Withdrawal/Redaction Sheet
Clinton Library

DOCUMENT NO. AND TYPE	SUBJECT/TITLE	DATE	RESTRICTION
001. email	Janet L. Yellen to Sarah Johanna Reber at 14:25:07.00. Subject: Re: reference. (1 page)	03/02/1999	b(6)
002. email	Matthew R. McBrady to Janet L. Yellen at 22:30:59.00. Subject: Meeting tomorrow with Dole representatives. (partial) (1 page)	03/11/1999	b(6)

COLLECTION:

Clinton Presidential Records
Automated Records Management System [Email]
CEA ([Yellen])
OA/Box Number: 950000

FOLDER TITLE:

[02/26/1999 - 03/11/1999]

2013-0723-F
ab1295

RESTRICTION CODES

Presidential Records Act - [44 U.S.C. 2204(a)]

P1 National Security Classified Information [(a)(1) of the PRA]
P2 Relating to the appointment to Federal office [(a)(2) of the PRA]
P3 Release would violate a Federal statute [(a)(3) of the PRA]
P4 Release would disclose trade secrets or confidential commercial or financial information [(a)(4) of the PRA]
P5 Release would disclose confidential advice between the President and his advisors, or between such advisors [a)(5) of the PRA]
P6 Release would constitute a clearly unwarranted invasion of personal privacy [(a)(6) of the PRA]

C. Closed in accordance with restrictions contained in donor's deed of gift.
PRM. Personal record misfile defined in accordance with 44 U.S.C. 2201(3).
RR. Document will be reviewed upon request.

Freedom of Information Act - [5 U.S.C. 552(b)]

b(1) National security classified information [(b)(1) of the FOIA]
b(2) Release would disclose internal personnel rules and practices of an agency [(b)(2) of the FOIA]
b(3) Release would violate a Federal statute [(b)(3) of the FOIA]
b(4) Release would disclose trade secrets or confidential or financial information [(b)(4) of the FOIA]
b(6) Release would constitute a clearly unwarranted invasion of personal privacy [(b)(6) of the FOIA]
b(7) Release would disclose information compiled for law enforcement purposes [(b)(7) of the FOIA]
b(8) Release would disclose information concerning the regulation of financial institutions [(b)(8) of the FOIA]
b(9) Release would disclose geological or geophysical information concerning wells [(b)(9) of the FOIA]

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Janet L. Yellen (CN=Janet L. Yellen/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME:26-FEB-1999 17:36:33.00

SUBJECT: Labor/Trade Follow-UP

TO: Nouriel Roubini (CN=Nouriel Roubini/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TEXT:
We will try to arrange this meeting for the week of March 15 and you should come. Let's talk about what to include in the agenda when Bob Lawrence arrives next week.
---------------------- Forwarded by Janet L. Yellen/CEA/EOP on 02/26/99 05:35 PM ---------------------------

Karen Tramontano
02/25/99 02:19:36 PM
Record Type: Record

To: Michele Jolin/CEA/EOP
cc: Janet L. Yellen/CEA/EOP, Gene B. Sperling/OPD/EOP, Lael Brainard/OPD/EOP
Subject: Labor/Trade Follow-UP

Michele,

I spoke w/ janet the beginning of this week and asked her if she would convene a meeting of labor economists --as she did when we encountered difficulties w/ global climate change -- to begin a dialgoue to hopefully develop a common framework in which to discuss trade, job loss etc. the labor community titles this dialogue as the deindustrialization of america --without agreeing to the caption -- i think the dialgoue is worthwhile.
If you would help me w/ three items -- I would greatly appreciate it
1. give me possible dates when janet and other cea economists have about 2 hours;
2. work w/ me on a list of other administration participants e.g. nec, labor, commerce, ustr
3. work w/ me to develop either an agenda or a list of topics through which we can structure the dialogue

the sooner we can put this meeting together -- the better. thanks, kt

---------------------- Forwarded by Janet L. Yellen/CEA/EOP on 02/26/99 05:35 PM ---------------------------

Karen Tramontano
02/25/99 04:48:34 PM
Record Type: Record

To: See the distribution list at the bottom of this message
cc: Melissa G. Green/OPD/EOP, Paul A. Tuchmann/OVP @ OVP
Subject: Follow-Up Labor Meeting

I know I spoken briefly to each of you and said I would circulate a memo -- since I have not done that yet, I thought I would briefly update you on my thinking. I've also talked w/ Alexis Herman and Kitty Higgins. After the wonderful meeting john and i had in florida -- i thought 4 next steps would be appropriate.

1. Pull together the economists in the Administration and schedule a meeting w/ the economists in the labor community to have the "deindustrialization" of America discussion. They believe its as a result of trade -- I think we believe otherwise. I hope a thorough discussion of the issues, our areas of agreement and disagreement will be helpful. Janet has agreed to convene the meeting. If we could do this next week -- that would be great. We should have a pre-meeting to talk through the agenda/approach -- see previous e-mail

2. Pull together a policy meeting w/ labor community policy folks to answer the question: "What does it mean to include labor and enviornmental rights" in traditional trading authority. Lael/Rick have agreed to this process -- I'd include policy folks from labor/commerce/ustr -- Gerry Shea would like to exclude labor legislative folks -- and is trying to come up w/ the appropriate policy folks -- I am pushing him for times next week.

3. Have an internal discussion/analysis on economic incentives we provide to industry and go through a process to determine whether -- where we have made the decision to provide economic incentives--we can condition those incentives on requiring capital and the means of production to remain in the united states -- (when the President spoke at the Steel workers, Machnists and Autoworkers Conference he spoke about his Sperling/Jackson initiative and they loved it because they heard it as jobs remaining in th eir communities) I don't know whether we can or if its good policy to condition incentives -- but I believe that if NEC could run a process to figure this out and we could talk about it as something we are looking at, it would be helpful

4. CEA, Labor, Commerce -- identify and analyze the growing sector of the economy to determine whether there are practical, economic, legal or other impediments to organizing workers in the growing sectors --- if there are, we should figure out whether there is legislative or other vehicles we could propose that may help to level the playing field. We would have to think this through very carefully, but we may be able to fashion an approach that puts us on the side of providing tools to workers in a chang ing economy and in growth industries. Perhaps it is appropriate for CEA to take the lead on the analysis -- and NEC to take the lead on the

discussion?? I could use some guidance here.

i think these next steps also would help with our trade strategy. it puts us in the position of having heard some of the concerns of workers who are losing their jobs and unions who are concerned about a changing and global economy and responding in a thoughtful way. thanks, and please give me feedback on any of these ideas.

Message Sent
To:
Gene B. Sperling/OPD/EOP
Janet L. Yellen/CEA/EOP
Lael Brainard/OPD/EOP
Ron Klain/OVP @ OVP
Monica M. Dixon/OVP @ OVP
Richard M. Samans/OPD/EOP

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Jeffrey A. Frankel (CN=Jeffrey A. Frankel/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME: 1-MAR-1999 17:20:06.00

SUBJECT: Commerce Paper Steel Enforcement Proposals

TO: Janet L. Yellen (CN=Janet L. Yellen/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TEXT:
---------------------- Forwarded by Jeffrey A. Frankel/CEA/EOP on 03/01/99
05:20 PM ---------------------------

Malcolm R. Lee
03/01/99 04:57:18 PM
Record Type: Record

To: See the distribution list at the bottom of this message
cc:
Subject: Commerce Paper Steel Enforcement Proposals

---------------------- Forwarded by Malcolm R. Lee/OPD/EOP on 03/01/99
03:57 PM ---------------------------

EBiel @ doc.gov
03/01/99 04:51:12 PM
Record Type: Record

To: Malcolm R. Lee/OPD/EOP
cc:
Subject: re: Malcolm Lee's internet address

Steel document with first page revised. EB
---------- Original Text ----------

From: S=Malcolm(u)R.(u)Lee/C=US/A=INTERNET/DDA=ID/Malcolm(u)R.(u)Lee(, on
3/1/99 3:48 PM:

Internet address: Malcolm_R._Lee@opd.eop.gov

underscore and period

- STEELOP1.DOC
- BEYOND.RTF

Message Sent

To:____

earp_gordana @ ustr.gov@INET@VAXGTWY @ VAXGTWY
esserman_sue @ ustr.gov @ INET @ VAXGTWY
novick_robert @ ustr.gov @ INET @ VAXGTWY
Karen Tramontano/WHO/EOP
Melissa G. Green/OPD/EOP
Sharon H. Yuan/OPD/EOP
Lael Brainard/OPD/EOP
Charles M. Brain/WHO/EOP
Joshua Gotbaum/OMB/EOP
Nouriel Roubini/CEA/EOP
Jeffrey A. Frankel/CEA/EOP

=================== ATTACHMENT 1 ===================
ATT CREATION TIME/DATE: 0 00:00:00.00

TEXT:
Unable to convert ARMS_EXT:[ATTACH.D39]MAIL42525746Q.036 to ASCII,
The following is a HEX DUMP:

PROPOSALS FOR STRENGTHENED TRADE REMEDIES/ENFORCEMENT

The proposals below track the issues raised at the Principals' meeting last Friday, February 26, and are organized under five general headings: (1) Increased Resources; (2) Improved Monitoring/Early Warning System; (3) Early and Effective Relief; (4) Anti-Circumvention; and
(5) Other Enhanced Enforcement.

I. INCREASED RESOURCES

[Proposal is for an additional $10 million for Commerce Department to implement all listed below; in addition, other resources could be requested for Customs, USTR, etc.]

A. Expanded Import Monitoring and Response to Import Surges

- Additional resources would improve current steel import monitoring and ability to identify additional import-sensitive industries, monitor shifts in product mix or country resulting from application of trade laws, etc.
- Other initiatives would include action plans to provide options for quicker relief from import surges
- This directly responds to points raised in House Caucus meetings and Ways and Means Trade Subcommittee hearing last week

B. Expedited Trade Cases When Warranted by Import Surges

- Additional resources would be allocated specifically to those cases being expedited

C. Technical Assistance to Small- and Medium-Sized Enterprises (SMEs)

- Legal assistance/counseling for SMEs on how to file a case, assemble required data, etc.
- This may be especially useful for agricultural producers/likely to be popular with Congress

D. Expanded Subsidies Enforcement

- Intent is to ensure that unfair subsidies do not keep U.S. industries from entering overseas markets, while improving efforts to pressure foreign governments to stop subsidization

E. Increased Resources for WTO Dispute Settlement

- Two components: vigorous defense when application of U.S. dumping and countervailing duty laws challenged in WTO, while ensuring U.S. producers are treated fairly in foreign dumping cases

II IMPROVED MONITORING/EARLY WARNING SYSTEM

A. Special HTS Suffix for Tracking Imports Subject to Investigations

- Would provide separate statistical breakout (suffix) for import data collected by Customs/compiled by Census to clarify the products subject to investigation or order and allow easier tracking of products (volumes and prices) covered by trade cases

B. Exception to OMB Directive for Public Access to Early Trade Data

- Under new guidelines as part of Steel Action Plan, Census now releases preliminary steel import data to the public 20-25 days before the release of the official trade statistics
- Guidelines permit release of preliminary import statistics only in very limited situations by requiring proof of import surges, significant import penetration, prior history of unfair trade, etc.
- Release of preliminary steel import data in December and January has proven very useful to both Administration and industry
- Congress would provide guidance to continue applying this approach -- not changing terms of this narrow exception
- Proposal has not yet been reviewed with Census/other statistical agencies

III. EARLY AND EFFECTIVE RELIEF

A. Authority to Collect Cash Deposits in Face of Import Surges

- Once there is a preliminary determination of dumping, Commerce must impose some form of security on future imports to cover the potential liability for dumping duties; by law, this may be either cash deposit or bond
- Current standard for requiring cash deposit is narrow (where necessary "to protect the revenue")
- Proposal would eliminate this "protect revenue" requirement and provide more flexibility to require cash deposits in the case of import surges
- Still need to assess degree of Hill interest and to review WTO consistency and what other key trading partners do here

IV ANTI-CIRCUMVENTION

A. Clarify/Strengthen Current Anti-Circumvention Provisions

- U.S. Court of International Trade (CIT) recently has interpreted "minor alterations" provision narrowly (e.g., prevented Commerce from conducting an inquiry when the chemical composition of a steel product was slightly modified even though it had the same uses as before), severely limiting its value as anti-circumvention tool
- Proposal would enhance effectiveness of dumping law/orders
- Strong Congressional interest in/support for improving current law, especially in light of restrictive CIT interpretations

V. OTHER ENHANCED ENFORCEMENT

A. Codify Existing Authority for Border Measures to Enforce Suspension Agreements

- Successful and timely enforcement of suspension agreements may depend on Commerce's ability to impose special import procedures for merchandise covered by the agreement -- such as in cases of perishable agricultural products
- Proposal would clarify Commerce's authority in this area; it would also provide explicit authority to punish individual violators of a suspension agreement without terminating the agreement in its entirety

B. Clarify Use of Adverse Inferences

- Recent CIT decision interprets law to severely restrict use of adverse inferences, undermining vigorous dumping enforcement
- Proposal would amend law to clarify use of such information
- Use of "facts available" has been controversial issue with trading partners, etc.

C. Greater Sharing of Proprietary Data among Commerce, ITC, and Customs

- Trade Secrets Act prohibits releasing Customs and ITC data to parties in a dumping case -- even under Administrative Protective Order
- Proposal would allow sharing of certain such data with Commerce; would be useful in enforcing dumping orders and suspension agreements
- Treasury/Customs has expressed concern pending more careful review of this proposal

D. Currency Conversion

- In converting prices in home market currencies to U.S. dollars, Commerce usually uses the exchange rate on the date of the U.S. sale
- WTO Antidumping Agreement and U.S. law provide for an exception when there is "sustained movement" in the exchange rate -- allowing exporters at least 60 days to adjust their export prices

- Current law interpreted so this applies only to appreciating currencies -- meaning foreign exporters benefit from use of an average exchange rate from an earlier period, which effectively results in a lower home market price and therefore lower dumping margin
- Proposal would apply this narrow exception to depreciating currencies as well, i.e., would use an average exchange rate from an earlier period for two months when there is a sustained depreciation of a foreign currency against the dollar
- This stops well short of what domestic industries have asked for and may seek from Congress, but it addresses their chief concern that sustained currency devaluations may affect accuracy and validity of dumping analysis
- Treasury, NSC, and CEA expressed concerns pending more careful analysis of proposal

E. Dates for ITC's Injury Analysis

- Under current practice, ITC looks at trends over a three-year period before the filing of a petition and excludes new, unfolding, and potentially relevant data that become available during the course of its investigation
- While some cutoff date is needed so ITC can complete its analysis, more direction is needed so it considers and weighs more heavily data that are more recent

F. Clarify Conditions for Cumulating Imports

- When a dumping petition is filed against several countries on the same day, the ITC cumulates the imports from all the countries under certain conditions
- Proposal would clarify conditions under which imports may be cumulated; would provide more certainty to ITC's injury analysis

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Nouriel Roubini (CN=Nouriel Roubini/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME: 1-MAR-1999 09:16:49.00

SUBJECT: Re: Labor/Trade Follow-UP

TO: Janet L. Yellen (CN=Janet L. Yellen/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TEXT:
Would love to join this meeting. That week I will be in Cambridge on Fri the 19th but any other day would be good.
Nouriel

Janet L. Yellen
02/26/99 05:35:50 PM
Record Type: Record

To: Nouriel Roubini/CEA/EOP
cc:
Subject: Labor/Trade Follow-UP

We will try to arrange this meeting for the week of March 15 and you should come. Let's talk about what to include in the agenda when Bob Lawrence arrives next week.
---------------------- Forwarded by Janet L. Yellen/CEA/EOP on 02/26/99 05:35 PM ---------------------------

Karen Tramontano
02/25/99 02:19:36 PM
Record Type: Record

To: Michele Jolin/CEA/EOP
cc: Janet L. Yellen/CEA/EOP, Gene B. Sperling/OPD/EOP, Lael Brainard/OPD/EOP
Subject: Labor/Trade Follow-UP

Michele,

I spoke w/ janet the beginning of this week and asked her if she would convene a meeting of labor economists --as she did when we encountered difficulties w/ global climate change -- to begin a dialgoue to hopefully develop a common framework in which to discuss trade, job loss etc. the

labor community titles this dialogue as the deindustrialization of america --without agreeing to the caption -- i think the dialgoue is worthwhile.
If you would help me w/ three items -- I would greatly appreciate it
1. give me possible dates when janet and other cea economists have about 2 hours;
2. work w/ me on a list of other administration participants e.g. nec, labor, commerce, ustr
3. work w/ me to develop either an agenda or a list of topics through which we can structure the dialogue

the sooner we can put this meeting together -- the better. thanks, kt

---------------------- Forwarded by Janet L. Yellen/CEA/EOP on 02/26/99 05:35 PM ---------------------------

Karen Tramontano
02/25/99 04:48:34 PM
Record Type: Record

To: See the distribution list at the bottom of this message
cc: Melissa G. Green/OPD/EOP, Paul A. Tuchmann/OVP @ OVP
Subject: Follow-Up Labor Meeting

I know I spoken briefly to each of you and said I would circulate a memo -- since I have not done that yet, I thought I would briefly update you on my thinking. I've also talked w/ Alexis Herman and Kitty Higgins. After the wonderful meeting john and i had in florida -- i thought 4 next steps would be appropriate.

1. Pull together the economists in the Administration and schedule a meeting w/ the economists in the labor community to have the "deindustrialization" of America discussion. They believe its as a result of trade -- I think we believe otherwise. I hope a thorough discussion of the issues, our areas of agreement and disagreement will be helpful. Janet has agreed to convene the meeting. If we could do this next week -- that would be great. We should have a pre-meeting to talk through the agenda/approach -- see previous e-mail

2. Pull together a policy meeting w/ labor community policy folks to answer the question: "What does it mean to include labor and enviornmental rights" in traditional trading authority. Lael/Rick have agreed to this process -- I'd include policy folks from labor/commerce/ustr -- Gerry Shea would like to exclude labor legislative folks -- and is trying to come up w/ the appropriate policy folks -- I am pushing him for times next week.

3. Have an internal discussion/analysis on economic incentives we provide to industry and go through a process to determine whether -- where we have made the decision to provide economic incentives--we can condition those incentives on requiring capital and the means of production to remain in the united states -- (when the President spoke at the Steel workers,

Machnists and Autoworkers Conference he spoke about his Sperling/Jackson initiative and they loved it because they heard it as jobs remaining in th eir communities) I don't know whether we can or if its good policy to condition incentives -- but I believe that if NEC could run a process to figure this out and we could talk about it as something we are looking at, it would be helpful

4. CEA, Labor, Commerce -- identify and analyze the growing sector of the economy to determine whether there are practical, economic, legal or other impediments to organizing workers in the growing sectors --- if there are, we should figure out whether there is legislative or other vehicles we could propose that may help to level the playing field. We would have to think this through very carefully, but we may be able to fashion an approach that puts us on the side of providing tools to workers in a chang ing economy and in growth industries. Perhaps it is appropriate for CEA to take the lead on the analysis -- and NEC to take the lead on the discussion?? I could use some guidance here.

i think these next steps also would help with our trade strategy. it puts us in the position of having heard some of the concerns of workers who are losing their jobs and unions who are concerned about a changing and global economy and responding in a thoughtful way. thanks, and please give me feedback on any of these ideas.

Message Sent
To:____

Gene B. Sperling/OPD/EOP
Janet L. Yellen/CEA/EOP
Lael Brainard/OPD/EOP
Ron Klain/OVP @ OVP
Monica M. Dixon/OVP @ OVP
Richard M. Samans/OPD/EOP

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Douglas W. Elmendorf (CN=Douglas W. Elmendorf/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME: 1-MAR-1999 17:32:41.00

SUBJECT: speech materials

TO: Janet L. Yellen (CN=Janet L. Yellen/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TEXT:
=================== ATTACHMENT 1 ===================
ATT CREATION TIME/DATE: 0 00:00:00.00

TEXT:
Unable to convert ARMS_EXT:[ATTACH.D55]MAIL404667468.036 to ASCII,
The following is a HEX DUMP:

Draft 2/2/99

Fiscal Policy

Let me turn now to a subject that is one of the Administration's greatest accomplishments in economic policy and also one of our Nation's greatest challenges for the future.

