year's pace, putting more money in consumers' pockets. Standard economic theory indicates that most of these refunds will be saved, but experience suggests that a significant fraction will be spent.

Why are refunds higher? Income tax refunds through February were $4.4 billion (28 percent) higher than in the same period a year ago (see chart). Increased use of computers for tax preparation and filing may be contributing to faster processing and an increase in the proportion of refunds received earlier in the year. But total refunds will probably be higher than last year's $100 billion as well. One private forecast sees refunds totaling about $17 billion more in 1999 than in 1998, with much of the increase attributable to the education and child tax credits enacted in 1997. This increase represents about 0.3 percent of annual disposable personal income.

Cumulative Tax Refunds



Consumer behavior. Economic theory posits that rational consumers try to smooth consumption over time, implying that windfall increases in income will mostly be saved. However, many lower- and middle-income taxpayers may view a tax refund as a means to achieve desired levels of consumption, which might otherwise have been limited by borrowing constraints. In addition, consumers may deliberately overwithhold taxes through the year as a form of forced saving that provides a spendable "windfall" tax refund. This year's refunds may also be larger than expected if consumers did not adjust their withholding to take the new credits into account.

Empirical evidence. The empirical evidence on household consumption and income tax refunds suggests that tax refunds boost consumption noticeably. One recent study finds evidence that even many consumers who do not face borrowing constraints tend to spend a high fraction of their tax refunds. Studies of the 1975 tax rebate and the 1992 reduction in withholding rates also suggest a relatively high spending response.

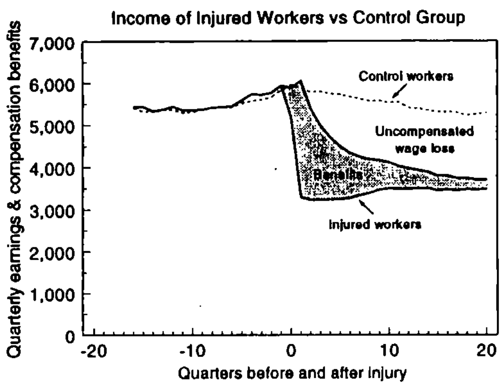
Conclusion. The macroeconomic impact of higher tax refunds will be relatively small, whether they are saved or spent, because of their relatively minor impact on disposable income. But this year's experience with higher refunds associated with new tax credits will provide economists with more evidence for testing and refining their understanding of consumer behavior.

SPECIAL ANALYSIS

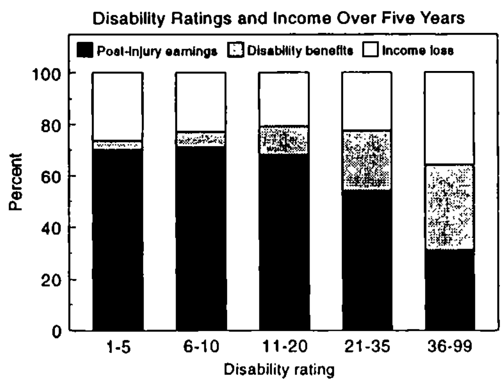
The Impact of Workplace Injuries: Evidence from California

Workplace injuries can lead to substantial reductions in work time and earnings, according to a recent study of workers in California. Workers Compensation (a state-run program) offsets only a small fraction of foregone earnings, and in many cases workers with similar injury-induced earnings losses receive different benefits.

Earnings losses are substantial. The study uses the earnings of uninjured co-workers with similar recent earnings to estimate the earnings loss of workers who file compensation claims for permanent injuries (about 40 percent of indemnity injuries). It finds that the earnings of injured workers making claims fall sharply in the quarter of injury, leaving a substantial gap between their income and that of uninjured co-workers—even though both had similar wages during the 5 years leading up to the injury (see upper chart). Moreover, the decline in earnings appears to be permanent, with a 34 percent earnings gap 5 years after injury. Workers Compensation cushions workers from reduced wages and time away from work, but only for a short period after the injury. Because wage losses persist and benefit payments run out, benefits compensate slightly less than 40 percent of workers' full losses over a 5-year period after an accident.