Before President Clinton took office in 1993, the Congressional Budget Office projected that the budget deficit would top $350 billion in 1998 and continue climbing. Publicly held debt had increased from 26 percent of GDP in 1981 to 50 percent in 1993, and it too was expected to increase rapidly during the rest of the 1990s. Instead, the budget outlook has improved dramatically: in 1998 we enjoyed the first budget surplus since 1969 and the largest surplus as a share of GDP since 1957. The ratio of debt-to-GDP has fallen to 44 percent. More important, the Administration now projects substantial surpluses in the unified Federal budget and a further decline in debt well into the future.

This remarkable reversal in our fiscal fortunes owes to several factors. The first was a set of tough policy decisions made by the President and Congress. In 1993 and again in 1997, the budget deficit was reduced by slowing the growth of entitlements and imposing stringent caps on discretionary spending. A second factor reducing the deficit was strong economic growth, which boosted tax revenue considerably and dampened spending a little. Finally, technical factors boosted receipts and depressed outlays over and above what policy changes and macroeconomic conditions can account for. [On the receipts side, higher-than-anticipated capital gains realizations and changes in the distribution of income among taxpayers boosted individual income tax revenue beyond expectations. On the outlays side, spending for Federal health programs--primarily Medicare and Medicaid--has been lower than expected, most likely reflecting slower growth in health care costs economy-wide.]

Achieving a surplus in the Federal budget has provided the foundation for tackling longer term problems. The most important of these problems is posed by the aging of the population, with its implications for future imbalances in Social Security and Medicare and for the strength of the economy as a whole.

[The most commonly used yardstick to measure the financial soundness of the Social Security system is its 75-year actuarial balance. The Social Security actuaries now project that the current balance in the Trust Fund together with projected revenues over the next 75 years will be insufficient to fund the benefits promised under current law. By 2013, payroll contributions are expected to fall short of benefits. By 2021 the shortfall is expected to exceed Trust Fund interest earnings, so the Trust Fund will begin to decline. And by 2032, the Trust Fund is expected to be depleted, after which time contributions would still be sufficient to pay about three-quarters of current law benefits. Of course, future taxes and benefits will depend on a variety of economic and demographic factors that cannot be predicted perfectly, so the actual problem may be smaller or larger than we now believe.]

With respect to Social Security, the primary factors that will push benefits above payroll tax receipts are improvements in life expectancy and a reduction in birth rates, which have put us on a path of rapid declines in the number of employed workers for every retiree. When the Social Security Act was passed in 1935, the life expectancy of a 65-year-old American was about 13 years. Today, life expectancy for a 65-year-old is 18 years and rising. At the same time, people are retiring earlier. In 1950 the average age for first receiving Social Security retirement benefits was 68; today it is 63. As a consequence of these changes, the ratio of employed workers to retirees has fallen from about 5 to 1 in 1960 to 3-1/2 to 1 today. In only 30 years time, it will be just 2 to 1 and still falling. With respect to Medicare, these same demographic effects combine with the rising cost of medical care to pose an even greater threat to the finances of that program.

For the Nation as a whole, the central problem is how to provide a high standard of living for both workers and retirees, even though a smaller share of the population will be in the workforce. A natural solution is to make workers more productive by increasing investment in both physical and human capital, which will, in turn, raise labor productivity. In doing so, we can increase the size of the total economic pie, which is the prerequisite to meeting the retirement costs of the baby boom generation without unduly burdening future workers.

The key to accomplishing this goal is to increase national saving. Net national saving has increased from 3.1 percent of GDP in 1992 to 6.7 percent of GDP today, an increase that is accounted for entirely by an increase in government saving. Fiscal discipline has been a centerpiece of this Administration's economic policy, and the President is now trying to ensure that this discipline continues into the first decades of the 21st century.

In his State of the Union address a year ago, the President proposed to reserve the budget surplus until agreement had been reached on a plan to secure the viability of Social Security. With this commitment to "save Social Security first," a yearlong process of public education and bipartisan discussion followed. In his State of the Union address last week, the President put forward a compreheneisve framework for Social Security reform that also addresses several other critical objectives for this Nation. Let me first discuss the various pieces of this plan, and then return to the plan's overall macroeconomic impact.

Regarding Social Security, the President proposed to transfer 62 percent of the projected unified budget surpluses over the next 15 years to Social Security, amounting to about $2.8

trillion. About a quarter of those transfers would be invested in corporate equities, with the remainder invested in special Treasury securities like the current balance in the trust fund. Investing in a mixture of bonds and equities is, of course, standard for private or state and local government pension plans, and the President intends to limit the trust fund's holdings of equities to only 15percent of its total assets, which is more conservative than most pension plans.

I should emphasize that we are very sensitive to the possible dangers associated with government ownership of private firms, so we intend to work with Congress to devise a mechanism to ensure that the investments are made independently, without political interference, and with low administrative costs by the most efficient private-sector managers. Under this plan, only 4 percent of the overall stock market would be owned by Social Security, about equal to the share controlled by Fiedlity Investments, and much less than the share owned by state and local pension plans. It is worth noting that, as an approach for investing in the stock market, equity investment through the trust fund has at least two key advantages over investing through individual accounts: substantially lower administrative expenses, and much greater risk sharing of market fluctuations both within and across generations.

According to the indepdent Social Security actuaries, the transfers and equity investments would ensure the solvency of Social Security through 2055, 33 years beyond the expected exhaustion date of the trust fund under current law. However, 75-year actuarial balance is the usual measure of solvency, and the President has emphasized his desire to make the hard-headed, painful, but sensible choices needed to extend the trust fund through 2075. Many possibilities have been suggested by policy analysts, including increasing the normal or early retirement age, raising the maximum level of taxable earnings, enrolling state and local government workers in Social Security, and so forth. None of these changes would be easy, and all would require bipartisan support to succeed. Nevertheless, 75-year balance can be achieved without excessive pain, and any changes that are implemented could be phased in very gradually.

The President also proposed two specific changes in Social Security rules. One is to eliminate the "earnings test," whereby workers who earn more than a base amount lose between 30 and 50 cents of Social Security benefits for each extra dollar they earn. This is the worst form of tax: in present value sense, it is hardly a tax at all, because the benefit reduction while earning is made up by increased benefits later, but it appears to be a tax and is confusing and burdensome, so it probably discourages work. It is probably one of the factors contributing to early retirement.

The President also wants to reform Social Security to reduce poverty among elderly women who are widows. The poverty rate for *all* elderly women was 13 percent in 1997, but for widowed elderly women it was 18 percent. In contrast, the poverty rate of married women was about 5 percent and for widowed men about 12 percent. Currently, widow benefits vary from 50 to 67 percent of benefits for a married couple when both were alive. However, using the official poverty thresholds, a widow needs 79 percent of a couple's income to maintain her pre-widowhood consumption. This is a key reason why widow poverty is so much higher than overall elderly poverty.

The President has stated clearly that his foremost priority is securing the future of the Social Security system. If that goal is reached, then the President stated that the remaining projected surpluses over the next 15 years should be dedicated to three purposes. First, 15 percent of the projected surpluses would be transferred to the Medicare trust fund. The Administration, the Congress, and the Medicare commission should work to use these funds as part of broader reforms. Even without such reforms, however, the transfers would extend the projected solvency of the Medicare trust fund to 2020. Second, 12 percent of the projected surpluses would be used to create Universal Savings Accounts, which would help people save more for their retirement needs. One possible structure for these accounts would have the government provide a fixed contribution for most working Americans and an additional matching portion, with a higher matching rate for lower income workers. These accounts would not be part of the Social Security system but would provide additional retirement resources. The remainder of the projected surpluses over the next 15 years would be reserved to improve military readiness and to meet pressing domestic priorities in such areas as education and research.

This framework for Social Security reform dramatically extends the Administration's commitment to fiscal discipline and saving for our Nation's future. Evaluated from a macroeconomic perspective--from the perspective of national savings--this plan saves, in essence, between 77 and 89 percent of the projected surpluses, depending on one's evaluation of the saving impact of the USA accounts. The transfers to Social Security and Medicare amount to 77 percent of the federal budget and about 2 percent of GDP, and they are pure additions to national saving. In addition, the USA accounts amount to 12 percent of the budget and could be viewed as a tax cut that is highly likely to add to personal saving. Only 11 percent of the surpluses are devoted to additional government spending.

Dedicating the surpluses to Social Security and Medicare serves two purposes. First, it helps to lock in the surpluses so they are not used for tax cuts or wasteful spending. Second, it gives these critical programs a "first call" on the benefits of our fiscal discipline. And these benefits will be large.

This is a fiscally conservative, pro-growth plan that comes close to a plan of simply paying off debt. Publicly held debt is projected to fall from 44 percent of GDP today to about 7 percent in 2014. That would represent the smallest burden of government debt on the economy since the United States entered World

War I in 1917. In addition, some of the surpluses will be used to purchase equities, which will represent an asset of the government. The dramatic decline in national debt would icnrease private capital investment, raise future national income, and free up government resources by reducing debt servicing costs.

[this probably needs more of a wrap-up]

MEMORANDUM TO JANET YELLEN
FROM: Doug Elmendorf
DATE: December 1, 1998
SUBJECT: Provocative Social Security Ideas

There are several pieces here that could be rearranged or combined as desired:

1) Individual accounts have serious problems but also real advantages. (Pages 2-5)
   This is new to you, although it includes text and ideas you've seen before.

2) Is "pain-free" Social Security reform possible? (Page 6)
   I think I passed these notes on to you earlier.

3) Cutting benefits vs. prefunding benefits. (Page 7)
   I think I passed these notes on to you earlier as well.

4) Why do we want to fix Social Security? (Page 8)
   This is a summary of Larry Summers' opening comments at the meeting with the President several weeks ago. As you recall, it covers several issues we've discussed.

I'm happy to rework this material or to start again in some other direction if I've misunderstood what you're looking for.

Individual accounts have serious problems but also real advantages.

The basic problem: Social Security benefits would become defined contribution rather than defined benefit. The basic advantage: Social Security would be removed from the unified budget.

Serious Problems

1. Administrative costs

The Social Security Administration uses less than 1 cent per dollar of benefits paid out. In terms of annual fees, this corresponds to about 5 bps per year.

Vanguard--one of the mutual fund industry's leaders in cost reduction--uses 20 bps per year for indexed funds. The cost of IAs would be significantly higher:

* much smaller accounts,
* needing to keep track of *how much* money goes into *which* accounts, and
* management fees on non-indexed funds.

Alternatively, we could have more limited services.

2. Investment choices and government guarantees

Many people have no experience in making investment choices. They might make bad long-term choices (no stocks) or mis-time market moves.

We could limit portfolio choices or provide some type of guarantee.

Marty Feldstein has claimed that providing a guarantee against investment risk would not be costly to taxpayers. But he has understated the risk in several ways:

* even if the chance of needing the guarantee is small, the amount to be paid in that situation could be huge -- this is the essence of insurance
* he assumes that people hold a fixed portfolio 60:40 stocks and bonds -- but people would presumably have the option of going entirely into stocks, and might do so if there were a good guarantee -- or, people could mis-time the market by buying at peaks and selling at troughs -- both of these would raise the probability of needing a guarantee and the amount to be paid out

3. Annuitization

Social Security provides an inflation-indexed annuity, protecting beneficiaries against both longevity and inflation risk.

Annuitizing individual accounts is possible but complicated:

* government control and involvement would be large
    * Unless annuitization were mandatory, some people would run out of money, and adverse selection would be a serious problem.
    * Unless annuitization were publicly run, costs would be high and unisex pricing would be impossible.
    * Unless early access were restricted, some people would have too little money for a comfortable retirement.
    * Unless the public program were off-budget, budget numbers would be badly distorted.
* ensuring the desirable outcome on these specifics would be difficult to ensure
    * Policymakers will focus on the perceived key issues, and annuitization details are not likely to be on that list.
    * Many of the specifics involve more public rules or involvement than IA supporters are likely to support.
* volatility of payment levels owing to financial-market developments would be substantial
    * Gradual purchase of annuities helps, but equity variability is large.
    * Variable annuities could be used, but then you lose the inflation protection.

These problems would be much larger if IAs represented a larger share of total Social Security benefits.

In sum

Defined-benefit pension plans have real advantages over defined-contribution plans: they naturally spread investment and longevity risk, and they have low administrative costs and require little knowledge by participants.

DB plans have diminished in importance in the private sector because of our dynamic labor market. People don't work for the same company their entire lives, and companies come and go. So non-portable benefits that depend on consistent corporate management have a problem. But these problems don't exist with Social Security, so this is the place to have DB pensions.

Note that many of the solutions to these problems amount to making IAs behave more like DB pensions. But then what are the advantages of IAs?

Real Advantages

The primary advantage is removing Social Security from the unified budget, which would have several effects (#1-#4 below). There are also other effects (#5-#7 below).

1. Pre-funding

We could pre-fund benefits in a way that we've proven unable to do with Social Security in the unified budget. This would raise national saving, which is probably the appropriate response to an aging population. (It would probably not raise saving dollar-for-dollar, because of private saving responses.) Moreover, it would make each cohort more responsible for its own retirement, which probably is fair.

2. Equity returns without corporate governance problems

Putting equities into the public retirement system would have minimal effects on the nation as a whole: Although one can work out a variety of general equilibrium effects, the primary impact is simply to leave more bonds and fewer equities in private hands.

Still, there may be advantages to this step. For example, raising the expected return on public assets relative to private assets may be progressive, since private assets are held disproportionately by rich people. (Risk-sharing is probably not a reason to do this, contrary to Peter Diamond's claims. Efficiency of financial markets would not be improved by government risk-sharing because ownership of major equities is already sufficiently broad. Equity would not necessarily be improved either. The government already bears substantial equity risk through capital taxation, and that may be enough to achieve appropriate intergenerational risk-sharing. Poor people bear no direct risk today (or receive the higher return directly), but they bear some through the government budget, and they probably would not be the residual claimant through the Social Security system anyway.)

But public equity investments raises a host of concerns:

* deciding what to buy -- some of this emerges under IAs as well, if we limit investment options
* deciding how to exercise control -- the government could hold 10% or more of total equities under some hypothetical plans (and depending on equity performance)

3. Less budget distortion

With Social Security in the unified budget, we seem flush with money now and will seem starved for money in 20 years. These swings in availability of funding for other needs are not useful.

4. Less political risk

Pre-funded benefits would be less susceptible to the whims of future political leaders.

5. More clarity about redistribution

In addition to the progressive income redistribution, Social Security redistributes money in a variety of other ways (for example, from dual-earner families to single-earner families). These issues have not been discussed openly for decades, and setting up IAs would force the country to be explicit about the types and amount of redistribution we favored.

6. Less distortion to labor supply

People tend to view current FICA "contributions" as taxes. Some of that is related to real redistribution, but some is related to the general fog around the whole system in people's minds. IAs would be clearer, so people's perceived marginal tax rates would be smaller for the same amount of actual redistribution.

7. "Double-counting" may seem less peculiar

Moving the funds out of the government would at least prevent triple counting by some future Congress.

Is "Pain-Free" Social Security Reform Possible?

- Several years ago, concern about the Social Security imbalance (and growing entitlements for the elderly in general) implied that benefits should be cut or taxes raised. These painful measures have been the standard in Social Security reform (for example, in 1983).

- Suddenly, the possibility of "pain-free" reform has emerged, stemming from two novelties:
    - the emergence of projected budget surpluses
    - a willingness to invest public funds in the stock market

- But these developments do not really offer a free lunch.

  Devoting too much of the projected surpluses to reform has costs:
    - Projected surpluses might not materialize, leaving a big fiscal gap.
    - Surpluses used to fund benefits cannot be used for spending initiatives or tax cuts.

  Investing in equities has costs:
    - Stocks may not yield the return we expect.
    - Swapping equities for bonds with the private sector contributes nothing to the nation as a whole.

- Because of population aging, the nation cannot maintain historic patterns of Social Security replacement rates, tax rates, and discretionary spending into the next century. Small adjustments in each of these areas would reduce the need for big adjustments in any one area.

- Trimming benefits or raising taxes--in addition to setting aside some of the projected surpluses--is good public policy.

Cutting Benefits vs. Prefunding Benefits

We have been viewing these options as perfect substitutes in terms of fiscal responsibility, and I think this view is mostly correct. However, several factors suggest that cutting benefits is more fiscally responsible than prefunding them--for a given projected 75-year impact:

1. Benefit cuts have better effects beyond the 75-year window.

2. Prefunding benefits has greater risk.
   If we cut benefits, they're cut. But the projected effect of prefunding depends on equities earning the return we project and yet-unrealized surpluses coming to pass.

3. Prefunding wouldn't raise saving as much as we project.
   Our calculations assume that all of the surplus devoted to prefunding represents incremental saving. In fact, some of the money placed in IAs would be offset by lower other saving (and maybe extra money placed in the trust fund would be offset too), and some of the money used for tax cuts would be saved. So the net saving could be 2/3 or so of our projections.

4. Future flows matter as well as stocks.
   Large deficits cause economic dislocations and put pressure on other spending even if the stock of debt is low. (Note that under TF in equities plans, future deficits are smaller because of equity sales.) Large amounts of dis-saving cause economic dislocations even if the stock of capital is high.

In addition, we may also prefer the equity implications of benefit cuts. If we believe that the government is already committing too large a share of its resources to older people in the next century, then we would prefer to devote some of the surpluses to other national needs. (Politics may make this difficult, however.)

These arguments suggest that devoting more of the surplus to Social Security reform in order to raise future benefits--an idea raised at the principals' meeting--is not good policy.

Also, these arguments illustrate the limitations of calculating changes in national savings. National savings is the best measure of the impact of reform on the size of the future economic pie. National savings adjusted for changes in benefit levels is the best measure of what we're doing for future generations.

Larry Summers: Why Do We Want to Fix Social Security?

First, because currently legislated taxes are insufficient to pay currently legislated benefits over the next 75 years. Social Security is essentially a pension system, and the actuaries have given us a bad report on the funding of that system. This problem could be fixed by raising the payroll tax, cutting benefits, achieving a higher rate of return, or transferring general revenue.

Second, because the share of the U.S. population over age 65 will increase sharply in the next century. Regardless of what pieces of paper are held by the Social Security Trust Fund, society will face a larger burden of caring for older people. This burden has been perceived partly as an "entitlements problem," because growing government expenditures for the elderly could direct money away from other social needs. People who have been concerned about this problem might feel that using general revenue to finance Social Security would move our fiscal system in exactly the wrong direction.

Third, because we want to block the use of the projected surpluses for a large tax cut that would mortgage our future to a greater degree. The key question here is what would happen to the surpluses in the absence of Social Security reform. If the surpluses would be eliminated by a tax cut, then using them for Social Security reform instead would improve the situation in 2030. But if the surpluses could be maintained without Social Security reform, then committing them to the Trust Fund creates a danger of making the 2030 problem worse if the surpluses do not materialize.

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: John F. Morrall III (CN=John F. Morrall III/OU=OMB/O=EOP [OMB])

CREATION DATE/TIME: 1-MAR-1999 10:15:30.00

SUBJECT: fyi: Heads up on clearance of OSHA rule

TO: Janet L. Yellen (CN=Janet L. Yellen/OU=CEA/O=EOP@EOP [CEA])
READ:UNKNOWN

TO: Sally Katzen (CN=Sally Katzen/OU=OPD/O=EOP@EOP [OPD])
READ:UNKNOWN

CC: Daniel J. Chenok (CN=Daniel J. Chenok/OU=OMB/O=EOP@EOP [OMB])
READ:UNKNOWN

CC: Stuart Shapiro (CN=Stuart Shapiro/OU=OMB/O=EOP@EOP [OMB])
READ:UNKNOWN

CC: Donald R. Arbuckle (CN=Donald R. Arbuckle/OU=OMB/O=EOP@EOP [OMB])
READ:UNKNOWN

TEXT:
Don Arbuckle asked me to forward this heads up note on clearance of an OSHA rule. We would like to complete review by cob today since today is day 91 of our 90 day review period.
---------------------- Forwarded by John F. Morrall III/OMB/EOP on 03/01/99 10:01 AM ---------------------------

Stuart Shapiro
02/25/99 12:00:44 PM
Record Type: Record

To: Joshua Gotbaum/OMB/EOP@EOP, Donald R. Arbuckle/OMB/EOP@EOP
cc: John F. Morrall III/OMB/EOP@EOP, Daniel J. Chenok/OMB/EOP@EOP, Larry R. Matlack/OMB/EOP@EOP
Subject: fyi: Heads up on clearance of OSHA rule

OMB is planning to clear OSHA's proposed rule on Payment for Personal Protective Equipment (PPE) by the end of the week (the 90th day is Sunday February 28). The rule would require employers to pay for all personal protective equipment used by employees except for safety shoes and prescription eyewear. This has always been OSHA's policy position but there has been no regulatory language to support it, and several circuit courts have ruled against OSHA based on lack of legal support for the policy. The rule is strongly supported by labor unions and will likely be opposed by employer groups.

The proposed rule claims that benefits will be over $280 million while costs will be over $60 million. The benefits come from injuries prevented due to employer payment. If employers pay for PPE, OSHA assumes that equipment will be worn more often and injuries will be prevented. The costs are the costs of additional PPE purchased when employers are paying rather than employees. There is considerable uncertainty in the data used to arrive at the dollar figures but it is the best currently available. OSHA is conducting a survey to get better data on the current extent of employer payment for PPE. OSHA has committed to reopening the comment period on the proposed rule once the results of this survey become available.

Let us know if you have any questions or reactions.

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Todd Stern (CN=Todd Stern/OU=WHO/O=EOP [WHO])

CREATION DATE/TIME: 1-MAR-1999 11:05:07.00

SUBJECT: oecd meeting

TO: Janet L. Yellen (CN=Janet L. Yellen/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TEXT:
I'm interested to hear results of your OECD meeting today re climate change. I'm also interested in pursuing the idea you floated with Moe about getting environment and economics/finance ministers together to talk about trading and costs. Could you give me a call when it's convenient?
Thanks. tds

Clinton Presidential Records
Automated Records Management System
[EMAIL] and Tape Restoration Project [Email]

This is not a presidential record. This is used as an administrative marker by the William J. Clinton Presidential Library Staff.

This marker identifies a responsive email, already made available within another collection.

Collection: 2013-0306-F

Bucket: CEA

Creation Date: 1999-03-02

Subject: Background information on unions, trade, etc.

Creator: Janet L. Yellen CN=Janet L. Yellen/OU=CEA/O=EOP [CEA]

Withdrawal/Redaction Marker
Clinton Library

DOCUMENT NO. AND TYPE	SUBJECT/TITLE	DATE	RESTRICTION
001. email	Janet L. Yellen to Sarah Johanna Reber at 14:25:07.00. Subject: Re: reference. (1 page)	03/02/1999	b(6)

COLLECTION:

Clinton Presidential Records
Automated Records Management System [Email]
CEA ([Yellen])
OA/Box Number: 950000

FOLDER TITLE:

[02/26/1999 - 03/11/1999]

2013-0723-F
ab1295

RESTRICTION CODES

Presidential Records Act - [44 U.S.C. 2204(a)]

P1 National Security Classified Information [(a)(1) of the PRA]
P2 Relating to the appointment to Federal office [(a)(2) of the PRA]
P3 Release would violate a Federal statute [(a)(3) of the PRA]
P4 Release would disclose trade secrets or confidential commercial or financial information [(a)(4) of the PRA]
P5 Release would disclose confidential advice between the President and his advisors, or between such advisors [a)(5) of the PRA]
P6 Release would constitute a clearly unwarranted invasion of personal privacy [(a)(6) of the PRA]

C. Closed in accordance with restrictions contained in donor's deed of gift.
PRM. Personal record misfile defined in accordance with 44 U.S.C. 2201(3).
RR. Document will be reviewed upon request.

Freedom of Information Act - [5 U.S.C. 552(b)]

b(1) National security classified information [(b)(1) of the FOIA]
b(2) Release would disclose internal personnel rules and practices of an agency [(b)(2) of the FOIA]
b(3) Release would violate a Federal statute [(b)(3) of the FOIA]
b(4) Release would disclose trade secrets or confidential or financial information [(b)(4) of the FOIA]
b(6) Release would constitute a clearly unwarranted invasion of personal privacy [(b)(6) of the FOIA]
b(7) Release would disclose information compiled for law enforcement purposes [(b)(7) of the FOIA]
b(8) Release would disclose information concerning the regulation of financial institutions [(b)(8) of the FOIA]
b(9) Release would disclose geological or geophysical information concerning wells [(b)(9) of the FOIA]

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Janet L. Yellen (CN=Janet L. Yellen/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME: 2-MAR-1999 14:04:49.00

SUBJECT: Re: Bloomberg

TO: Matthew S. Milner (CN=Matthew S. Milner/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TEXT:
Thanks very much for the information and the new equity page. For some reason, the change in yield figures on our Bloomberg monitor do not coincide with those on the Knight Ridder setup, which made me think the measurements were not in basis points.

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Steven N. Braun (CN=Steven N. Braun/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME: 2-MAR-1999 19:37:51.00

SUBJECT: draft letter to moynihan attached

TO: Janet L. Yellen (CN=Janet L. Yellen/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TEXT:
==================== ATTACHMENT 1 ====================
ATT CREATION TIME/DATE: 0 00:00:00.00

TEXT:
Unable to convert ARMS_EXT:[ATTACH.D91]MAIL421658560.036 to ASCII,
The following is a HEX DUMP:

March 2, 1999

Dear Senator Moynihan,

John Podesta asked me to respond to your letter of February 24th concerning methodological revisions to the CPI and how these should be used to update the Boskin Commision estimates. Some of the recent and prospective methodological revisions to the CPI were known to the Boskin Commission, and some were not. Therefore, your citation from correspondence between our staffs--speculating that the Boskin Commission would probably revise down its estimate of bias by only about 0.3 percentage point rather than the cumulative 0.7 percentage point of actual and prospective CPI revisions--remains appropriate.

Based on the latest edition of the *Economic Report of the President* (*ERP*), I would guess that the the Boskin Commission would lower its estimate of bias by about 0.29 percentage point, as the Commission did not anticipate the methodological revisions shown below. (The precise figures cited in your letter were based on correspondence of a year ago and are consistent with table 2-4 from the 1998 *ERP*. We have revised slightly our estimates of CPI methodological changes in our 1999 edition. The relevant tables and discussion from both the 1998 and 1999 editions are attached.)

Methodological Revisions not Anticipated by the Boskin Commission

Change	Effect
Hospital Services index	-.01
Personal computer hedonics	-.04
Geometric means	-.20
Rotation by item	-.04
Total	-.29

I regret the confusion in the debate over which methodological changes ought to be counted against the Boskin Commission estimates, and I am open to suggestions on how to clear this up. Perhaps members of the Boskin Commission ought to make a joint statement saying how much the recent BLS methodological changes would lower their estimate of bias.

Sincerely,

Janet L. Yellen

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Janet L. Yellen (CN=Janet L. Yellen/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME: 2-MAR-1999 14:02:57.00

SUBJECT: Eastern Speech

TO: Charles F. Stone (CN=Charles F. Stone/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TEXT:
Attached is a copy of the speech I gave at the National Economics Club--just a slightly reworked version of the Center for National Policy ERP speech. Any suggestions of how I might rework it for the Eastern Economics Association would be greatly appreciated. ==================== ATTACHMENT 1 ====================

ATT CREATION TIME/DATE: 0 00:00:00.00

TEXT:
Unable to convert ARMS_EXT:[ATTACH.D87]MAIL49001556C.036 to ASCII,
The following is a HEX DUMP:

The 1998 Economic Report of the President

Dr. Janet Yellen
Chairman, President's Council of Economic Advisers
National Economics Club
February 25, 1999

Thank you. It is a pleasure to be here. I appreciate your invitation to talk today about the *Economic Report of the President,* and to discuss the outlook for the American economy. As you may know, the Employment Act of 1946, which created the Council of Economic Advisers, requires the President to submit an *Economic Report* to the Congress each year. Preparation of this report is a central function of the Council of Economic Advisers, and it is always worthwhile endeavor because it gives us a chance to reflect in an organized way on economic developments in the American and world economy and to explain the economic logic of the Administration's agenda.

In addition to giving us the responsibility for producing an annual report, the Employment Act of 1946, together with its later amendments, also gave the Federal government responsibility for stabilizing short-run economic fluctuations, promoting balanced and noninflationary economic growth, and fostering low unemployment. One purpose of the *Economic Report* is to tell Congress whether we have met those responsibilities. Last year was a year for baseball home-run records, and it was also a year for economic records. We were especially happy to be able to report this year--the fifty-third year after the Act-- we achieved the longest peacetime economic expansion on record—and the records go back to 1854. In fact, that's why we chose a red cover for this year's *Economic Report* -- to symbolize our Nation's

"red hot economy."

In the remainder of my remarks I would like to focus in greater detail on the characteristics of this extraordinary expansion, and discuss the outlook going forward. I want to particularly emphasize one of the themes in this year's Report: that the strong labor market we are now enjoying is producing benefits, particularly for groups that have not seen much economic progress for a long time. Finally, I'd like to briefly discuss two longer-term economic challenges which we ought to address now: the need to prepare our nation for the seismic demographic shift which is underway; and the necessity of implementing improvements in the architecture of the international financial system to make it less crisis prone while preserving the benefits of outward-looking trade and investment policies.

STATE OF THE ECONOMY

Let me begin by saying a bit about the state of the U.S. economy. In our view, our Nation's economy is the strongest it has been in a generation. In 1998, growth was impressive, and job creation was vigorous while inflation declined. Real GDP grew 3.9 percent. Nonagricultural jobs increased by about 2.9 million during the year, and the average unemployment rate for the year dropped to 4.5 percent, its lowest level since 1969. The consumer price index rose by only 1.6 percent, its smallest increase since 1964, and other measures of inflation were even more muted.

As you all know, this year the Federal budget moved strongly into surplus. In the 1992 fiscal year the budget deficit was $290 billion and expected to rise further with no change in policy. But beginning in 1993, the deficit began to decline steadily as a consequence of a shift to fiscal discipline. In 1998, the budget *surplus* was $69 billion, the largest surplus as a share of

GDP since 1957, and surpluses are projected well into the future: the Administration now projects surpluses in the unified Federal budget amounting to about $4.5 trillion over the next 15 years. I will return to the budget and the use of those surpluses to address demographic challenges in a few minutes.

The current economic expansion is only the third on record that has lasted at least 7 years. This year's report puts the expansion in its historical context by comparing it with the other two long expansions--the 106-month long expansion of the 1960s (the longest in peace or war) and the 92-month long expansion of the 1980s. Judged in terms of overall economic performance this expansion has been not only long but excellent--especially with respect to inflation and unemployment. By this time in the expansion of the 1960s, for example, inflation was rising sharply and was much higher than now, at about 5%. In the 80s expansion, inflation was also rising at this stage and had reached 5%. By contrast, inflation now is much lower and has been coming down. Since the need to combat high or rising inflation is what typically brings an expansion to an end, this greatly raises the prospects for a continuing expansion. The combination of low inflation and low unemployment is particularly remarkable and shatters long held views and simple textbook theories about the possibility of combining low unemployment and inflation. In fact, the misery index, which is the sum of inflation and unemployment, is lower at this stage of the current expansion than in either the expansion of the 60s or the 80s.

This is also an expansion which is investment-driven--to a far greater extent than in either of the other two long expansions. This investment is contributing to improvements in productivity and future growth and it is working to hold inflation down. Of course, it didn't occur by accident --it's the consequence of fiscal discipline and reflects a conscious choice to

shift the policy mix toward a tighter fiscal policy coupled with a lower interest rate, accommodative monetary policy to stimulate investment and spur economic growth.

The continuing strong economic performance in 1998 is all the more remarkable because it took place at a time of considerable stress to the world economy. A third of all world economies were in outright recession or experiencing markedly slower growth by late 1998. After growing at 4.2% in 1997, world economic growth slowed to an estimated 2.2 percent in 1998, a pace comparable to the growth rates registered during the pronounced world slowdowns of 1974-75, 1980-83, and 1990-91. Our trade deficit rose and exports declined, particularly to countries in East Asia, producing a drag on economic growth and inflicting hardship on some sectors of the U.S. economy. The international environment remains exceptionally risky, with the prospects for growth in Europe, for a recovery Japan and for a pickup in activity in crisis afflicted countries highly uncertain. Even so, we believe that the U.S. economy has entered 1999 on course to continue growing and the chances are good that next year at this time we will be on the verge of marking the longest economic expansion—whether in peace or war—ever.

It's traditional for *The Economic Report* to present the Administration's economic forecast and to discuss its logic and I'd like to spend a few minutes reviewing it. The main purpose of the Administration economic forecast is for use in the preparation of our budget. This Administration consciously decided back in 1993 to establish a reputation for using credible forecasts so that, budget balancing efforts--and now proposals to use the emerging budget surpluses--would not be based on rosy scenarios. This means that, as we go about making our forecast, we would prefer to err on the conservative side. Our forecast for a projection period extending through 2007 looks for a continuation of the economic expansiion with further

employment and real wage growth, but with GDP projected to grow at a much slower, 2.0% rate on average over the next 3 years in comparison with the roughly 3.9% average pace of the last three years. We project that unemployment will edge up slightly. We also anticipate that the CPI will rise at a 2.3% annual rate next year and thereafter--close to the increase in the core CPI over the past year. This reflects our expectation that some of the special factors, including plunging oil and import prices, which depressed inflation this year will contibute less in containing inflation next year and thereafter. After 2001, we project that real GDP growth will resume growth at our estimate of trend--2.4%, and the unemployment rate is projected to stabilize at 5.3%, of our working estimate of NAIRU, the unemployment rate consistent with stable inflation over the longer term.

Our forecast is similar to CBO, the Blue Chip, and other private forecasts, although perhaps a touch on the conservative side in its assumptions about the pace of sustainable growth. A natural question is why we forecast a slowdown in growth when the extent of momentum in domestic demand has been extraordinary and we ended the year with GDP growing at a stunning 5.6% pace in the fourth quarter. Our forecast of more moderate growth going forward reflects our view that several components of domestic demand may be poised to grow at slower rates. In particular, consumption, which constitutes two-thirds of output, has been growing well in excess of income, so that the personal saving rate has declined to zero. In our view, this largely reflects stock-market gains. Unless the stock market continues to surge, the impetus from wealth on consumption is likely to wane, so that consumption will moderate to match the growth of income. As for business investment, slowing consumption growth, coupled with a capacity utilization rate which is now below its historical average, may exert some restraint on the

demand for new investment goods. The past year's boom in housing starts reflects strong income gains and the impact of lower mortgage rates, but it has elevated housing starts well above their demographic fundamentals. We expect some restraint going forward in this component of demand as well.

One of the key questions in preparing the forecast concerns the trend pace of productivity growth. The official measure of productivity in the nonfarm business sector has grown at about a 2% annual rate over the past 3 years, substantially above the 1.1% annual growth rate between the business cycle peaks of 1973 and 1990 and the 1.3% pace from 1973 thru 1998. Investment growth has been exceptional, and capital accumulation should work to boost productivity. However, cyclical factors also affect productivity. Productivity growth is usually slow during recessions, rapid in the middle of an expansion and tapers off in advance of the business cycle peak. Strong productivity growth over the last three years could reflect strong output growth. On the other hand, productivity has grown even faster than would be anticipated based on cyclical factors and it is perfectly possible that the growth rate of trend productivity has risen. The extraordinarily low rates of inflation as measured by the PCE and GDP price indexes combined with healthy profits also suggest faster productivity growth than our forecast assumes. In this sense, our productivity growth assumption is conservative and I can only hope that reality shows that we were wrong. Nothing matters more to living standards over the long run than the pace of productivity improvement and an increase in the trend pace of productivity of even a tenth or two is of enormous importance for the long-term outlook for real wages and per capita income.

THE BENEFITS OF A STRONG LABOR MARKET

Let me next turn to a topic which receives emphasis in this year's *Report,* namely the impact of a strong labor market on low-wage and minority workers. Our report presents clear evidence of improvements during the last few years of this expansion.

It was once commonly accepted that an economic expansion is a rising tide that lifts all boats, so that the most surefire way to alleviate poverty and help disadvantaged groups was to keep the economy expanding. However, in the late 1970s, a new, long-term trend toward widening inequality began to afflict the economy, most likely as a consequence of pervasive technological changes raising the demand for skilled labor and lowering the demand for unskilled workers. In addition, productivity growth declined substantially, for reasons that are still not well understood. During the expansion of the 1980's, real wages declined, particularly among less skilled men. During the current expansion, we saw real wages stagnate for the first five years of the expansion. However, this has finally become an expansion in which a rising tide is lifting all boats. American workers are enjoying direct and measurable progress and in the *Report,* we describe the CEA's analysis of real wage growth. Let me talk briefly about some of these findings:

Wage growth has been particularly strong for historically disadvantaged groups. After years of decline, the real wages of black men began to increase in 1993, and they have risen by 5.8 percent in the last 2 years (since 1996). Black women and Hispanic men and women have also experienced recent gains. The tight labor market of the 1990s appears to be helping even young minority workers, who suffered greater wage declines than others in the 1980s. In 1998 alone, the real wages of young black men aged 16-24 rose by 6.2 percent.

It is well known that less-skilled men have experienced long-term wage decline since the later 1970s. In 1998, real wages among men aged 20 and over who are high school dropouts rose by 7 percent. This was the first time since at least 1979 that their wages rose. In addition, real hourly wages for men at the 10th and 20th percentiles of the earnings distribution rose 6 percent since 1993.

Immigrants, too, are earning more. Mexican- and Central American-born immigrants -- who account for about 30 percent of new immigrants since 1980 -- have had real wage growth since 1995 of almost 7 percent for men and almost 4 percent for women.

It is too early to declare victory in reversing adverse long-term trends in wages for less skilled workers. In particular, it remains hard to know how much of this turnaround is due to particularly favorable business cycle conditions. Nor is this Administration taking the improvements for granted. First, it is committed to maintaining the macroeconomic stability that is a necessary condition for ensuring that all Americans participate in the country's growing prosperity. Second, the Administration continues to stress the importance of education and training policies that address the challenges of a changing economy and a changing society.

MAINTAINING FISCAL DISCIPLINE

Although this year's economic report concludes that our economy is strong and that the prospects for continued growth are excellent, we recognize that our Nation faces other, broader challenges as we move into the 21st century.

One of the key challenges we face is to prepare our nation to meet the needs of an aging population. The ratio of employed workers to retirees has fallen from about 5 to 1 in 1960 to 3-1/2 to 1 today. In only 30 years time, it will be just 2 to 1 and still falling. The same demographic effects that have

impaired the finances of Social Security also impact Medicare and Medicaid.

As you know, in his State of the Union the President proposed a plan for how to use the currently projected unified budget surpluses and how to address the financial imbalance of the Social Security system. He proposed devoting 62% of the surpluses over the next 15 years--about $2.8 trillion with a small portion, about 1/4, devoted to equity purchases--to extend the solvency of the Social security system until 2055. Further reforms would be needed to achieve full 75 year actuarial balance, which is the most commonly used measure of financial soundness. Assuming that a solution for social security can be achieved, the President has also proposed using 15% of the projected surpluses for Medicare, ensuring the Medicare Trust Fund is secure for another 20 years. The President has emphasized the need to utilize the extra funding as part of a broad effort to strengthen the Medicare program. He also proposed creating a new system of universal savings accounts (USA Accounts) outside of Social Security with 12 percent of the surplus to help working Americans build wealth to meet their retirement needs--a way of strengthening the current pension system and helping Americans save. The government would provide an equal dollar contribution for most working individuals and provide matches for individual contributions with larger matches going to lower income workers. Finally, the President would reserve 11 percent of the projected surpluses for military readiness and education and research.

Rather than commenting in detail on the President's Social Security plan, let me talk about the overall macroeconomic impact of this plan. For the nation as a whole, the central problem in coping with an aging population is to provide a high standard of living for both workers and retirees even though a smaller share of the population will be in the workforce. A natural solution is to make workers more

productive by increasing investment in both physical and human capital, which will, in turn, raise labor productivity. In doing so, we can boost the size of the total economic pie, which is the prerequisite to meeting the retirement costs of the baby boom generation without unduly burdening future workers. The key to accomplishing this is to increase national saving, a goal to which continued fiscal discipline would contribute. National saving increased from 3.1 percent of gross domestic product in 1992 to 6.7 percent in the first three quarters of 1998, but the improvement is accounted for entirely by the elimination of the federal budget deficit, as private saving actually declined relative to total output with the personal saving rate hitting zero in the last quarter of the year. The framework offered by the President for the use of emerging budget surpluses would dramatically increase national saving. Evaluated from a macroeconomic perspective--from the perspective of national savings--this plan saves, in essence, between 77 and 89 percent of the projected surpluses, depending on one's evaluation of the saving impact of the USA accounts. The transfers to Social Security and Medicare amount to 77 percent of the federal budget and about 2 percent of GDP, and they are pure additions to national saving. The USA accounts amount to 12 percent of the unified budget surpluses and could be viewed as a tax cut that is highly likely to add to personal saving. Only 11 percent of the surpluses are devoted to additional government spending.