Problems with the disability rating system. In California, the amount of benefits is based on a numerical rating derived from doctors' descriptions of the severity of an injury. The study found that this system does a poor job of linking benefits to earnings losses for those with less severe injuries. In particular, earnings losses tended to be comparable in the three lowest (least severe disability) ratings categories. But because a lower disability rating means a smaller benefit, the net income loss was largest for those with the least severe disabilities (see lower chart). In cases where the same injury was evaluated by different raters, the study found considerable variation in these ratings. For example, claims rated 10 by insurance adjusters received ratings ranging from 2 to 82 by the state evaluation unit.



Conclusion. Workplace injuries can generate substantial earnings losses, and California's compensation process is thought by many to be both unpredictable and inequitable—which may be why it is also litigious. Although other states use different disability ratings systems, the scant available evidence suggests that they too have difficulties with consistency and predictability.

ARTICLE

Changes in the Video Programming Market

Dramatic changes in the structure of the television programming market in the past 15 years have reduced the magnitude of conventional market failures that produced duplicative programming and ignored many strongly held audience preferences. But in other ways these changes have simply altered the market failure mechanism and given rise to new regulatory challenges.

Historical market failures. For years, viewers did not pay for television, and broadcast licensees measured viewer preferences indirectly through audience counts and advertising rates. Ignoring the relative strength of different audience preferences was a recipe for inefficiency: a program able to attract 100 nearly indifferent viewers was more likely to be aired than one that would be highly valued by 99 people. Advertisers, not viewers, chose programs.

The limited number of channels available in even the largest market was a second source of possible market failure. With only a small number of competitors, competing channels had an incentive to duplicate the most popular formats so long as their individual shares of advertising revenues from such programming were higher than the revenues from switching to the next most popular format. The result could be program homogeneity that is economically rational for each broadcaster but leaves segments of the viewing market under-served.

Policy remedies. Over the years, the Federal Communications Commission has taken aim at the failures of the conventional broadcasting market through a series of policies that conditioned renewal of free spectrum licenses on the provision of diverse programming that met the needs and desires of the communities the licencees served. Although the efficacy of those policies has been debated, they addressed real problems.

What has changed? Changes in the video programming market have reduced the kinds of failures that plagued the first decades of broadcasting. The number of broadcast stations has grown, from about 1200 in 1985 to over 1500 in 1997. A fourth major network has begun to compete with the three large incumbents and a fifth is beginning to develop. Finally, broadcasters might use their free digital spectrum to bring additional channels into the market. Although conventional broadcast is thus more competitive than in the past and can potentially offer a greater range of programming for viewers, variations on formats already proven to be lucrative may limit the introduction of novel programming.

Importantly, subscription-based, multichannel video providers like cable and direct broadcast satellite (DBS) services have entered the market successfully. Because consumers pay directly for these services—and, in the cases of premium channels and pay-per-view events, directly for specific programming—consumer preferences are better communicated than they are for regular broadcasters. Moreover, cable and DBS operators have an economic incentive to choose a mix of programming that will attract viewers to their systems. With more than half of all cable subscribers receiving more than 54 channels, and only 3 percent of cable subscribers receiving fewer than 30 channels, the video market can now satisfy a far broader diversity of viewing preferences than in the past.

New challenges. These diversity- and efficiency-enhancing changes have not removed all hazards to consumer welfare. Increased integration between program producers and channel providers means that some independent programming may, just as in the days of scarce channels, have a harder time finding an outlet to viewers. This problem can be exacerbated by increased consolidation of video distribution systems (such as cable operators). The fact that advertisers still play a central role in choosing programming could also lead to less diversity than audiences ideally want. In addition, as competing systems divide audiences among an increasing array of channels, the revenues for any given program may decline and drive channels to seek lower cost formats. If program quality correlates with program cost, then lower quality programming may result. Finally, increased competition might also make program providers less willing to allocate time on their stations or systems to public service programming devoted to children, education, or political debate.

Conclusion. The programming market today is much larger and more competitive than in the past. Segmentation of the market between free and pay sectors has reduced the dominant influence of broadcast networks, but it has raised other issues. Although these changes have in large part eliminated the mechanisms that historically created concerns about program diversity and satisfaction of audience preferences, those concerns have not vanished. Moreover, recent market changes have given rise to new concerns about program quality and public service programming. The quality problem may be partly cured by market forces, as consumers have the opportunity to pay for programming they strongly desire and as rival video programmers compete on quality as well as price. The diversity, consolidation, and public-interest issues are more difficult problems that remain subject to some Federal regulation.