Dedicating the surpluses to Social Security and Medicare serves two purposes. First, it helps to lock in the surpluses so they are not used for tax cuts or wasteful spending. Second, it gives these critical programs a "first call" on the benefits of our fiscal discipline. And these benefits will be large.

This is a fiscally conservative, pro-growth plan that comes close in its macroeconomic

impact to a plan of simply paying off debt. Publicly held debt is projected to fall from 44 percent of GDP today to about 7 percent in 2014. That would represent the smallest burden of government debt on the economy since the United States entered World War I in 1917. In addition, some of the surpluses will be used to purchase equities, which will represent an asset of the government. The dramatic decline in national debt would increase private capital investment, keep interest rates low or drive them lower, raise future national income, free up government resources by reducing debt servicing costs and fuel economic growth. We have estimated, for example, that in comparison with the exploding ratios of debt to GDP forecast back in 1993, the President's plan, which substitutes productive capital assets in private portfolios for unproductive debt would lower interest rates by about 2.5%. Even compared to a more optimistic baseline in which we assume that the political process would have achieved budget savings sufficient to hold the debt to GDP ratio at 50%, the President's plan lowers interest rates by 1-1.25% by 2014 and would raise GDP by 3.5-4.5%--a substantial increase in the size of the pie.

MEETING THE INTERNATIONAL CHALLENGE

Let me conclude by saying just a few words about the challenges we face on the international economic front and then stop and take your questions.

A first challenge for the United States is to insure that, at this time of economic fragility in so many regions, we do not build new walls of protectionism here, that could set off a dangerous chain reaction around the world, imperilling the world's prospects for growth while harming our own exporters and consumers. The crisis has taken a toll on some sectors in the United States, steel being notable example. The Administration is committed to vigrous enforcement of our trade laws to insure that American industries are not victimized by unfair trade. However we must also recognize that, as the crisis economies recover, their demand for U.S. goods and services will increase as well, once again fueling our

own export growth.

Beyond keeping markets open, the Administration believes that a serious program of reform is needed to strengthen the underpinnings of international financial system to make it less crisis prone and to improve the mechanisms available for dealing with any crises that may nevertheless occur. Unfortunately, there is just no silver bullet--no simple solution that would guarantee countries the benefits of global capital flows while eliminating the risk that a crisis of confidence could once again result in the painful withdrawal of that access. Even so, international agreement is finally emerging on the steps that can and should be taken to strengthen the architecture of the financial system so that it is less crisis-prone going forward. The needed steps include measures to increase transparency and accountability in the operations of individual countries, of financial and corporate institutions and of the international financial institutions themselves to enhance the availability, relevance and reliability of information available for evaluating risk in lending. Reforms are also needed to strengthen the prudential supervision and regulation of banks and other domestic financial institutions: to create stronger incentives for borrowers and lenders to weigh risk and act with appropriate discipline, thereby reducing the odds of a crisis. Countries will need to reassess implicit and explicit government guarantees which create moral hazard and exacerbate risktaking, including the implicit promise of bailouts of corporations considered too big to fail, and semi-fixed exchange rate regimes which reduced the perceived riskiness of foreign currency exposure. Finally, measures are needed to improve creditor coordination in crises and to promote the orderly, cooperative and equitable resolution of international financial crises that may occur in the future. The United States is working intensively with key emerging markets, with other industrialized nations, and

the relevant international organizations, to put in place the building blocks of this new architecture to ensure that the unprecedented growth, increase in welfare and opportunity experienced in the 50 years after the creation of the Bretton Woods system are maintained in the future.

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Ryan D. Edwards (CN=Ryan D. Edwards/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME: 3-MAR-1999 18:02:43.00

SUBJECT: OECD Ministerial

TO: Janet L. Yellen (CN=Janet L. Yellen/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TEXT:
Hi Janet,

I just got a fax from Gary Clements at the State Department, and I immediately called him up. The issue of the Ministerial scheduling was on his mind; apparently they want to take "option B," from the two choices we had previously discussed.

I told Gary the reason why you opted for option A --- that you couldn't make it to a BIAC/TUAC meeting the previous day in that event --- and he understood and seemed to think that was just fine.

So I think we'll see option B adopted, and I think you'll be off the hook for BIAC/TUAC.

-Ryan

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Janet L. Yellen (CN=Janet L. Yellen/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME: 3-MAR-1999 12:54:25.00

SUBJECT:

TO: Robert Z. Lawrence (CN=Robert Z. Lawrence/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TEXT:
==================== ATTACHMENT 1 ====================
ATT CREATION TIME/DATE: 0 00:00:00.00

TEXT:
Unable to convert ARMS_EXT:[ATTACH.D21]MAIL41788366G.036 to ASCII,
The following is a HEX DUMP:

The 1998 Economic Report of the President

Dr. Janet Yellen
Chairman, President's Council of Economic Advisers
National Economics Club
February 25, 1999

Thank you. It is a pleasure to be here. I appreciate your invitation to talk today about the *Economic Report of the President,* and to discuss the outlook for the American economy. As you may know, the Employment Act of 1946, which created the Council of Economic Advisers, requires the President to submit an *Economic Report* to the Congress each year. Preparation of this report is a central function of the Council of Economic Advisers, and it is always worthwhile endeavor because it gives us a chance to reflect in an organized way on economic developments in the American and world economy and to explain the economic logic of the Administration's agenda.

In addition to giving us the responsibility for producing an annual report, the Employment Act of 1946, together with its later amendments, also gave the Federal government responsibility for stabilizing short-run economic fluctuations, promoting balanced and noninflationary economic growth, and fostering low unemployment. One purpose of the *Economic Report* is to tell Congress whether we have met those responsibilities. Last year was a year for baseball home-run records, and it was also a year for economic records. We were especially happy to be able to report this year--the fifty-third year after the Act-- we achieved the longest peacetime economic expansion on record—and the records go back to 1854. In fact, that's why we chose a red cover for this year's *Economic Report* -- to symbolize our Nation's

"red hot economy."

In the remainder of my remarks I would like to focus in greater detail on the characteristics of this extraordinary expansion, and discuss the outlook going forward. I want to particularly emphasize one of the themes in this year's Report: that the strong labor market we are now enjoying is producing benefits, particularly for groups that have not seen much economic progress for a long time. Finally, I'd like to briefly discuss two longer-term economic challenges which we ought to address now: the need to prepare our nation for the seismic demographic shift which is underway; and the necessity of implementing improvements in the architecture of the international financial system to make it less crisis prone while preserving the benefits of outward-looking trade and investment policies.

STATE OF THE ECONOMY

Let me begin by saying a bit about the state of the U.S. economy. In our view, our Nation's economy is the strongest it has been in a generation. In 1998, growth was impressive, and job creation was vigorous while inflation declined. Real GDP grew 3.9 percent. Nonagricultural jobs increased by about 2.9 million during the year, and the average unemployment rate for the year dropped to 4.5 percent, its lowest level since 1969. The consumer price index rose by only 1.6 percent, its smallest increase since 1964, and other measures of inflation were even more muted.

As you all know, this year the Federal budget moved strongly into surplus. In the 1992 fiscal year the budget deficit was $290 billion and expected to rise further with no change in policy. But beginning in 1993, the deficit began to decline steadily as a consequence of a shift to fiscal discipline. In 1998, the budget *surplus* was $69 billion, the largest surplus as a share of

GDP since 1957, and surpluses are projected well into the future: the Administration now projects surpluses in the unified Federal budget amounting to about $4.5 trillion over the next 15 years. I will return to the budget and the use of those surpluses to address demographic challenges in a few minutes.

The current economic expansion is only the third on record that has lasted at least 7 years. This year's report puts the expansion in its historical context by comparing it with the other two long expansions--the 106-month long expansion of the 1960s (the longest in peace or war) and the 92-month long expansion of the 1980s. Judged in terms of overall economic performance this expansion has been not only long but excellent--especially with respect to inflation and unemployment. By this time in the expansion of the 1960s, for example, inflation was rising sharply and was much higher than now, at about 5%. In the 80s expansion, inflation was also rising at this stage and had reached 5%. By contrast, inflation now is much lower and has been coming down. Since the need to combat high or rising inflation is what typically brings an expansion to an end, this greatly raises the prospects for a continuing expansion. The combination of low inflation and low unemployment is particularly remarkable and shatters long held views and simple textbook theories about the possibility of combining low unemployment and inflation. In fact, the misery index, which is the sum of inflation and unemployment, is lower at this stage of the current expansion than in either the expansion of the 60s or the 80s.

This is also an expansion which is investment-driven--to a far greater extent than in either of the other two long expansions. This investment is contributing to improvements in productivity and future growth and it is working to hold inflation down. Of course, it didn't occur by accident --it's the consequence of fiscal discipline and reflects a conscious choice to

shift the policy mix toward a tighter fiscal policy coupled with a lower interest rate, accommodative monetary policy to stimulate investment and spur economic growth.

The continuing strong economic performance in 1998 is all the more remarkable because it took place at a time of considerable stress to the world economy. A third of all world economies were in outright recession or experiencing markedly slower growth by late 1998. After growing at 4.2% in 1997, world economic growth slowed to an estimated 2.2 percent in 1998, a pace comparable to the growth rates registered during the pronounced world slowdowns of 1974-75, 1980-83, and 1990-91. Our trade deficit rose and exports declined, particularly to countries in East Asia, producing a drag on economic growth and inflicting hardship on some sectors of the U.S. economy. The international environment remains exceptionally risky, with the prospects for growth in Europe, for a recovery Japan and for a pickup in activity in crisis afflicted countries highly uncertain. Even so, we believe that the U.S. economy has entered 1999 on course to continue growing and the chances are good that next year at this time we will be on the verge of marking the longest economic expansion—whether in peace or war—ever.

It's traditional for *The Economic Report* to present the Administration's economic forecast and to discuss its logic and I'd like to spend a few minutes reviewing it. The main purpose of the Administration economic forecast is for use in the preparation of our budget. This Administration consciously decided back in 1993 to establish a reputation for using credible forecasts so that, budget balancing efforts--and now proposals to use the emerging budget surpluses--would not be based on rosy scenarios. This means that, as we go about making our forecast, we would prefer to err on the conservative side. Our forecast for a projection period extending through 2007 looks for a continuation of the economic expansiion with further

employment and real wage growth, but with GDP projected to grow at a much slower, 2.0% rate on average over the next 3 years in comparison with the roughly 3.9% average pace of the last three years. We project that unemployment will edge up slightly. We also anticipate that the CPI will rise at a 2.3% annual rate next year and thereafter--close to the increase in the core CPI over the past year. This reflects our expectation that some of the special factors, including plunging oil and import prices, which depressed inflation this year will contibute less in containing inflation next year and thereafter. After 2001, we project that real GDP growth will resume growth at our estimate of trend--2.4%, and the unemployment rate is projected to stabilize at 5.3%, of our working estimate of NAIRU, the unemployment rate consistent with stable inflation over the longer term.

Our forecast is similar to CBO, the Blue Chip, and other private forecasts, although perhaps a touch on the conservative side in its assumptions about the pace of sustainable growth. A natural question is why we forecast a slowdown in growth when the extent of momentum in domestic demand has been extraordinary and we ended the year with GDP growing at a stunning 5.6% pace in the fourth quarter. Our forecast of more moderate growth going forward reflects our view that several components of domestic demand may be poised to grow at slower rates. In particular, consumption, which constitutes two-thirds of output, has been growing well in excess of income, so that the personal saving rate has declined to zero. In our view, this largely reflects stock-market gains. Unless the stock market continues to surge, the impetus from wealth on consumption is likely to wane, so that consumption will moderate to match the growth of income. As for business investment, slowing consumption growth, coupled with a capacity utilization rate which is now below its historical average, may exert some restraint on the

demand for new investment goods. The past year's boom in housing starts reflects strong income gains and the impact of lower mortgage rates, but it has elevated housing starts well above their demographic fundamentals. We expect some restraint going forward in this component of demand as well.

One of the key questions in preparing the forecast concerns the trend pace of productivity growth. The official measure of productivity in the nonfarm business sector has grown at about a 2% annual rate over the past 3 years, substantially above the 1.1% annual growth rate between the business cycle peaks of 1973 and 1990 and the 1.3% pace from 1973 thru 1998. Investment growth has been exceptional, and capital accumulation should work to boost productivity. However, cyclical factors also affect productivity. Productivity growth is usually slow during recessions, rapid in the middle of an expansion and tapers off in advance of the business cycle peak. Strong productivity growth over the last three years could reflect strong output growth. On the other hand, productivity has grown even faster than would be anticipated based on cyclical factors and it is perfectly possible that the growth rate of trend productivity has risen. The extraordinarily low rates of inflation as measured by the PCE and GDP price indexes combined with healthy profits also suggest faster productivity growth than our forecast assumes. In this sense, our productivity growth assumption is conservative and I can only hope that reality shows that we were wrong. Nothing matters more to living standards over the long run than the pace of productivity improvement and an increase in the trend pace of productivity of even a tenth or two is of enormous importance for the long-term outlook for real wages and per capita income.

THE BENEFITS OF A STRONG LABOR MARKET

Let me next turn to a topic which receives emphasis in this year's *Report,* namely the impact of a strong labor market on low-wage and minority workers. Our report presents clear evidence of improvements during the last few years of this expansion.

It was once commonly accepted that an economic expansion is a rising tide that lifts all boats, so that the most surefire way to alleviate poverty and help disadvantaged groups was to keep the economy expanding. However, in the late 1970s, a new, long-term trend toward widening inequality began to afflict the economy, most likely as a consequence of pervasive technological changes raising the demand for skilled labor and lowering the demand for unskilled workers. In addition, productivity growth declined substantially, for reasons that are still not well understood. During the expansion of the 1980's, real wages declined, particularly among less skilled men. During the current expansion, we saw real wages stagnate for the first five years of the expansion. However, this has finally become an expansion in which a rising tide is lifting all boats. American workers are enjoying direct and measurable progress and in the *Report,* we describe the CEA's analysis of real wage growth. Let me talk briefly about some of these findings:

Wage growth has been particularly strong for historically disadvantaged groups. After years of decline, the real wages of black men began to increase in 1993, and they have risen by 5.8 percent in the last 2 years (since 1996). Black women and Hispanic men and women have also experienced recent gains. The tight labor market of the 1990s appears to be helping even young minority workers, who suffered greater wage declines than others in the 1980s. In 1998 alone, the real wages of young black men aged 16-24 rose by 6.2 percent.

It is well known that less-skilled men have experienced long-term wage decline since the later 1970s. In 1998, real wages among men aged 20 and over who are high school dropouts rose by 7 percent. This was the first time since at least 1979 that their wages rose. In addition, real hourly wages for men at the 10th and 20th percentiles of the earnings distribution rose 6 percent since 1993.

Immigrants, too, are earning more. Mexican- and Central American-born immigrants -- who account for about 30 percent of new immigrants since 1980 -- have had real wage growth since 1995 of almost 7 percent for men and almost 4 percent for women.

It is too early to declare victory in reversing adverse long-term trends in wages for less skilled workers. In particular, it remains hard to know how much of this turnaround is due to particularly favorable business cycle conditions. Nor is this Administration taking the improvements for granted. First, it is committed to maintaining the macroeconomic stability that is a necessary condition for ensuring that all Americans participate in the country's growing prosperity. Second, the Administration continues to stress the importance of education and training policies that address the challenges of a changing economy and a changing society.

MAINTAINING FISCAL DISCIPLINE

Although this year's economic report concludes that our economy is strong and that the prospects for continued growth are excellent, we recognize that our Nation faces other, broader challenges as we move into the 21st century.

One of the key challenges we face is to prepare our nation to meet the needs of an aging population. The ratio of employed workers to retirees has fallen from about 5 to 1 in 1960 to 3-1/2 to 1 today. In only 30 years time, it will be just 2 to 1 and still falling. The same demographic effects that have

impaired the finances of Social Security also impact Medicare and Medicaid.

As you know, in his State of the Union the President proposed a plan for how to use the currently projected unified budget surpluses and how to address the financial imbalance of the Social Security system. He proposed devoting 62% of the surpluses over the next 15 years--about $2.8 trillion with a small portion, about 1/4, devoted to equity purchases--to extend the solvency of the Social security system until 2055. Further reforms would be needed to achieve full 75 year actuarial balance, which is the most commonly used measure of financial soundness. Assuming that a solution for social security can be achieved, the President has also proposed using 15% of the projected surpluses for Medicare, ensuring the Medicare Trust Fund is secure for another 20 years. The President has emphasized the need to utilize the extra funding as part of a broad effort to strengthen the Medicare program. He also proposed creating a new system of universal savings accounts (USA Accounts) outside of Social Security with 12 percent of the surplus to help working Americans build wealth to meet their retirement needs--a way of strengthening the current pension system and helping Americans save. The government would provide an equal dollar contribution for most working individuals and provide matches for individual contributions with larger matches going to lower income workers. Finally, the President would reserve 11 percent of the projected surpluses for military readiness and education and research.

Rather than commenting in detail on the President's Social Security plan, let me talk about the overall macroeconomic impact of this plan. For the nation as a whole, the central problem in coping with an aging population is to provide a high standard of living for both workers and retirees even though a smaller share of the population will be in the workforce. A natural solution is to make workers more

productive by increasing investment in both physical and human capital, which will, in turn, raise labor productivity. In doing so, we can boost the size of the total economic pie, which is the prerequisite to meeting the retirement costs of the baby boom generation without unduly burdening future workers. The key to accomplishing this is to increase national saving, a goal to which continued fiscal discipline would contribute. National saving increased from 3.1 percent of gross domestic product in 1992 to 6.7 percent in the first three quarters of 1998, but the improvement is accounted for entirely by the elimination of the federal budget deficit, as private saving actually declined relative to total output with the personal saving rate hitting zero in the last quarter of the year. The framework offered by the President for the use of emerging budget surpluses would dramatically increase national saving. Evaluated from a macroeconomic perspective--from the perspective of national savings--this plan saves, in essence, between 77 and 89 percent of the projected surpluses, depending on one's evaluation of the saving impact of the USA accounts. The transfers to Social Security and Medicare amount to 77 percent of the federal budget and about 2 percent of GDP, and they are pure additions to national saving. The USA accounts amount to 12 percent of the unified budget surpluses and could be viewed as a tax cut that is highly likely to add to personal saving. Only 11 percent of the surpluses are devoted to additional government spending.

Dedicating the surpluses to Social Security and Medicare serves two purposes. First, it helps to lock in the surpluses so they are not used for tax cuts or wasteful spending. Second, it gives these critical programs a "first call" on the benefits of our fiscal discipline. And these benefits will be large.

This is a fiscally conservative, pro-growth plan that comes close in its macroeconomic

impact to a plan of simply paying off debt. Publicly held debt is projected to fall from 44 percent of GDP today to about 7 percent in 2014. That would represent the smallest burden of government debt on the economy since the United States entered World War I in 1917. In addition, some of the surpluses will be used to purchase equities, which will represent an asset of the government. The dramatic decline in national debt would increase private capital investment, keep interest rates low or drive them lower, raise future national income, free up government resources by reducing debt servicing costs and fuel economic growth. We have estimated, for example, that in comparison with the exploding ratios of debt to GDP forecast back in 1993, the President's plan, which substitutes productive capital assets in private portfolios for unproductive debt would lower interest rates by about 2.5%. Even compared to a more optimistic baseline in which we assume that the political process would have achieved budget savings sufficient to hold the debt to GDP ratio at 50%, the President's plan lowers interest rates by 1-1.25% by 2014 and would raise GDP by 3.5-4.5%--a substantial increase in the size of the pie.

MEETING THE INTERNATIONAL CHALLENGE

Let me conclude by saying just a few words about the challenges we face on the international economic front and then stop and take your questions.

A first challenge for the United States is to insure that, at this time of economic fragility in so many regions, we do not build new walls of protectionism here, that could set off a dangerous chain reaction around the world, imperilling the world's prospects for growth while harming our own exporters and consumers. The crisis has taken a toll on some sectors in the United States, steel being notable example. The Administration is committed to vigrous enforcement of our trade laws to insure that American industries are not victimized by unfair trade. However we must also recognize that, as the crisis economies recover, their demand for U.S. goods and services will increase as well, once again fueling our

own export growth.

Beyond keeping markets open, the Administration believes that a serious program of reform is needed to strengthen the underpinnings of international financial system to make it less crisis prone and to improve the mechanisms available for dealing with any crises that may nevertheless occur. Unfortunately, there is just no silver bullet--no simple solution that would guarantee countries the benefits of global capital flows while eliminating the risk that a crisis of confidence could once again result in the painful withdrawal of that access. Even so, international agreement is finally emerging on the steps that can and should be taken to strengthen the architecture of the financial system so that it is less crisis-prone going forward. The needed steps include measures to increase transparency and accountability in the operations of individual countries, of financial and corporate institutions and of the international financial institutions themselves to enhance the availability, relevance and reliability of information available for evaluating risk in lending. Reforms are also needed to strengthen the prudential supervision and regulation of banks and other domestic financial institutions: to create stronger incentives for borrowers and lenders to weigh risk and act with appropriate discipline, thereby reducing the odds of a crisis. Countries will need to reassess implicit and explicit government guarantees which create moral hazard and exacerbate risktaking, including the implicit promise of bailouts of corporations considered too big to fail, and semi-fixed exchange rate regimes which reduced the perceived riskiness of foreign currency exposure. Finally, measures are needed to improve creditor coordination in crises and to promote the orderly, cooperative and equitable resolution of international financial crises that may occur in the future. The United States is working intensively with key emerging markets, with other industrialized nations, and

the relevant international organizations, to put in place the building blocks of this new architecture to ensure that the unprecedented growth, increase in welfare and opportunity experienced in the 50 years after the creation of the Bretton Woods system are maintained in the future.

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Janet L. Yellen (CN=Janet L. Yellen/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME: 3-MAR-1999 11:43:57.00

SUBJECT:

TO: Robert Z. Lawrence (CN=Robert Z. Lawrence/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TEXT:
=================== ATTACHMENT 1 ===================
ATT CREATION TIME/DATE: 0 00:00:00.00

TEXT:
Unable to convert ARMS_EXT:[ATTACH.D47]MAIL47781366G.036 to ASCII,
The following is a HEX DUMP:

The 1998 Economic Report of the President

Dr. Janet Yellen
Chairman, President's Council of Economic Advisers
National Economics Club
February 25, 1999

Thank you. It is a pleasure to be here. I appreciate your invitation to talk today about the *Economic Report of the President,* and to discuss the outlook for the American economy. As you may know, the Employment Act of 1946, which created the Council of Economic Advisers, requires the President to submit an *Economic Report* to the Congress each year. Preparation of this report is a central function of the Council of Economic Advisers, and it is always worthwhile endeavor because it gives us a chance to reflect in an organized way on economic developments in the American and world economy and to explain the economic logic of the Administration's agenda.

In addition to giving us the responsibility for producing an annual report, the Employment Act of 1946, together with its later amendments, also gave the Federal government responsibility for stabilizing short-run economic fluctuations, promoting balanced and noninflationary economic growth, and fostering low unemployment. One purpose of the *Economic Report* is to tell Congress whether we have met those responsibilities. Last year was a year for baseball home-run records, and it was also a year for economic records. We were especially happy to be able to report this year--the fifty-third year after the Act-- we achieved the longest peacetime economic expansion on record—and the records go back to 1854. In fact, that's why we chose a red cover for this year's *Economic Report* -- to symbolize our Nation's

"red hot economy."

In the remainder of my remarks I would like to focus in greater detail on the characteristics of this extraordinary expansion, and discuss the outlook going forward. I want to particularly emphasize one of the themes in this year's Report: that the strong labor market we are now enjoying is producing benefits, particularly for groups that have not seen much economic progress for a long time. Finally, I'd like to briefly discuss two longer-term economic challenges which we ought to address now: the need to prepare our nation for the seismic demographic shift which is underway; and the necessity of implementing improvements in the architecture of the international financial system to make it less crisis prone while preserving the benefits of outward-looking trade and investment policies.

STATE OF THE ECONOMY

Let me begin by saying a bit about the state of the U.S. economy. In our view, our Nation's economy is the strongest it has been in a generation. In 1998, growth was impressive, and job creation was vigorous while inflation declined. Real GDP grew 3.9 percent. Nonagricultural jobs increased by about 2.9 million during the year, and the average unemployment rate for the year dropped to 4.5 percent, its lowest level since 1969. The consumer price index rose by only 1.6 percent, its smallest increase since 1964, and other measures of inflation were even more muted.

As you all know, this year the Federal budget moved strongly into surplus. In the 1992 fiscal year the budget deficit was $290 billion and expected to rise further with no change in policy. But beginning in 1993, the deficit began to decline steadily as a consequence of a shift to fiscal discipline. In 1998, the budget *surplus* was $69 billion, the largest surplus as a share of

GDP since 1957, and surpluses are projected well into the future: the Administration now projects surpluses in the unified Federal budget amounting to about $4.5 trillion over the next 15 years. I will return to the budget and the use of those surpluses to address demographic challenges in a few minutes.

The current economic expansion is only the third on record that has lasted at least 7 years. This year's report puts the expansion in its historical context by comparing it with the other two long expansions--the 106-month long expansion of the 1960s (the longest in peace or war) and the 92-month long expansion of the 1980s. Judged in terms of overall economic performance this expansion has been not only long but excellent--especially with respect to inflation and unemployment. By this time in the expansion of the 1960s, for example, inflation was rising sharply and was much higher than now, at about 5%. In the 80s expansion, inflation was also rising at this stage and had reached 5%. By contrast, inflation now is much lower and has been coming down. Since the need to combat high or rising inflation is what typically brings an expansion to an end, this greatly raises the prospects for a continuing expansion. The combination of low inflation and low unemployment is particularly remarkable and shatters long held views and simple textbook theories about the possibility of combining low unemployment and inflation. In fact, the misery index, which is the sum of inflation and unemployment, is lower at this stage of the current expansion than in either the expansion of the 60s or the 80s.

This is also an expansion which is investment-driven--to a far greater extent than in either of the other two long expansions. This investment is contributing to improvements in productivity and future growth and it is working to hold inflation down. Of course, it didn't occur by accident --it's the consequence of fiscal discipline and reflects a conscious choice to

shift the policy mix toward a tighter fiscal policy coupled with a lower interest rate, accommodative monetary policy to stimulate investment and spur economic growth.

The continuing strong economic performance in 1998 is all the more remarkable because it took place at a time of considerable stress to the world economy. A third of all world economies were in outright recession or experiencing markedly slower growth by late 1998. After growing at 4.2% in 1997, world economic growth slowed to an estimated 2.2 percent in 1998, a pace comparable to the growth rates registered during the pronounced world slowdowns of 1974-75, 1980-83, and 1990-91. Our trade deficit rose and exports declined, particularly to countries in East Asia, producing a drag on economic growth and inflicting hardship on some sectors of the U.S. economy. The international environment remains exceptionally risky, with the prospects for growth in Europe, for a recovery Japan and for a pickup in activity in crisis afflicted countries highly uncertain. Even so, we believe that the U.S. economy has entered 1999 on course to continue growing and the chances are good that next year at this time we will be on the verge of marking the longest economic expansion—whether in peace or war—ever.

It's traditional for *The Economic Report* to present the Administration's economic forecast and to discuss its logic and I'd like to spend a few minutes reviewing it. The main purpose of the Administration economic forecast is for use in the preparation of our budget. This Administration consciously decided back in 1993 to establish a reputation for using credible forecasts so that, budget balancing efforts--and now proposals to use the emerging budget surpluses--would not be based on rosy scenarios. This means that, as we go about making our forecast, we would prefer to err on the conservative side. Our forecast for a projection period extending through 2007 looks for a continuation of the economic expansiion with further

employment and real wage growth, but with GDP projected to grow at a much slower, 2.0% rate on average over the next 3 years in comparison with the roughly 3.9% average pace of the last three years. We project that unemployment will edge up slightly. We also anticipate that the CPI will rise at a 2.3% annual rate next year and thereafter--close to the increase in the core CPI over the past year. This reflects our expectation that some of the special factors, including plunging oil and import prices, which depressed inflation this year will contibute less in containing inflation next year and thereafter. After 2001, we project that real GDP growth will resume growth at our estimate of trend--2.4%, and the unemployment rate is projected to stabilize at 5.3%, of our working estimate of NAIRU, the unemployment rate consistent with stable inflation over the longer term.

Our forecast is similar to CBO, the Blue Chip, and other private forecasts, although perhaps a touch on the conservative side in its assumptions about the pace of sustainable growth. A natural question is why we forecast a slowdown in growth when the extent of momentum in domestic demand has been extraordinary and we ended the year with GDP growing at a stunning 5.6% pace in the fourth quarter. Our forecast of more moderate growth going forward reflects our view that several components of domestic demand may be poised to grow at slower rates. In particular, consumption, which constitutes two-thirds of output, has been growing well in excess of income, so that the personal saving rate has declined to zero. In our view, this largely reflects stock-market gains. Unless the stock market continues to surge, the impetus from wealth on consumption is likely to wane, so that consumption will moderate to match the growth of income. As for business investment, slowing consumption growth, coupled with a capacity utilization rate which is now below its historical average, may exert some restraint on the

demand for new investment goods. The past year's boom in housing starts reflects strong income gains and the impact of lower mortgage rates, but it has elevated housing starts well above their demographic fundamentals. We expect some restraint going forward in this component of demand as well.

One of the key questions in preparing the forecast concerns the trend pace of productivity growth. The official measure of productivity in the nonfarm business sector has grown at about a 2% annual rate over the past 3 years, substantially above the 1.1% annual growth rate between the business cycle peaks of 1973 and 1990 and the 1.3% pace from 1973 thru 1998. Investment growth has been exceptional, and capital accumulation should work to boost productivity. However, cyclical factors also affect productivity. Productivity growth is usually slow during recessions, rapid in the middle of an expansion and tapers off in advance of the business cycle peak. Strong productivity growth over the last three years could reflect strong output growth. On the other hand, productivity has grown even faster than would be anticipated based on cyclical factors and it is perfectly possible that the growth rate of trend productivity has risen. The extraordinarily low rates of inflation as measured by the PCE and GDP price indexes combined with healthy profits also suggest faster productivity growth than our forecast assumes. In this sense, our productivity growth assumption is conservative and I can only hope that reality shows that we were wrong. Nothing matters more to living standards over the long run than the pace of productivity improvement and an increase in the trend pace of productivity of even a tenth or two is of enormous importance for the long-term outlook for real wages and per capita income.

THE BENEFITS OF A STRONG LABOR MARKET

Let me next turn to a topic which receives emphasis in this year's *Report,* namely the impact of a strong labor market on low-wage and minority workers. Our report presents clear evidence of improvements during the last few years of this expansion.

It was once commonly accepted that an economic expansion is a rising tide that lifts all boats, so that the most surefire way to alleviate poverty and help disadvantaged groups was to keep the economy expanding. However, in the late 1970s, a new, long-term trend toward widening inequality began to afflict the economy, most likely as a consequence of pervasive technological changes raising the demand for skilled labor and lowering the demand for unskilled workers. In addition, productivity growth declined substantially, for reasons that are still not well understood. During the expansion of the 1980's, real wages declined, particularly among less skilled men. During the current expansion, we saw real wages stagnate for the first five years of the expansion. However, this has finally become an expansion in which a rising tide is lifting all boats. American workers are enjoying direct and measurable progress and in the *Report,* we describe the CEA's analysis of real wage growth. Let me talk briefly about some of these findings:

Wage growth has been particularly strong for historically disadvantaged groups. After years of decline, the real wages of black men began to increase in 1993, and they have risen by 5.8 percent in the last 2 years (since 1996). Black women and Hispanic men and women have also experienced recent gains. The tight labor market of the 1990s appears to be helping even young minority workers, who suffered greater wage declines than others in the 1980s. In 1998 alone, the real wages of young black men aged 16-24 rose by 6.2 percent.

It is well known that less-skilled men have experienced long-term wage decline since the later 1970s. In 1998, real wages among men aged 20 and over who are high school dropouts rose by 7 percent. This was the first time since at least 1979 that their wages rose. In addition, real hourly wages for men at the 10th and 20th percentiles of the earnings distribution rose 6 percent since 1993.

Immigrants, too, are earning more. Mexican- and Central American-born immigrants -- who account for about 30 percent of new immigrants since 1980 -- have had real wage growth since 1995 of almost 7 percent for men and almost 4 percent for women.

It is too early to declare victory in reversing adverse long-term trends in wages for less skilled workers. In particular, it remains hard to know how much of this turnaround is due to particularly favorable business cycle conditions. Nor is this Administration taking the improvements for granted. First, it is committed to maintaining the macroeconomic stability that is a necessary condition for ensuring that all Americans participate in the country's growing prosperity. Second, the Administration continues to stress the importance of education and training policies that address the challenges of a changing economy and a changing society.

MAINTAINING FISCAL DISCIPLINE

Although this year's economic report concludes that our economy is strong and that the prospects for continued growth are excellent, we recognize that our Nation faces other, broader challenges as we move into the 21st century.

One of the key challenges we face is to prepare our nation to meet the needs of an aging population. The ratio of employed workers to retirees has fallen from about 5 to 1 in 1960 to 3-1/2 to 1 today. In only 30 years time, it will be just 2 to 1 and still falling. The same demographic effects that have

impaired the finances of Social Security also impact Medicare and Medicaid.

As you know, in his State of the Union the President proposed a plan for how to use the currently projected unified budget surpluses and how to address the financial imbalance of the Social Security system. He proposed devoting 62% of the surpluses over the next 15 years--about $2.8 trillion with a small portion, about 1/4, devoted to equity purchases--to extend the solvency of the Social security system until 2055. Further reforms would be needed to achieve full 75 year actuarial balance, which is the most commonly used measure of financial soundness. Assuming that a solution for social security can be achieved, the President has also proposed using 15% of the projected surpluses for Medicare, ensuring the Medicare Trust Fund is secure for another 20 years. The President has emphasized the need to utilize the extra funding as part of a broad effort to strengthen the Medicare program. He also proposed creating a new system of universal savings accounts (USA Accounts) outside of Social Security with 12 percent of the surplus to help working Americans build wealth to meet their retirement needs--a way of strengthening the current pension system and helping Americans save. The government would provide an equal dollar contribution for most working individuals and provide matches for individual contributions with larger matches going to lower income workers. Finally, the President would reserve 11 percent of the projected surpluses for military readiness and education and research.

Rather than commenting in detail on the President's Social Security plan, let me talk about the overall macroeconomic impact of this plan. For the nation as a whole, the central problem in coping with an aging population is to provide a high standard of living for both workers and retirees even though a smaller share of the population will be in the workforce. A natural solution is to make workers more

productive by increasing investment in both physical and human capital, which will, in turn, raise labor productivity. In doing so, we can boost the size of the total economic pie, which is the prerequisite to meeting the retirement costs of the baby boom generation without unduly burdening future workers. The key to accomplishing this is to increase national saving, a goal to which continued fiscal discipline would contribute. National saving increased from 3.1 percent of gross domestic product in 1992 to 6.7 percent in the first three quarters of 1998, but the improvement is accounted for entirely by the elimination of the federal budget deficit, as private saving actually declined relative to total output with the personal saving rate hitting zero in the last quarter of the year. The framework offered by the President for the use of emerging budget surpluses would dramatically increase national saving. Evaluated from a macroeconomic perspective--from the perspective of national savings--this plan saves, in essence, between 77 and 89 percent of the projected surpluses, depending on one's evaluation of the saving impact of the USA accounts. The transfers to Social Security and Medicare amount to 77 percent of the federal budget and about 2 percent of GDP, and they are pure additions to national saving. The USA accounts amount to 12 percent of the unified budget surpluses and could be viewed as a tax cut that is highly likely to add to personal saving. Only 11 percent of the surpluses are devoted to additional government spending.

Dedicating the surpluses to Social Security and Medicare serves two purposes. First, it helps to lock in the surpluses so they are not used for tax cuts or wasteful spending. Second, it gives these critical programs a "first call" on the benefits of our fiscal discipline. And these benefits will be large.

This is a fiscally conservative, pro-growth plan that comes close in its macroeconomic

impact to a plan of simply paying off debt. Publicly held debt is projected to fall from 44 percent of GDP today to about 7 percent in 2014. That would represent the smallest burden of government debt on the economy since the United States entered World War I in 1917. In addition, some of the surpluses will be used to purchase equities, which will represent an asset of the government. The dramatic decline in national debt would increase private capital investment, keep interest rates low or drive them lower, raise future national income, free up government resources by reducing debt servicing costs and fuel economic growth. We have estimated, for example, that in comparison with the exploding ratios of debt to GDP forecast back in 1993, the President's plan, which substitutes productive capital assets in private portfolios for unproductive debt would lower interest rates by about 2.5%. Even compared to a more optimistic baseline in which we assume that the political process would have achieved budget savings sufficient to hold the debt to GDP ratio at 50%, the President's plan lowers interest rates by 1-1.25% by 2014 and would raise GDP by 3.5-4.5%--a substantial increase in the size of the pie.

MEETING THE INTERNATIONAL CHALLENGE

Let me conclude by saying just a few words about the challenges we face on the international economic front and then stop and take your questions.

A first challenge for the United States is to insure that, at this time of economic fragility in so many regions, we do not build new walls of protectionism here, that could set off a dangerous chain reaction around the world, imperilling the world's prospects for growth while harming our own exporters and consumers. The crisis has taken a toll on some sectors in the United States, steel being notable example. The Administration is committed to vigrous enforcement of our trade laws to insure that American industries are not victimized by unfair trade. However we must also recognize that, as the crisis economies recover, their demand for U.S. goods and services will increase as well, once again fueling our

own export growth.

Beyond keeping markets open, the Administration believes that a serious program of reform is needed to strengthen the underpinnings of international financial system to make it less crisis prone and to improve the mechanisms available for dealing with any crises that may nevertheless occur. Unfortunately, there is just no silver bullet--no simple solution that would guarantee countries the benefits of global capital flows while eliminating the risk that a crisis of confidence could once again result in the painful withdrawal of that access. Even so, international agreement is finally emerging on the steps that can and should be taken to strengthen the architecture of the financial system so that it is less crisis-prone going forward. The needed steps include measures to increase transparency and accountability in the operations of individual countries, of financial and corporate institutions and of the international financial institutions themselves to enhance the availability, relevance and reliability of information available for evaluating risk in lending. Reforms are also needed to strengthen the prudential supervision and regulation of banks and other domestic financial institutions: to create stronger incentives for borrowers and lenders to weigh risk and act with appropriate discipline, thereby reducing the odds of a crisis. Countries will need to reassess implicit and explicit government guarantees which create moral hazard and exacerbate risktaking, including the implicit promise of bailouts of corporations considered too big to fail, and semi-fixed exchange rate regimes which reduced the perceived riskiness of foreign currency exposure. Finally, measures are needed to improve creditor coordination in crises and to promote the orderly, cooperative and equitable resolution of international financial crises that may occur in the future. The United States is working intensively with key emerging markets, with other industrialized nations, and

the relevant international organizations, to put in place the building blocks of this new architecture to ensure that the unprecedented growth, increase in welfare and opportunity experienced in the 50 years after the creation of the Bretton Woods system are maintained in the future.

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Janet L. Yellen (CN=Janet L. Yellen/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME: 4-MAR-1999 17:35:45.00

SUBJECT: Re: Tobin

TO: Douglas W. Elmendorf (CN=Douglas W. Elmendorf/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TEXT:
I sent Tobin a note saying that the op-ed is fine and we have no further
comments.

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Nouriel Roubini (CN=Nouriel Roubini/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME: 4-MAR-1999 22:33:49.00

SUBJECT: Latest headlines from the banana war frontlines...

TO: Robert Z. Lawrence (CN=Robert Z. Lawrence/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TO: Janet L. Yellen (CN=Janet L. Yellen/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

CC: Matthew R. McBrady (CN=Matthew R. McBrady/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TEXT:
-
EU Angry Over U.S. Tariff Threat - AP (03/04/99)
-
US-EU Banana Trade Hassle Continues - AP (03/04/99)
-
Bananas split trading giants - BBC (03/04/99)
-
Tension mounts over banana row - BBC (03/04/99)
-
European Union, United States On Path Of Trade Confrontation - Reuters (03/04/99)
-
U.S. And EU On Path Of Trade Confrontation - Reuters (03/04/99)
-
U.S. Banana Move Stirs European Outrage - Reuters (03/04/99)
-
UK Minister Summons U.S. Envoy In Banana Trade Row - Reuters (03/04/99)
-
WTO chief urges US,EU to patch up banana row in "positive spirit" - AFP (03/04/99)

Britain condemns US trade offensive in banana row - AFP (03/04/99)

Anglo-US tension over bananas - BBC (03/04/99)

U.S. hits Europe with big tariffs - Philadelphia Inquirer (03/04/99)

UK Summons U.S. Ambassador In Banana Dispute - Reuters (03/04/99)

US Levies Sanctions in Trade Fight - AP (03/04/99)

Trade fight spills over into handbags, coffee makers - CNN (03/04/99)

Kingstown Journal: An Outpost in the Banana and Marijuana Wars - NY Times (Registration required) (03/04/9

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Douglas W. Elmendorf (CN=Douglas W. Elmendorf/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME: 4-MAR-1999 09:25:39.00

SUBJECT: FYI: my views on budget issues

TO: Janet L. Yellen (CN=Janet L. Yellen/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TEXT:
---------------------- Forwarded by Douglas W. Elmendorf/CEA/EOP on 03/04/99 09:27 AM ---------------------------

Douglas_W._Elmendorf @ oa.eop.gov
03/04/99 09:11:47 AM
Record Type: Record

To: Jeff B. Liebman/OPD/EOP
cc: See the distribution list at the bottom of this message
Subject: Re: Meeting Thursday on budget issues

With all respect to Gene, I don't think that refining the meaning of "off-budget" is an effective approach to the problem.