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

States' Reserves Found Inadequate. Some 40 states do not have enough savings in budget reserves and rainy day funds to maintain services if a recession similar to the 1990-91 downturn were to begin in 2000, according to the Center on Budget and Policy Priorities (CBPP). At the end of fiscal year 1998, state balances totaled $34 billion—less than half of the $80 billion CBPP estimates states would need during a mild recession. Moreover, according to enacted 1999 budgets, states plan an additional $4 billion cut in reserves to pay for tax cuts or spending initiatives not supported by current revenues. On average, states would need to more than double their reserves as a percentage of expenditures, from 8.5 percent to 18.6 percent, in order to maintain services without raising taxes during a downturn. Only eight states (Delaware, Indiana, Iowa, Maine, Massachusetts, Michigan, Minnesota, and North Dakota) appear to have adequate reserves, while 11 states (Idaho, Oregon, Texas, West Virginia, Wisconsin, Tennessee, South Dakota, Nevada, Utah, New Hampshire, and Georgia) would have shortfalls exceeding 20 percent of current outlays.

Microlending in the United States. Microlending began as a poverty-alleviation strategy in developing countries, as exemplified by the Grameen Bank in Bangladesh. In the United States it has also been used to help entrepreneurs of all incomes. At last count in 1996, there were about 200 microlending programs in the United States, up from only a handful in the mid-1980s. Loans generally range from $500 to $25,000 and are made for the business development of microenterprises—firms with fewer than five employees and generating less than $250,000 in annual revenues. Many programs cater to already established businesses and emphasize credit rather than networking or training. Other programs focus on welfare-to-work clients and people in poverty and offer loans complemented by training, technical assistance, and support networks. Among the approximately 45,000 clients served by microlenders in 1996, 16 percent were low-income and 7 percent were welfare recipients. Funds for microlenders generally come from bank credit lines, government sources, and foundations.

Unequal Pay Strikes Out. Does unequal pay inspire greater individual effort and productivity or do large pay differentials generate dissatisfaction and poorer quality work? Research shows that both views may be valid, depending on the degree of inequality and the nature of the business and its workers. A new study from the field sheds some light on this topic for an organization where work interdependencies are important—major league baseball. Here unequal pay seems to hurt performance, according to a study of pay and performance data from 29 major league baseball teams between 1985 and 1993. The idea is not that the salary structure should not reflect quality differences among players. Indeed, the study found that higher pay was related to better performance. However, after adjusting for factors such as past performance, age, experience, and pay levels, the study found that unequal pay distributions translated into poorer statistics such as batting average or earned run average for lower paid players in a number of areas—and into lower standings for their teams.

INTERNATIONAL ROUNDUP

Nigeria Cozies up to the IMF. Nigerian President-elect Obasanjo has said he would be prepared to work toward an IMF-sponsored reform program but has emphasized the need for debt relief, according to recent press reports. Obasanjo, who has not yet indicated whether he will accept plans by the transition government to bring Nigeria back into the IMF fold, cut short a European tour to meet with IMF Director Camdessus in Nigeria. Camdessus praised the transition government's reform efforts and called for a growth strategy emphasizing good governance, economic liberalization (including privatization, deregulation, and openness), and macroeconomic stabilization. He acknowledged that the current global environment of reduced investor confidence and low oil prices was unfavorable, but found Nigeria's progress under existing informal IMF staff monitoring encouraging. The country has, however, wavered on monetary policy, the flexible exchange rate, and privatization, and the IMF is likely to raise these issues in its May review. A positive review could ultimately boost Nigeria's chances for debt relief.

The Autumn of the Oligarchs. The huge corporate alliances known as *keiretsu* that have long dominated Japan's economy may be in the process of slowly unraveling. A recent *Business Week* article detailed trouble at Mitsubishi, considered by many the mightiest of the *keiretsu*, where Mitsubishi Electric, Mitsubishi Chemical, and Mitsubishi Materials have recently suffered hundreds of millions of dollars in losses; Bank of Tokyo-Mitsubishi has had to scramble for capital from the alliance in order to avoid a government bailout; and Mitsubishi Motors may be looking for a foreign partner. Similar troubles have been reported at other *keiretsu*. For example, Nissan Motors, which is allied with the Fuyo *keiretsu*, may soon sell a substantial minority stake in its operations to Renault in order to reduce its $21 billion debt load. In addition, some Japanese banks have begun to unwind some of their cross-shareholdings, the financial ties that bind together the *keiretsu*.