I'm not surprised that different people on Capitol Hill mean different things by the term, and that some people don't know what they mean. But two days in a row now the newspapers have described apparently large groups of Members who mean to take the traditional on-budget/off-budget distinction seriously -- which the President's plan does not do. I don't think we can rebut this (legitimate) argument by finding more creative ways to describe what we're doing.

Instead, we should focus on describing the legitimate benefits of the President's plan, as Barbara suggested yesterday: "The President's opponents are focused on accounting rules, but the bottom line is the effect of the proposal. The President's plan reduces publicly held det to 7% of GDP by 2014 and pays it off several years later. It also extends the solvency of Social Security until 2055. Moreover, the plan runs surpluses in the government's overall finances for the next 45 years, even after paying Social Security benefits."

The one way in which I think it's reasonable to engage the on-budget/off-budget bit directly is to try to rearrange the SS transfers (and other bits of the plan) so that we're transferring more than the off-budget amount _in each year_ in addition to _on average_ over the 15 years. This is partly consistent with our need to rearrange money for the USAs. But we'll still be stuck by our desire to do more discretionary spending in the first few years, and we'll have to settle for a phase-in approach.

The other issue I'd suggest talking about is the basic math of some of these IA plans. For example, suppose they used some of the 12.4% (as Gene seemed to suggest, although he also said it wasn't a carve-out, which confuses me). We know that if that money just buys govt bonds, then the total funding stream for retirement benefits is no greater or smaller than under the current system (which buys bonds through the trust fund). In fact, these plans have two disadvantages: higher admin. costs and probably higher benefits (because the clawback is under 100%). But they also have three possible advantages: more equity investments, corporate tax revenue (with the caveat that Alan and I discussed yesterday), and more years of new revenue flowing in. This last piece seems especially important to me: the PDV of on-budget surpluses between now and 2025 roughly equals the PDV of UB surpluses between now and 2014. So if you're willing to stretch out your SS fix, you can do lots of things (but still not everything).

Message Copied
To:

Barbara Chow/OMB/EOP
Joseph J. Minarik/OMB/EOP
Jack A. Smalligan/OMB/EOP
david.wilcox @ treas.sprint.com
alan.cohen @ treas.sprint.com
Sandra Yamin/OMB/EOP
Douglas W. Elmendorf/CEA/EOP

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Elise H. Golan (CN=Elise H. Golan/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME: 4-MAR-1999 17:45:31.00

SUBJECT: hormone dispute

TO: Robert Z. Lawrence (CN=Robert Z. Lawrence/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TO: Janet L. Yellen (CN=Janet L. Yellen/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TEXT:

Janet and Robert,
Attached is a decription of the US- EU hormone meeting that took place
this morning. The general direction seems good.

Elise =================== ATTACHMENT 1 ===================
ATT CREATION TIME/DATE: 0 00:00:00.00

TEXT:
Unable to convert ARMS_EXT:[ATTACH.D79]MAIL48781876I.036 to ASCII,
The following is a HEX DUMP:

Memorandum
To: Janet Yellen and Robert Lawrence
From: Elise Golan
Date: March 4, 1999

Subject: Beef Hormone Dispute with the EU

Today the US hosted members of DG IV for a meeting to discuss options to resolve the beef hormone dispute. The meeting was chaired by Peter Scher and attended by State, Treasury, and USDA/FAS. All of the options under consideration are interim measures designed to bridge the gap between the May 13 deadline for lifting the hormone ban and finalization of the EU's risk assessments. The EU's final decision on the ban will only be made once the risk assessments have been completed, a process that could stretch to mid 2000.

Option One. The EU would pay the US compensation for the loss of beef sales during the interim period. They calculate the amount of compensation at approximately $100 million per year. The EU proposes that this compensation be targeted to the beef sector by lifting the duty and quota on high quality (hormone-free) beef. The US expressed unwillingness to consider compensation without a finite time frame. In addition, the high quality beef compensation would probably not be sufficient for two reasons: first, the US does not currently fill its high quality beef quota, and second, only a small number of producers supply the high quality market meaning that such compensation would have no value to the vast majority of beef producers.

Option Two. In order to address consumer fears in Europe, the US would label all beef products with some sort of county of origin label. The EU stated that only hormone labeling would be acceptable. Peter Scher expressed US willingness to be flexible on the exact form of labeling, with the implication that a form of hormone labeling would be negotiable. There was general consensus among the negotiators that the labeling option is the best solution for working around the "grey areas" of risk assessment and consumer concerns.

Option Three. Retaliation by the US after the May 13th deadline - and a counter move by the EU to "rig" WTO compliance by declaring the hormone ban temporary (evoking section 5.7). I think it was agreed that this would be counter productive for both sides and for the moment this option seems to be off the table.

As things stand now, the US would accept some type of compensation/labeling solution if the EU time frame for lifting the ban and implementing labeling could be shortened from the *two* years the EU negotiators currently estimate to complete the risk assessment and legislative process. The Section 301 committee also met this morning - to calculate US damages from the EU hormone ban. Matt attended and will send a memo on the state of the damage assessment.

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Michele Jolin (CN=Michele Jolin/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME: 4-MAR-1999 11:56:07.00

SUBJECT: labeling

TO: Elise H. Golan (CN=Elise H. Golan/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TO: Robert Z. Lawrence (CN=Robert Z. Lawrence/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TO: Nouriel Roubini (CN=Nouriel Roubini/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TO: Janet L. Yellen (CN=Janet L. Yellen/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TEXT:
Below is a message from Lael.
---------------------- Forwarded by Michele Jolin/CEA/EOP on 03/04/99
11:54 AM ---------------------------

Lael Brainard
03/03/99 06:09:32 PM
Record Type: Record

To: Michele Jolin/CEA/EOP
cc:
bcc:
Subject: Re: labeling

Thanks. I have asked Bruce to check whether this is appropriate moment to
elevate to Deputies level.

Michele Jolin
03/03/99 04:19:36 PM

Record Type: Record

To: Lael Brainard/OPD/EOP, Bruce McNamer/OPD/EOP
cc:
Subject: labeling

Janet and Robert Lawerence are both anxious about having an NEC process (or at least interagency mtgs) on the labeling issue. I believe this has already been expressed to you via Elise or Nouriel. But I just wanted to underscore it -- since both Janet and Robert brought it up in our staff meeting this morning.
Thanks.
Michele

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Nouriel Roubini (CN=Nouriel Roubini/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME: 4-MAR-1999 10:23:04.00

SUBJECT: E.U.'s Brittan Says U.S. Banana Action Violates WTO Rules

TO: Robert Z. Lawrence (CN=Robert Z. Lawrence/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TO: Janet L. Yellen (CN=Janet L. Yellen/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TEXT:
March 4, 1999
Dow Jones Newswires
E.U.'s Brittan Says U.S. Banana Action Violates WTO Rules

BRUSSELS -- European Union Trade Commissioner Leon Brittan said Thursday that a U.S. move Wednesday to impose sanctions against imports of E.U. products because of the E.U.'s banana import system breaches World Trade Organization rules.

At a press conference, Brittan said the U.S. action risks causing serious damage to E.U.-U.S. trade relations.

"This American action is not the act of a party seeking a rapid settlement (of the banana dispute)," Brittan said. "It risks a major trade confrontation for the sake of a couple of weeks."

His remarks come a day after the Clinton administration instructed importers of up to $520 million in E.U. products to post bonds to cover a 100% tariff should it be imposed. This pushes the U.S. closer to punishing the E.U. in a trade dispute over the E.U.'s banana import regime.

The move, effective immediately, allows the U.S. to honor its March 3 deadline for taking action against the E.U. without running afoul of the WTO.

Under WTO rules, the U.S. may not impose punitive tariffs until a WTO panel agrees that the size of the duties it seeks to impose is appropriate. That panel isn't expected to reach a decision before March 15.

The U.S. has said its economic interests have suffered to the tune of $520 million.

It asked a WTO Dispute Settlement Panel to agree on that damage estimate, which would permit the U.S. to recover that amount through punitive tariffs on a dozen types of E.U. exports ranging from electric coffee makers to pecorino cheese. The panel was scheduled to decide by Tuesday, but it sought additional information from the U.S., postponing its decision as a result.

Brittan said the E.U. Commission, the E.U. executive branch, will request urgent consultations with the U.S. over its latest sanctions move.

He also said the Commission will request an urgent meeting of the WTO General Council to discuss the matter and make the issue part of a recent E.U. complaint to the WTO about U.S. legislation that is a basis of the sanctions threats.

"We will now ensure that these new illegal measures form part of our complaint in the WTO," Brittan said. He added that the Commission is "urgently consulting (E.U.) member states on our further response."

Brittan didn't rule out the possibility that the E.U. would take retaliatory action against the U.S.

In response to a reporter's question, he said E.U. sanctions against the U.S. are possible if the E.U. wins its case in the WTO. He said the E.U. won't apply counter sanctions before a WTO ruling.

Brittan said the potential damage of the U.S.-E.U. banana dispute to the WTO system is "worrying." But he said the WTO system will likely survive the trouble.

"I think it will be stronger than this dispute," Brittan said. "But clearly what has been done reveals a huge gap between American protestations of commitment to the WTO and the reality of their action."

Brittan added: "American policy in not being driven by concern for its commercial interests, still less by solidarity with its closest allies, but by internal political pressures from American companies and congressmen."

The U.S. plans to impose 100% duties on imports of E.U. products worth an estimated $520 million a year because of objections to an E.U. banana import system that took effect Jan. 1. The E.U. agreed last year to change the system after the WTO, acting on a complaint in part from the U.S., said the system at the time was illegal.

The U.S. says the system favors E.U. imports of African and Caribbean bananas at the expense of imports of lower-cost Latin American bananas.

The Commission has repeatedly said the U.S. should ask for a WTO panel to rule on the new system and wait for the ruling before applying sanctions against the E.U.

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Nouriel Roubini (CN=Nouriel Roubini/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME: 4-MAR-1999 09:41:04.00

SUBJECT: Our trade policy

TO: Robert Z. Lawrence (CN=Robert Z. Lawrence/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TO: Janet L. Yellen (CN=Janet L. Yellen/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TEXT:
We are starting today a WTO-illegal trade war on bananas;
we are threatening the same (with clear deadlines) on beef hormones and
Canadian magazines;
we are threatening to ban the Concorde flights on a minor trade dispute
(the House passed the ban yesterday);
we are slapping right and left prohibitive tariffs on steel products and
threatening countries to restrain their exports of steel or else...;
we are going to propose a long list of border-line WTO-inconsistent
anti-dumping and CVD statutes;
we are significantly weakening the Section 201 standard.
It seems like a trade policy gone beserk. Should there be a high level
discussion of what is our trade policy agenda?
Nouriel

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Bert I. Huang (CN=Bert I. Huang/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME: 5-MAR-1999 19:34:43.00

SUBJECT: AFL-CIO

TO: Rebecca M. Blank (CN=Rebecca M. Blank/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TO: Michele Jolin (CN=Michele Jolin/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TO: Janet L. Yellen (CN=Janet L. Yellen/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TEXT:
I've just returned from Karen's meeting on AFL-CIO issues and will update you fully on the proceedings in writing. From the WH, Lael and David Beier were in attendance; also DOL, HHS, and DOT.

The only pressing matter is for Janet to discuss the economists roundtable with Karen -- assembling an agenda or list of questions to guide the conversation and firming the date (3/16? 3/17?) and list of participants, if not already settled.

Thanks -- fascinating meeting.

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Steven N. Braun (CN=Steven N. Braun/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME: 5-MAR-1999 10:35:56.00

SUBJECT: emp statement with my adds

TO: Janet L. Yellen (CN=Janet L. Yellen/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TO: Alice H. Williams (CN=Alice H. Williams/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

CC: Michele Jolin (CN=Michele Jolin/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TEXT:
=================== ATTACHMENT 1 ===================
ATT CREATION TIME/DATE: 0 00:00:00.00

TEXT:
Unable to convert ARMS_EXT:[ATTACH.D10]MAIL422442867.036 to ASCII,
The following is a HEX DUMP:

Statement of Janet L. Yellen

Today's employment report indicates that the economy remains on a path of strong noninflationary growth. Nonfarm payroll employment rose a robust 275,000 in February. Since January 1993, the economy has created 18.1 million jobs, with 16.8 million of these jobs in the private sector.

The unemployment rate in February edged up slightly to 4.4 percent from 4.3 percent in January. The unemployment rate has now been below 5 percent for 20 months without signs of inflationary pressure. Our nation's continued and long-lasting strong labor market is benefiting all Americans, including historically disadvantaged groups.

Even with this strong labor market, inflation continues to remain in check. Average hourly earnings rose 0.1 percent. Over the past 12 months, average hourly earnings increased 3.6 percent over a period when consumer prices rose about 1¾ percent. This means that American workers are experiencing strong real wage gains, while inflation remains tame.

In February, employment was up sharply in construction and retail trade while employment in manufacturing and oil and gas extraction fell. Most other sectors posted moderate gains. Reflecting the weakness in the world economy during the past year, manufacturing employment fell 1.8 percent and employment in oil and gas extraction fell 14 percent. Thankfully, we have a dynamic economy where losses in a few sectors are offset by gains elsewhere. Over the past 12 months, for example, employment in computer services rose 13 percent and employment in engineering and management services rose 7 percent.

Recent indicators suggest that the U.S. economy remains on a healthy and balanced course. Despite the challenges facing the U.S. economy with the recent international financial turmoil, the U.S. economy is likely to continue during the first part of 1999 on a path of solid growth with low unemployment, low inflation, solid job gains and improved living standards for American workers.

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Michele Jolin (CN=Michele Jolin/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME: 5-MAR-1999 10:08:45.00

SUBJECT: agenda for mtg w/ Karen Tromantano

TO: Rebecca M. Blank (CN=Rebecca M. Blank/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TO: Janet L. Yellen (CN=Janet L. Yellen/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TEXT:
The meeting w/ Karen regarding the meeting w/ labor leaders on trade issues is going to be rescheduled. Probably to 4PM today. Attached is an agenda for that meeting.

=================== ATTACHMENT 1 ===================
ATT CREATION TIME/DATE: 0 00:00:00.00

TEXT:
Unable to convert ARMS_EXT:[ATTACH.D5]MAIL42681286G.036 to ASCII,
The following is a HEX DUMP:

Labor/Trade Meeting

1. Scheduled for Tuesday, March 16 from 10AM -12noon

   -- who from the labor community should be invited?
   -- should CEA invite labor community folks?

2. Administration Participants?

   Rebecca Blank (CEA)
   Robert Lawerence (CEA)
   Nouriel Roubini (CEA)

   Lael Brainard (NEC)
   David Walters (USTR)
   Bob Cumby (Treasury)
   Robert Shapiro (Commerce)
   Jon Orszag (Commerce)
   Ed Montgomery (Labor)
   Harry Holzer (Labor)

3. Pre-Mtg w/ Administration participants?

   -- Options: Tues, March 8 @ 3PM
   Wed, March 9 in afternoon
   Fri, March 10 @ 10AM

   -- is there work/ analysis that needs to be done before the March 16 mtg w/ labor leaders?

4. Agenda for March 16 meeting

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Nora E. Gordon (CN=Nora E. Gordon/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME: 5-MAR-1999 00:14:54.00

SUBJECT: child labor executive order

TO: Janet L. Yellen (CN=Janet L. Yellen/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TO: Robert Z. Lawrence (CN=Robert Z. Lawrence/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TO: Rebecca M. Blank (CN=Rebecca M. Blank/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TEXT:
I learned at an NEC child labor working group today that Gene has approved an executive order banning federal procurement of goods produced by indentured or forced child labor. It seems that other agencies are all signed off on this. NEC plans to pass this on to John Podesta as early as next week, and does not anticipate any changes or problems.

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Nouriel Roubini (CN=Nouriel Roubini/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME: 5-MAR-1999 10:01:35.00

SUBJECT: A meeting of the CEA international group

TO: Robert Z. Lawrence (CN=Robert Z. Lawrence/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TO: Janet L. Yellen (CN=Janet L. Yellen/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

CC: Howard A. Shelanski (CN=Howard A. Shelanski/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

CC: Matthew R. McBrady (CN=Matthew R. McBrady/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

CC: Elise H. Golan (CN=Elise H. Golan/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TEXT:
I suggest a meeting today of the international trade group to discuss developments in trade policy and how CEA should coordinate its work on this. The banana row has not turned into a war; another is starting on hush-kit aircraft and the Concorde. Beef hormones has the potential of becoming an issue 10 times more contentious than bananas; there is a whole slew of initiatives on steel, trade law changes and Section 201 that are worrisome. USTR/NEC sent us last nite a midnite a set of trade amendments with a 10.30am deadline for comments (as they want to bring it up to the Hill by this afternoon). This process sucks as there is no due process; we have 2 hours to comment on issues that normally take literally months to discuss,assess and decide.

On bananas, the WW made a major political/diplomatic blunder with the decision go go ahead with the tariffs; supposedly, even USTR was opposed to doing anything before the end of the artbitration process. We just look like naive idiots to the outside world. What we got is:
1. We started an action that is clearly WTO-illegal and risks to destroy the new WTO dispute settlement process. On the first serious arbitration case, we did something that is outright illegal.
2. We have all of Europe up in arms on this issues and losing the PR battle when we had a sensible economic case made by USTR and Matt at the Geneva arbitration panel.
3. The EU is calling for WTO general council meeting to condemn the US action.
4. We have pissed off the arbitrators that needed another 2 week to reach an accelerated decision before the WTO was going to rule on the new EU regime.
5. The EU petition challenging the totality of our section 301 legislation in a newly formed WTO panel has now a very strong argument. Our line of defense, that 301 does not require mandatory unilateral retaliation but

leaves discretion, has now been shattered by the decision to stick to an unilateral deadline 'imposed' by our laws and letters to Congress.
6. Chiquita's stock was down 5% yesterday on the news of this trade war; so they do not gain either.

If bananas is a problem, beef hormones has the potential to be a much worse trade war. We are on one side negotiating labeling with Europe and, on the other one, we are going ahead with official timelines and deadlines (as in the banana case) and drawing a retaliation list based on a totally far-fetched damage assessment. While we need maximum flexibility to negotiate, we are again locking ourselves in a extremely strict deadline (leading to retaliation action by mid-way). If banana is turning in a PR disaster, hormones will be 10 times worse. Asthe FT was saying this morning:
" But far more difficult disputes are looming, which do not simply involve business lobbies, but deep differences in social and cultural attitudes across the Atlantic. They include issues like hormones in beef, antibiotics in food, and trade in all genetically modified products.
These are not questions of blatant protectionism, but of more intractable differences."

Instead, we are cornering ourselves in another stupid, irrational set of deadlines on this issue.

On steel and trade policy, there are serious procedural and substantial issues. On the procedural side, USTR/NEC sent us last nite a midnite
a set of revised trade amendments with a 10.30am deadline today for comments/objections (as they want to bring it up to the Hill by this afternoon). We spent
2 full hours on one of these amendments in a staff meeting on Wed without reaching an agreement on WTO-consistent language. This process sucks as there is no due process; we have now 2 hours to comment on long set of issues/amendments that normally take literally months to discuss, assess and decide.
They are ramming through in 2 hours langauge that may be WTO-illegal.
On the substance, they are pushing for changes in trade laws that are severely protectionist; and I will not say more on this.

Nouriel

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Janet L. Yellen (CN=Janet L. Yellen/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME: 5-MAR-1999 09:47:25.00

SUBJECT: Unemployment statement

TO: Steven N. Braun (CN=Steven N. Braun/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TEXT:
==================== ATTACHMENT 1 ====================
ATT CREATION TIME/DATE: 0 00:00:00.00

TEXT:
Unable to convert ARMS_EXT:[ATTACH.D40]MAIL41189186T.036 to ASCII,
The following is a HEX DUMP:

Statement of Janet L. Yellen

Today's employment report indicates that the economy remains on a path of strong noninflationary growth. Nonfarm payroll employment rose a robust 275,000 in February. Since January 1993, the economy has created 18.1 million jobs, with 16.8 million of these jobs in the private sector.

The unemployment rate in February edged up slightly to 4.4 percent from 4.3 percent in January. The unemployment rate has now been below 5 percent for xx months without signs of inflationary pressure. Our nation's continued and long-lasting strong labor market is benefiting all Americans, including historically disadvantaged groups.

Even with this strong labor market, inflation continues to remain in check. Average hourly earnings rose 0.1 percent. Over the past 12 months, average hourly earnings increased 3.6 percent. This means that American workers are experiencing strong real wage gains, while inflation remains tame.

Recent indicators suggest that the U.S. economy remains on a healthy and balanced course. Despite the challenges facing the U.S. economy with the recent international financial turmoil, the U.S. economy is likely to continue during the first part of 1999 on a path of solid growth with low unemployment, low inflation, solid job gains and improved living standards for American workers.

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Michele Jolin (CN=Michele Jolin/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME: 5-MAR-1999 09:19:19.00

SUBJECT: unemploymnet stmt

TO: Janet L. Yellen (CN=Janet L. Yellen/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

CC: Steven N. Braun (CN=Steven N. Braun/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TEXT:
Attached is a draft.

=================== ATTACHMENT 1 ===================
ATT CREATION TIME/DATE: 0 00:00:00.00

TEXT:
Unable to convert ARMS_EXT:[ATTACH.D91]MAIL451171869.036 to ASCII,
The following is a HEX DUMP:

Statement of Janet L. Yellen

Today's employment report indicates that the economy is continuing on a path of steady, sustainable expansion with low unemployment and no signs of inflationary pressures. Nonfarm payroll employment rose a robust 275,000 in February. Since January 1993, the economy has created 18.1 million jobs, with 16.8 million of these jobs in the private sector.

The unemployment rate in February edged up slightly to 4.4 percent from 4.3 percent in January. The unemployment rate has now been below 5 percent for xx months with no signs of inflationary pressures. Our nation's continued and long-lasting strong labor market is benefiting all Americans: Hispanic unemployment is the lowest it's been on record and Black unemployment is the lowest it has been in 25 years [ck?].

Even with this strong labor market, inflation continues to remain in check. Average hourly earnings rose 0.1 percent. Over the past 12 months, average hourly earnings increased 3.6 percent. American workers are experiencing real gains, while inflation remains tame.

Recent indicators suggest that the U.S. economy remains on a healthy and balanced course. Despite the challenges facing the U.S. economy with the recent international financial turmoil, the U.S. economy is likely to continue during the first part of 1999 on this path of solid growth with low unemployment and inflation, which has led to rising wages for American workers. Our nation's continued high employment economy is making broad and lasting changes in the labor market and is ensuring that our nation's growing prosperity is being shared among all Americans

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Michele Jolin (CN=Michele Jolin/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME: 9-MAR-1999 15:20:14.00

SUBJECT: WEB to Sec Daley

TO: Janet L. Yellen (CN=Janet L. Yellen/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

CC: Charles F. Stone (CN=Charles F. Stone/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TEXT:
Janet -- Jon Orszag called to see if we would be willing to send the WEB over to Sec Daley. I told him I'd check w/ you. On the one hand, Daley (and Rob Shapiro) would likely benefit from seeing it, and now that CEA has been asked to provide it, it puts you in an akward position for you to say no to the request (and Jon would probably make it an issue w/ Daley). On the other hand, as you know, we don't distribute the WEB widely because we don't want other agencies complaining or trying to edit the document, and we also don't want your advice and analysis presented to the President leaked to the press or others. What is your view on this? My view is that in general the WEB should be provided to fewer people -- both because we don't want other agency input and because we don't want it leaked. Chad, what do you think?
Michele

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Janet L. Yellen (CN=Janet L. Yellen/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME:10-MAR-1999 16:33:38.00

SUBJECT: Letter to Senator Moynihan

TO: Alice H. Williams (CN=Alice H. Williams/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TEXT:
Attached is a letter responding to Senator Moynihan's letter to John Podesta. A copy of page 94 of the 1999 ERP should be attached and copies should be sent to Podesta and Gene Sperling. =================== ATTACHMENT 1
===================
ATT CREATION TIME/DATE: 0 00:00:00.00

TEXT:
Unable to convert ARMS_EXT:[ATTACH.D46]MAIL46761057H.036 to ASCII,
The following is a HEX DUMP:

March 2, 1999

Dear Senator Moynihan,

John Podesta asked me to respond to your letter of February 24th concerning methodological revisions to the CPI and the extent to which these revisions address the concerns enumerated by the Boskin Commision. You referred in you letter to correspondence between our staffs about a year ago. Steve Braun, a Senior Economist at the CEA, speculated in a memo to David Podoff on your staff that the Boskin Commission would probably deem it appropriate to revise down its estimate of bias in the CPI by about 0.33 percentage point as a consequence of BLS methodological revisions undertaken or planned by the BLS since 1995. He noted that BLS revisions implemented or announced since 1995 totalled 0.69 percentage point, but that 0.36 percentage point of that total had already been anticipated by the Boskin Commission.

Over the last year, CEA has slightly revised its estimates of the impacts of the various BLS methodological changes on the CPI. The most recent (1999) edition of the *Economic Report of the President*, (see the attached table) provides our current impact estimates. However, our bottom line is essentially unchanged. We would now guess that the Boskin Commission would consider it appropriate to lower its bias estimate by about 0.29 percentage point as a consequence of methodological changes implemented by BLS but unanticipated by the Commission. The precise breakdown is summarized in the following table:

Methodological Revisions not Anticipated by the Boskin Commission

Change	Effect
Hospital Services index	-.01
Personal computer hedonics	-.04
Geometric means	-.20
Rotation by item	-.04
Total	-.29

The discussion surrounding the impact of BLS methodology changes on CPI bias has certainly been confusing. Perhaps it would be useful if members of the Boskin Commission were to issue a joint statement clarifying the extent to which recent BLS methodological changes would lower their estimate of bias. Please let me know if I can be of further assistance.

Sincerely,

Janet L. Yellen

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Ryan D. Edwards (CN=Ryan D. Edwards/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME:11-MAR-1999 15:45:50.00

SUBJECT: Re: Retail Sales and GDP

TO: Janet L. Yellen (CN=Janet L. Yellen/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TEXT:
On the market memo, signing off early or not at all sounds perfectly fine with me. We can just see how things fall together. I've got the PPI right now, so I'll be right by with the CDW.

-Ryan

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Charles F. Stone (CN=Charles F. Stone/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME:11-MAR-1999 16:58:43.00

SUBJECT: latest draft

TO: Janet L. Yellen (CN=Janet L. Yellen/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TEXT:
=================== ATTACHMENT 1 ===================
ATT CREATION TIME/DATE: 0 00:00:00.00

TEXT:
Unable to convert ARMS_EXT:[ATTACH.D93]MAIL453865677.036 to ASCII,
The following is a HEX DUMP:

Economics for Presidents

Thank you. It is a pleasure to be here to talk to you about the connection, if any, between economics as practiced at academic institutions and economics as practiced in Washington. My focus will be on the macroeconomic policy goals laid out in the Employment Act of 1946, which created the Council of Economic Advisers. When I started to think about how to organize such a talk I did the standard academic thing and looked at the literature. And I found some useful models, all either prepared for or subsequently reprinted in the Journal of Economic Perspectives.

In a lecture entitled "What Central Bankers Could Learn from Academics—and Vice Versa" Alan Blinder asks two pertinent questions: 1) Is the training we give and the research we do in the academy useful in actual policymaking (in his context monetary policymaking)?; and 2) Could it be more useful if academics and policymakers would change their ways? After giving a "yes, but..." answer to each question, Blinder concludes by quoting Alfred Marshall to the effect that exact scientific reasoning seldom brings us very far on the way to the conclusion for which we are seeking, but that it would be foolish not to use it at all. "Trained common sense" is Marshall's phrase for what is needed, and Blinder suggests that we would be better off if policymakers paid more attention to the training part and academics paid more attention to the common sense part. This conclusion is echoed in Charlie Schultze's essay prepared for the JEP's symposium on the fiftieth anniversary of the Council of Economic Advisers entitled, "The CEA: An Inside Voice for Mainstream Economics." Schultze describes his continuing amazement at how few participants in Washington policy debates have a grasp of fundamental economic principles and how different from economists they analyze issues. He concludes that while it is important for the CEA to be well acquainted with the latest research, its greatest value added may be the injection of basic principles, well back from the frontiers of that research, into the debate.

So what is the "trained common sense" that academic economists have to offer? In microeconomics, the answer is fairly straightforward and pretty uncontroversial among economists. It revolves around the value of efficiency as a policy goal and the importance of getting incentives right. How successful economists have been at injecting these principles into the policy debate is less clear. In his 50th anniversary review essay, former CEA chairman Herb Stein concludes that microeconomic advice from the CEA has been important and successful. Schultze also identifies some important long-term successes, but more typically, he argues, the outcome is to convert an outcome from, say, fifth-best to third-best by suggesting more efficient ways of achieving some objective, or making the achievement of a "bad" objective less harmful. My immediate predecessor as CEA chairman, Joe Stiglitz, wrote an essay based on his experiences in which he asked why it is so difficult to implement even Pareto improvements.

The CEA's role in nudging the policy process toward efficiency is important, and I am proud of our ongoing efforts in that regard. But the main role of the CEA as envisioned in the Employment Act is to give the President advice on macroeconomic policy. Indeed, as my friend and teacher James Tobin once observed, it takes a lot of Harberger triangles to fill an Okun gap. In the rest of my remarks I would like to discuss some of the major macroeconomic developments of the past few years, and the challenges going forward, within the framework of trained common sense that I believe is appropriate for advising Presidents.

The Employment Act of 1946, which created the Council of Economic Advisers, requires the President to submit an *Economic Report* to the Congress each year. Preparation of this report is a central function of the Council of Economic Advisers, and it is always worthwhile endeavor because it gives us a chance to reflect in an organized way on economic developments in the American and world economy and to explain the economic logic of the

Administration=s agenda.

In addition to giving us the responsibility for producing an annual report, the Employment Act, together with its later amendments, also gave the Federal government responsibility for stabilizing short-run economic fluctuations, promoting balanced and noninflationary economic growth, and fostering low unemployment. One purpose of the *Economic Report* is to tell Congress whether we have met those responsibilities. Last year was a year for baseball home-run records, and it was also a year for economic records. We were especially happy to be able to report this year--the fifty-third year after the Act-- we achieved the longest peacetime economic expansion on recordCand the records go back to 1854. You might think of the red cover of this year=s *Economic Report* as symbolizing the Ared-hot economy.@

In our view, the Nation's economy is the strongest it has been in a generation. In 1998, growth was impressive, and job creation was vigorous while inflation declined. Real GDP grew 3.9 percent. Nonagricultural jobs increased by about 2.9 million during the year, and the average unemployment rate for the year dropped to 4.5 percent, its lowest level since 1969. The consumer price index rose by only 1.6 percent, its smallest increase since 1964, and other measures of inflation were even more muted.

As you all know, this year the Federal budget moved strongly into surplus. In the 1992 fiscal year the budget deficit was $290 billion and expected to rise further with no change in policy. But beginning in 1993, the deficit began to decline steadily as a consequence of a shift to fiscal discipline. In 1998, the budget *surplus* was $69 billion, the largest surplus as a share of GDP since 1957, and surpluses are projected well into the future: the Administration now projects surpluses in the unified Federal budget amounting to about $4.5 trillion over the next 15 years. I will return to the budget and the use of those surpluses to address demographic challenges in a few minutes.

The current economic expansion is only the third on record that has lasted at least 7 years. This year=s report puts the expansion in its historical context by comparing it with the other two long expansions--the 106-month long expansion of the 1960s (the longest in peace or war) and the 92-month long expansion of the 1980s. Judged in terms of overall economic performance this expansion has been not only long but excellent--especially with respect to inflation and unemployment. By this time in the expansion of the 1960s, for example, inflation was rising sharply and was much higher than now, at about 5%. In the 80s expansion, inflation was also rising at this stage and had reached 5%. By contrast, inflation now is much lower and has been coming down. Since the need to combat high or rising inflation is what typically brings an expansion to an end, this greatly raises the prospects for a continuing expansion.

This is also an expansion that is investment-driven--to a far greater extent than in either of the other two long expansions. This investment is contributing to improvements in productivity and future growth and it is working to hold inflation down. Of course, it didn=t occur by accident --it=s the consequence of fiscal discipline and reflects a conscious choice to shift the policy mix toward a tighter fiscal policy coupled with a lower interest rate, accommodative monetary policy to stimulate investment and spur economic growth.

Finally, continued strong growth in 1998 is all the more remarkable because it took place at a time of considerable stress to the world economy. A third of all world economies were in outright recession or experiencing markedly slower growth by late 1998. After growing at 4.2% in 1997, world economic growth slowed to an estimated 2.2 percent in 1998, a pace comparable to the growth rates registered during the pronounced world slowdowns of 1974-75, 1980-83, and 1990-91. Our trade deficit rose and exports declined, particularly to countries in East Asia, producing a drag on economic growth and inflicting hardship on some sectors of the U.S. economy. The international environment remains exceptionally risky, with the prospects for growth in Europe, for a recovery Japan and for a pickup in activity in crisis afflicted countries highly uncertain. Even so, we believe that the U.S. economy has entered 1999 on course to continue growing and the chances are good that next year at this time we will be on the verge of marking the longest economic expansionCwhether in peace or warCever.

I believe that these events and the policies that have been pursued since 1993 can be understood within a relatively simple macroeconomic policy framework. By pursuing a policy of deficit reduction right from the start, the Administration sought to accelerate the sluggish recovery from the 1990-91 recession by bringing down interest rates and stimulating private investment. Although this has been the only one of the three long post-war expansions in which fiscal policy was contractionary, our standard IS-LM model teaches us that an appropriately accommodative monetary policy can allow the economy to expand under such circumstances. And this is just what happened. The model also teaches us that the combination of a tight fiscal policy and an accommodative monetary policy should produce lower interest rates and tilt the composition of output toward investment. And, as I have mentioned, the contribution of investment to GDP growth has been quite substantial in this expansion.

One of the pleasant surprises of this expansion has been the continued good behavior of inflation. Based on standard statistical estimates of the NAIRU, the economy had entered incipient inflationary territory by the end of 1994 when the unemployment rate fell to 5.5 percent, yet actual inflation continued to fall well into 1998 as the unemployment rate fell another point. Although the NAIRU is an indicator of the risk of inflation, estimates of the NAIRU have a wide band of uncertainty and should not rigidly dictate policy. The recent behavior of inflation and unemployment provides a good example of the limits of rigorous science and the importance of the prudent application of trained common sense, especially in formulating the Administration's economic forecast.

The economic forecast is a key ingredient in the preparation of the budget. Back in 1993 this Administration consciously decided to establish a reputation for using credible economic forecasts so that, budget balancing efforts--and now proposals to use the emerging budget surpluses--would not be based on rosy scenarios. This means that, as we go about making our forecast, we would prefer to err on the conservative side. That means that we do not turn our backs on our training and assume that we are in a new era in which all the old economic relationships no longer hold. But common sense suggests giving modest weight to recent experience with tame inflation even as the unemployment rate is well below central tendency estimates of the NAIRU and with uncharacteristically strong late expansion productivity growth.

On balance, however, our forecast projects slower growth with a slight rise in the unemployment rate and a modest pickup in inflation. GDP projected to grow at a 2.0% rate on average over the next 3 years in comparison with the roughly 3.9% average pace of the last three years. We project that unemployment will edge up slightly. We also anticipate that the CPI will rise at a 2.3% annual rate next year and thereafter--close to the increase in the core CPI over the past year. This reflects our expectation that some of the special factors, including plunging oil and import prices, which depressed inflation this year will contibute less in containing inflation next year and thereafter. After 2001, we project that real GDP growth will resume growth at our estimate of trend--2.4%, and the unemployment rate is projected to stabilize at 5.3%.

Our forecast is similar to the Congressional Budget Office, the Blue Chip, and other private forecasts, although perhaps a touch on the conservative side in its assumptions about the pace of sustainable growth. A natural question is why we forecast a slowdown in growth when the extent of momentum in domestic demand has been extraordinary and we ended the year with GDP growing at a stunning 5.6% pace in the fourth quarter. Our forecast of more moderate growth going forward reflects our view that several components of domestic demand may be poised to grow at slower rates. In particular, consumption, which constitutes two-thirds of output, has been growing well in excess of income, so that the personal saving rate has declined to zero. In our view, this largely reflects stock-market gains. Unless the stock market continues to surge, the impetus from wealth on consumption is likely to wane, so that consumption will moderate to match the growth of income. As for business investment, slowing consumption growth, coupled with a capacity utilization rate which is now below its historical average, may exert some restraint on the demand for new investment goods. The past year=s boom in housing starts reflects strong income gains and the impact of lower mortgage rates, but it has elevated housing starts well above their demographic fundamentals. We expect some restraint going forward in this component of demand as well.

One of the key questions in preparing the forecast concerns the trend pace of productivity growth. The official measure of productivity in the nonfarm business sector has grown at about a 2% annual rate over the past 3 years, substantially above the 1.1% annual growth rate between the business cycle peaks of 1973 and 1990 and the 1.3% pace from 1973 thru 1998. Investment growth has been exceptional, and capital accumulation should work to boost productivity. However, cyclical factors also affect productivity. Productivity growth is usually slow during recessions, rapid in the middle of an expansion and tapers off in advance of the business cycle peak. Strong productivity growth over the last three years could reflect strong output growth. On the other hand, productivity has grown even faster than would be anticipated based on cyclical factors and it is perfectly possible that the growth rate of trend productivity has risen. The extraordinarily low rates of inflation as measured by the PCE and GDP price indexes combined with healthy profits also suggest faster productivity growth than our forecast assumes. In this sense, our productivity growth assumption is conservative and I can only hope that reality shows that we were wrong. Nothing matters more to living standards over the long run than the pace of productivity improvement, and an increase in the trend pace of productivity of even a tenth or two is of enormous importance for the long-term outlook for real wages and per capita income.

This brings up another encouraging development in the current expansion: the favorable impact of a strong labor market on low-wage and minority workers. It was once commonly accepted that an economic expansion is a rising tide that lifts all boats, so that the most surefire way to alleviate poverty and help disadvantaged groups was to keep the economy expanding. However, in the late 1970s, a new, long-term trend toward widening inequality began to afflict the economy, most likely as a consequence of pervasive technological changes raising the demand for skilled labor and lowering the demand for unskilled workers. In addition, productivity growth declined substantially, for reasons that are still not well understood. During the expansion of the 1980's, real wages declined, particularly among less skilled men. During the current expansion, we saw real wages continue to stagnate for the first five years of the expansion. However, this has finally become an expansion in which a rising tide is lifting all boats. Wage growth has been particularly strong for historically disadvantaged groups. After years of decline, the real wages of black men began to increase in 1993, and they have risen by 5.8 percent in the last 2 years (since 1996). Black women and Hispanic men and women have also experienced recent gains. The tight labor market of the 1990s appears to be helping even young minority workers, who suffered greater wage declines than others in the 1980s. In 1998 alone, the real wages of young black men aged 16-24 rose by 6.2 percent.

It is too early to declare victory in reversing adverse long-term trends in wages for less skilled workers. In particular, it remains hard to know how much of this turnaround is due to particularly favorable business cycle conditions. That is why the Adminstration, right from the beginning, has emphasized the importance of investments, not only in plant and equipment but also in the education and training of the labor force.

Let me turn in the time I have left to two very important issues that we currently face: maintaining fiscal discipline in an era of budget surpluses, and meeting the international challenge.

Preserving fiscal discipline is critical if we are to prepare our nation to meet the needs of an aging population. The ratio of employed workers to retirees has fallen from about 5 to 1 in 1960 to 3-1/2 to 1 today. In only 30 years time, it will be just 2 to 1 and still falling. The same demographic effects that have impaired the finances of Social Security also impact Medicare and Medicaid.