Re-Thinking CAP. In order to "support people rather than products," the EU Council of Agriculture Ministers has agreed on reform of the Common Agricultural Policy. The reforms would reduce intervention prices by up to 20 percent and increase direct lump-sum payments to producers. The result would be to make production choices responsive to world prices rather than domestic prices that are fixed by statute. Those who see the reforms as insufficient note that payments are not totally decoupled from production and that only minimal reforms were made in the dairy and beef sectors.

Do IMF Programs Impede Social Spending? Although IMF-supported programs typically require fiscal adjustment, a recent IMF study finds that education and health care expenditures continue to increase during such programs. However, the study of 145 developing and transition countries finds that these countries allocate a relatively large share of their education budget to post-secondary education, and an even larger part of health outlays to curative services. The report argues that a shift in resources toward primary education and basic health care would help the poor.

EYES ONLY

RELEASES THIS WEEK

Advance Durable Orders

Advance estimates for February show that new orders for durable goods fell 5.0 percent, following an increase of 3.3 percent in January.

MAJOR RELEASES NEXT WEEK

Consumer Confidence—Conference Board (Tuesday)
Gross Domestic Product (Wednesday)
NAPM Report on Business (Thursday)
Employment (Friday)

EYES ONLY

U.S. ECONOMIC STATISTICS

	1970-1993	1998	1998:2	1998:3	1998:4
Percent growth (annual rate)					
Real GDP (chain-type)	2.7	4.3	1.8	3.7	6.1
GDP chain-type price index	5.4	0.9	0.9	1.0	0.7
Nonfarm business (NFB) sector:					
Productivity (chain-type)	1.5	2.7	0.3	2.5	4.6
Real compensation per hour:					
Using CPI	0.6	2.5	2.2	2.3	1.7
Using NFB deflator	1.3	3.7	3.5	3.4	3.4
Shares of Nominal GDP (percent)					
Business fixed investment	10.9	11.0	11.2	10.9	11.1
Residential investment	4.5	4.3	4.3	4.4	4.5
Exports	8.2	11.3	11.3	11.0	11.3
Imports	9.2	13.0	13.1	12.9	13.1
Personal saving	5.2	0.3	0.3	0.1	0.1
Federal surplus	-2.7	N.A.	0.9	1.1	N.A.

	1970-1993	1998	Dec. 1998	Jan. 1999	Feb. 1999
Unemployment Rate (percent)	6.7**	4.5**	4.3	4.3	4.4
Payroll employment (thousands)					
increase per month			314	217	275
increase since Jan. 1993					18108
Inflation (percent per period)					
CPI	5.8	1.6	0.1	0.1	0.1
PPI-Finished goods	5.0	-0.1	0.4	0.5	-0.4

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

EYES ONLY

FINANCIAL STATISTICS

	1997	1998	Jan. 1999	Feb. 1999	March 25, 1999
Dow-Jones Industrial Average	7441	8626	9346	9323	9836
Interest Rates (percent per annum)					
3-month T-bill	5.06	4.78	4.34	4.44	4.39
10-year T-bond	6.35	5.26	4.72	5.00	5.21
Mortgage rate, 30-year fixed	7.60	6.94	6.79	6.81	6.98
Prime rate	8.44	8.35	7.75	7.75	7.75

INTERNATIONAL STATISTICS

Exchange Rates	**Current level March 25, 1999**	**Percent Change from** Week ago	Year ago
Euro (in U.S. dollars)	1.087	-1.1	N.A.
Yen (per U.S. dollar)	118.1	0.4	-8.3
Major currencies index (Mar. 1973=100) (trade-weighted value of the U.S. $)	95.24	0.3	-0.4

International Comparisons [1/]	**Real GDP growth** (percent change last 4 quarters)	**Unemployment rate** (percent)	**CPI inflation** (percent change in index last 12 months)
United States	4.3 (Q4)	4.4 (Feb)	1.6 (Feb)
Canada	2.8 (Q4)	7.8 (Jan)	0.6 (Jan)
Japan	-3.0 (Q4)	4.5 (Jan)	0.2 (Jan)
France	2.8 (Q4)	11.4 (Jan)	0.5 (Jan)
Germany	1.8 (Q4)	[2/] 7.2 (Jan)	0.5 (Dec)
Italy	0.9 (Q4)	12.4 (Oct)	1.5 (Dec)
United Kingdom	1.0 (Q4)	6.2 (Nov)	2.5 (Jan)

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 January was 9.1 percent.