As you know, in his State of the Union the President proposed a plan for how to use the currently projected unified budget surpluses and how to address the financial imbalance of the Social Security system. He proposed devoting 62% of the surpluses over the next 15 years--about $2.8 trillion with a small portion, about 1/4, devoted to equity purchases--to extend the solvency of the Social security system until 2055. Further reforms would be needed to achieve full 75 year actuarial balance, which is the most commonly used measure of financial soundness.

Assuming that a solution for social security can be achieved, the President has also proposed using 15% of the projected surpluses for Medicare, ensuring the Medicare Trust Fund is secure for another 20 years. The President has emphasized the need to utilize the extra funding as part of a broad effort to strengthen the Medicare program. He also proposed creating a new system of universal savings accounts (USA Accounts) outside of Social Security with 12 percent of the surplus to help working Americans build wealth to meet their retirement needs--a way of strengthening the current pension system and helping Americans save. The government would provide an equal dollar contribution for most working individuals and provide matches for individual contributions with larger matches going to lower income workers. Finally, the President would reserve 11 percent of the projected surpluses for military readiness and education and research.

Rather than commenting in detail on the President's Social Security plan, let me talk about the overall macroeconomic impact of this plan. Here the simple Solow growth model helps keep us focused on the key issues of national saving and investment. For the nation as a whole, the central problem in coping with an aging population is to provide a high standard of living for both workers and retirees even though a smaller share of the population will be in the workforce. A natural solution is to make workers more productive by increasing investment in both physical and human capital, which will, in turn, raise labor productivity. In doing so, we can boost the size of the total economic pie, which is the prerequisite to meeting the retirement costs of the baby boom generation without unduly burdening future workers. The key to accomplishing this is to increase national saving, a goal to which continued fiscal discipline would contribute.

National saving increased from 3.1 percent of gross domestic product in 1992 to 6.7 percent in the first three quarters of 1998, but the improvement is accounted for entirely by the elimination of the federal budget deficit, as private saving actually declined relative to total output with the personal saving rate hitting zero in the last quarter of the year. The framework offered by the President for the use of emerging budget surpluses would dramatically increase national saving. Evaluated from a macroeconomic perspective--from the perspective of national savings--this plan saves, in essence, between 77 and 89 percent of the projected surpluses, depending on one's evaluation of the saving impact of the USA accounts. The transfers to Social Security and Medicare amount to 77 percent of the federal budget and about 2 percent of GDP, and they are pure additions to national saving. The USA accounts amount to 12 percent of the unified budget surpluses and could be viewed as a tax cut that is highly likely to add to personal saving. Only 11 percent of the surpluses are devoted to additional government spending.

Dedicating the surpluses to Social Security and Medicare serves two purposes. First, it helps to lock in the surpluses so they are not used for tax cuts or wasteful spending. Second, it gives these critical programs a "first call" on the benefits of our fiscal discipline. And these benefits will be large.

This is a fiscally conservative, pro-growth plan that comes close in its macroeconomic impact to a plan of simply paying off debt. Publicly held debt is projected to fall from 44 percent of GDP today to about 7 percent in 2014. That would represent the smallest burden of government debt on the economy since the United States entered World War I in 1917. In addition, some of the surpluses will be used to purchase equities, which will represent an asset of the government. The dramatic decline in national debt would increase private capital investment, keep interest rates low or drive them lower, raise future national income, free up government resources by reducing debt servicing costs and fuel economic growth. We have estimated, for example, that in comparison with the exploding ratios of debt to GDP forecast back in 1993, the President's plan, which substitutes productive capital assets in private portfolios for unproductive debt would lower interest rates by about 2.5%. Even compared to a more optimistic baseline in which we assume that the political process would have achieved budget savings sufficient to hold the debt to GDP ratio at 50%, the President's plan lowers interest rates by 1-1.25% by 2014 and would raise GDP by 3.5-4.5%--a substantial increase in the size of the pie.

Let me conclude by saying just a few words about the challenges we face on the international economic front and then stop and take your questions.

A first challenge for the United States is to insure that, at this time of economic fragility in so many regions, we do not build new walls of protectionism here, that could set off a dangerous chain reaction around the world, imperilling the world=s prospects for growth while harming our own exporters and consumers. The crisis has taken a toll on some sectors in the United States, steel being notable example. The Administration is committed to vigrous enforcement of our trade laws to insure that American industries are not victimized by unfair trade. However we must also recognize that, as the crisis economies recover, their demand for U.S. goods and services will increase as well, once again fueling our own export growth.

Beyond keeping markets open, the Administration believes that a serious program of reform is needed to strengthen the underpinnings of international financial system to make it less crisis prone and to improve the mechanisms available for dealing with any crises that may nevertheless occur. Unfortunately, there is just no silver bullet--no simple solution that would guarantee countries the benefits of global capital flows while eliminating the risk that a crisis of confidence could once again result in the painful withdrawal of that access. Even so, international agreement is finally emerging on the steps that can and should be taken to strengthen the architecture of the financial system so that it is less crisis-prone going forward. The needed steps include measures to increase transparency and accountability in the operations of individual countries, of financial and corporate institutions and of the international financial institutions themselves to enhance the availability, relevance and reliability of information available for evaluating risk in lending. Reforms are also needed to strengthen the prudential supervision and regulation of banks and other domestic financial institutions: to create stronger incentives for borrowers and lenders to weigh risk and act with appropriate discipline, thereby reducing the odds of a crisis. Countries will need to reassess implicit and explicit government guarantees which create moral hazard and exacerbate risktaking, including the implicit promise of bailouts of corporations considered too big to fail, and semi-fixed exchange rate regimes which reduced the perceived riskiness of foreign currency exposure. Finally, measures are needed to improve creditor coordination in crises and to promote the orderly, cooperative and equitable resolution of international financial crises that may occur in the future. The United States is working intensively with key emerging markets, with other industrialized nations, and the relevant international organizations, to put in place the building blocks of this new architecture to ensure that the unprecedented growth, increase in welfare and opportunity experienced in the 50 years after the creation of the Bretton Woods system are maintained in the future.

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Janet L. Yellen (CN=Janet L. Yellen/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME:11-MAR-1999 14:36:36.00

SUBJECT: Retail Sales and GDP

TO: Ryan D. Edwards (CN=Ryan D. Edwards/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TEXT:
I thought you might be interested to know that Macroadvisers revised up their estimate of PCE growth from 3.4% to 4.5% as a consequence of today's retail sales release. They also revised upward their estimate of imports, because part of consumption is typically satisfied by imports. They raised estimated import growth from 4.7% to 5.5% in Q1. The bottom line was an upward revision in estimated first quarter GDP growth of 0.5 percentage point--from 2.6 to 3.1%. The revision to GDP growth was less than 2/3 of the change in PCE growth because of the import effect. Given Steve's previous range of 3 1/2 - 4 1/2, this suggests an upward revision to 4-5%.

Withdrawal/Redaction Marker
Clinton Library

DOCUMENT NO. AND TYPE	SUBJECT/TITLE	DATE	RESTRICTION
002. email	Matthew R. McBrady to Janet L. Yellen at 22:30:59.00. Subject: Meeting tomorrow with Dole representatives. (partial) (1 page)	03/11/1999	b(6)

COLLECTION:

Clinton Presidential Records
Automated Records Management System [Email]
CEA ([Yellen])
OA/Box Number: 950000

FOLDER TITLE:

[02/26/1999 - 03/11/1999]

2013-0723-F
ab1295

RESTRICTION CODES

Presidential Records Act - [44 U.S.C. 2204(a)]

P1 National Security Classified Information [(a)(1) of the PRA]
P2 Relating to the appointment to Federal office [(a)(2) of the PRA]
P3 Release would violate a Federal statute [(a)(3) of the PRA]
P4 Release would disclose trade secrets or confidential commercial or financial information [(a)(4) of the PRA]
P5 Release would disclose confidential advice between the President and his advisors, or between such advisors [a)(5) of the PRA]
P6 Release would constitute a clearly unwarranted invasion of personal privacy [(a)(6) of the PRA]

C. Closed in accordance with restrictions contained in donor's deed of gift.
PRM. Personal record misfile defined in accordance with 44 U.S.C. 2201(3).
RR. Document will be reviewed upon request.

Freedom of Information Act - [5 U.S.C. 552(b)]

b(1) National security classified information [(b)(1) of the FOIA]
b(2) Release would disclose internal personnel rules and practices of an agency [(b)(2) of the FOIA]
b(3) Release would violate a Federal statute [(b)(3) of the FOIA]
b(4) Release would disclose trade secrets or confidential or financial information [(b)(4) of the FOIA]
b(6) Release would constitute a clearly unwarranted invasion of personal privacy [(b)(6) of the FOIA]
b(7) Release would disclose information compiled for law enforcement purposes [(b)(7) of the FOIA]
b(8) Release would disclose information concerning the regulation of financial institutions [(b)(8) of the FOIA]
b(9) Release would disclose geological or geophysical information concerning wells [(b)(9) of the FOIA]

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Matthew R. McBrady (CN=Matthew R. McBrady/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME:11-MAR-1999 22:30:59.00

SUBJECT: Meeting tomorrow with Dole representatives

TO: Janet L. Yellen (CN=Janet L. Yellen/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

CC: Robert Z. Lawrence (CN=Robert Z. Lawrence/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

CC: Nouriel Roubini (CN=Nouriel Roubini/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TEXT:
Janet,

I'm sorry that I will not be able to attend tomorrow's meeting. [redacted] I briefed Nouriel on essential background earlier today, but thought I would take this opportunity to write down some thoughts as well. [002]

I spent about an hour with both Patrick Nielsen (Dole) and David Raboy (Economic Consultant) while in Geneva. Dole's participation in the entire damage assessment exercise is interesting. Dole's representatives declined the opportunity to be included early in the process, claiming they could contribute little to the overall assessment. Later in the process, however, they joined Chiquita, providing us a valuable boost. In its first submission to the arbitrators, the EU's main argument was that the US assessment was not of damage to US exports, per se, but of damage to a single US company. Having Dole prepared to refute this claim in Geneva was quite valuable.

In speaking with both Nielsen and Raboy, it became clear that Chiquita and Dole had very different starting points when the regime was initiated, and perhaps as a result, they reacted to it very differently. Chiquita had just invested in a great deal of assets (both production and transportation infrastructure) to optimize delivery of high quality Latin bananas to the European market. When the banana regime was instituted, Chiquita essentially refused to abandon this strategy, focusing instead on attempting to overturn the regime. Dole, on the other hand, had much less by way of brick and mortar assets in place, and so was strategically much more flexible.

In its banana regimes over the past 7 years, the EU has created many ways of hand picking who receives quota rents. The specifics get intricate long before they get interesting. The punch-line, however, is that by investing in various assets (European ripening business, EU or ACP production assets, etc.) companies can increase their allocation of licenses to distribute Latin bananas. Chiquita refused to play ball. Dole did not. According to my conversation with Raboy, it invested close to $200 million in book value terms, consisting of assets which it would certainly never have otherwise purchased. When the investments were undertaken, the quota rents to which they entitled Dole were explicitly included -- and extended out to a sunset of 2002. Despite mitigating Dole's loss of market share, and increasing the rents it was able to capture, however, these investments have underperformed any reasonable benchmark for required return on capital (or so I was told -- believably enough -- despite being shown no reasonable DCF valuation).

A little editorial license, then, is all that is required to explain Dole's behavior: insofar as the regime is amended or eliminated prior to 2002, cash flows that were built in to their original valuations will not materialize. Future cash flows, of course, more often than not do not end up matching the expected values built into the models. In this case, however, the investments have already proven to be dogs, and "sunk cost" is a mysterious concept to more than a few business decision makers. Also, it isn't a matter of the cash flows being a little off, but instead being (conceivably) reduced to zero. So, early on, Dole did not want to support the US case, since it wanted rather to continue earning the rents it had forecasted through 2002. At the 11th hour, however, Dole realized that the longer term benefit of allowing the world's second largest banana market to be allocated commercially rather than administratively would outweigh the cost of the foregone rents.

In a surprisingly candid conversation, that is the story I got (in not so many words...). Now, Dole wants to be sure that whatever happens to the regime, the new arrangement doesn't simply eliminate the rents without also providing Dole with some compensating advantages. Nielsen made it perfectly clear that Dole is eager to compete freely, on commercial terms. What he is afraid of, is a settlement that throws some extra fat in Chiquita's direction, costing Dole rents without providing it any attractive future growth prospects, etc.

Hopefully that will provide some useful background. Please apologize for me to those in attendance that I couldn't make the meeting. Unfortunately, I had been told the meeting would be sometime next week, and my travel plans had already been irrevocably set by the time I found out (today) that it was scheduled for tomorrow.

Have a nice weekend,
Matt

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Michele Jolin (CN=Michele Jolin/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME:11-MAR-1999 15:20:48.00

SUBJECT: draft remarks for roundtable

TO: Janet L. Yellen (CN=Janet L. Yellen/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TEXT:
Attached is a revised draft of your remarks. Would you mind taking a look at the remarks and making any changes? Then I will send the draft to OMB's communication's office and to Beverly Barnes (the WH press person in charge of this event) to be sure that there isn't overlap with what the others are saying. Your remarks do not have to be in final form -- and Doug will probably want to make some changes -- but I would like to get the draft to OMB and Beverly on Friday morning.
Thanks.

=================== ATTACHMENT 1 ===================
ATT CREATION TIME/DATE: 0 00:00:00.00

TEXT:
Unable to convert ARMS_EXT:[ATTACH.D23]MAIL44079367T.036 to ASCII,
The following is a HEX DUMP:

Remarks to Women Editors and Reporters Roundtable on Social Security
Janet L. Yellen, Chair
Council of Economic Advisers
March 15, 1999

"How Social Security Reform Will Affect Future Generations of Americans"

I appreciate this opportunity to talk about how the President's Social Security reform proposal will benefit women -- and all Americans -- in the future. The President's Social Security plan will benefit future generations of Americans in two critical ways: one way -- which is what Jack talked about earlier -- is by fundamentally strengthening the Social Security system so that all Americans are confident that they will receive benefits when they need them. The other way -- which I intend to focus on in my brief remarks -- is by taking steps that will strengthen our nation's economy, so that we can pay future Social Security benefits, provide other necessary government services and not impose an undue burden on future generations of American workers.

For the Nation as a whole, the central problem of our aging population is how to ensure that future workers and retirees enjoy a higher standard of living, even though a smaller share of the population will be in the workforce. A natural solution is to help make workers more productive by increasing investment in both physical and human capital, which will, in turn, raise workers productivity. In doing so, we can increase the size of the total economic pie, which is prerequisite to meeting the retirement costs of the baby boom generation without unduly burdening workers in the future.

The key to accomplishing this goal is to increase national saving. National saving is simply the sum of saving by households, by firms, and by governments. During this Administration, net national saving has increased sharply as a share of GDP, rising from 3.1 percent of GDP in 1992 to [6.7] percent of GDP last year. This gain is entirely a result of the increase in federal government saving — that is, the savings has come as a result of the dramatic reversal of the federal budget from large deficits to growing surpluses.

The President's proposal for Social Security reform will dramatically extend the Administration's record of fiscal discipline and saving for our Nation's future. Under this proposal, the government will devote three-quarters of the projected budget surpluses over the next 15 years to paying down debt and purchasing equities. For every dollar of publicly held debt that is redeemed, a one-dollar bond will be given to either the Social Security or Medicare trust funds, and each equity share would be placed in the Social Security trust fund. It is important to note, however, that building up these trust funds does not make any new commitments, it simply improves the ability of the funds to pay the benefits that are already required by current law.

According to current projections, the President's proposal will reduce this nation's debt from 44 percent of GDP today to only 7 percent by 2014, the smallest share since 1917. And, the government's overall financial position will be even stronger, because of the investments in equities. The reduction in debt in turn improves the future budget outlook by slashing required interest payments. In fact, the decline in interest expense will exceed the increase in Social

Security expense through the middle of the next century. According to current projections, the President's proposal allows the government to run a budget surplus until the late 2040s.

Both the debt paydown and equity purchase boost national saving, essentially freeing up room in private portfolios for holdings of additional productive capital. Compared to a policy of spending the projected budget surpluses, the President's proposal boosts the government's contribution to national saving by about 2 percent of GDP, which will generate a significant increase in the capital stock. More capital means higher productivity and wages, higher incomes, and lower interest rates. It also leads to a reduced dependence on foreign borrowing and, ultimately, an improving trade balance.

[JANET -- On the conference call, they suggested that you say something to address criticism of our projections. I drafted the following paragraph. It may not be on point -- but I took a stab so that you or Doug would know that they want you to address this issue.]

Finally, let me take a moment at this point to talk about the projections used by the Administration in developing the President's Social Security reform plan. Some policymakers and commentators have questioned how we can rely on projections of economic performance over the next 6 decades and how we can count on seeing surpluses in future years. Let me say: forecasting is always a difficult business. But, for the past 7 years, this Administration has built a record of credible, accurate economic forecasts. This Administration's economic projections have consistently been on target. [CHECK] Comparisons of our earlier projections with the economy's actual performance show only small differences. If anything, we have been too conservative; we have consistently underestimated real GDP growth and the increase in jobs, and overestimated inflation, interest rates, and the budget deficit. I believe that the projections used in the President's Social

Security plan are similarly sound and realistic. [And they are in line with the forecasts of the Blue Chip private forecasters and the Congressional Budget Office (CBO)] **[Is this last sentance true? Or are there other non-Administration sources to compare to?]**

To conclude, let me say that the President's Social Security reform plan takes a very important step toward addressing challenges that will face future generations of Americans. By setting aside the lion's share of the projected budget surpluses to pay down our nation's debt we will strengthen our economy for the future. Continuing the fiscal discipline that has been the centerpiece of this Administration's economic agenda will contribute greatly to preparing our Nation for the coming demographic changes. Dedicating the gains from this fiscal discipline to Social Security and Medicare will ensure the further success of these critical programs and will strengthen our nation's economy for future generations.

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Cordelia W. Reimers (CN=Cordelia W. Reimers/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME:11-MAR-1999 14:35:34.00

SUBJECT: splitting USA accts

TO: Janet L. Yellen (CN=Janet L. Yellen/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TEXT:
As I told you after lunch, I have thought some more since our conversation yesterday and am more inclined to favor mandatory splitting of the contributions to USA Accounts. Nora Gordon is doing a quick search for survey results on how couples manage family finances, so we can see whether the traditional pattern where the husband takes care of all finances is still widespread.

Here,s my rationale for requiring splitting matched voluntary contributions equally between spouses, and an "escape valve" for couples who do not want to share their assets equally:

The reason for the USA Accounts with the government match is to encourage saving for retirement. The public interest that justifies the subsidy is in making sure everyone has income from a USA Account when he or she retires. Given the prevailing patterns of managing family finances and the fact that most husbands earn more than their wives, it is likely that a disproportionate share of a couple,s contributions would go into joint accounts or accounts in the husband,s name.

In the event of divorce, the wife may be left with much less in her USA Account than her husband has in his. Divorce courts do not necessarily divide joint property equally, particularly if the husband earned a disproportionate share of the couple,s income. Accounts in one spouse,s name are even less likely to be divided equally.

The public interest is in making sure that the USA Accounts accumulated during the marriage are divided equally so that both spouses get equal benefit from the government,s matching contributions. The only way to make sure the USA Accounts will be divided equally is to make the contributions equal in the first place.

Provision could be made to divide the USA Accounts in some other fashion, but the hurdle should be rather high. Merely having the spouse getting the smaller share sign a consent is insufficient protection for wives whose husbands manage all the family finances. (He says, "sign this," and she does automatically, without being fully informed of the possible consequences. They do not anticipate divorce during the time they are happily married.)

Some couples have legal prenuptial or postnuptial agreements to divide their assets unequally. They could be permitted to override the mandatory equal split by filing an (abbreviated) copy of their agreement with their tax return. Couples who do not have formal legal agreements, but who wish to divide their assets unequally, can achieve the desired balance by shifting other assets between them. (Couples who have no other assets can,t do this, but again, the public interest is in making sure that both spouses have adequate resources for retirement.)

Nora also made a good point about the flat contributions for non-working spouses. I understand that this decision has already been made, but I,ll pass on the idea anyway:

The flat contribution for non-working spouses should be limited to those with dependent children or elderly relatives listed on the tax form. There is no more reason for the government to make a flat contribution for a spouse without caregiving responsibilities who can afford not to work than for a single person who can afford not to work. (This isn,t an issue if the flat contribution is phased out at a fairly low level of income.)