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Honorable Richard W. Riley  
Secretary  
Department of Education  
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Washington, DC 20202

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CS  
THE WHITE HOUSE  
WASHINGTON

970114

DATE: January 13, 1997

NOTE FOR: The Honorable Richard W. Riley  
Secretary of Education

The President has reviewed the attached, and it is forwarded to you  
for your:

Information

Action

Thank you.

Staff Secretary  
(x6-2702)

cc:

# WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

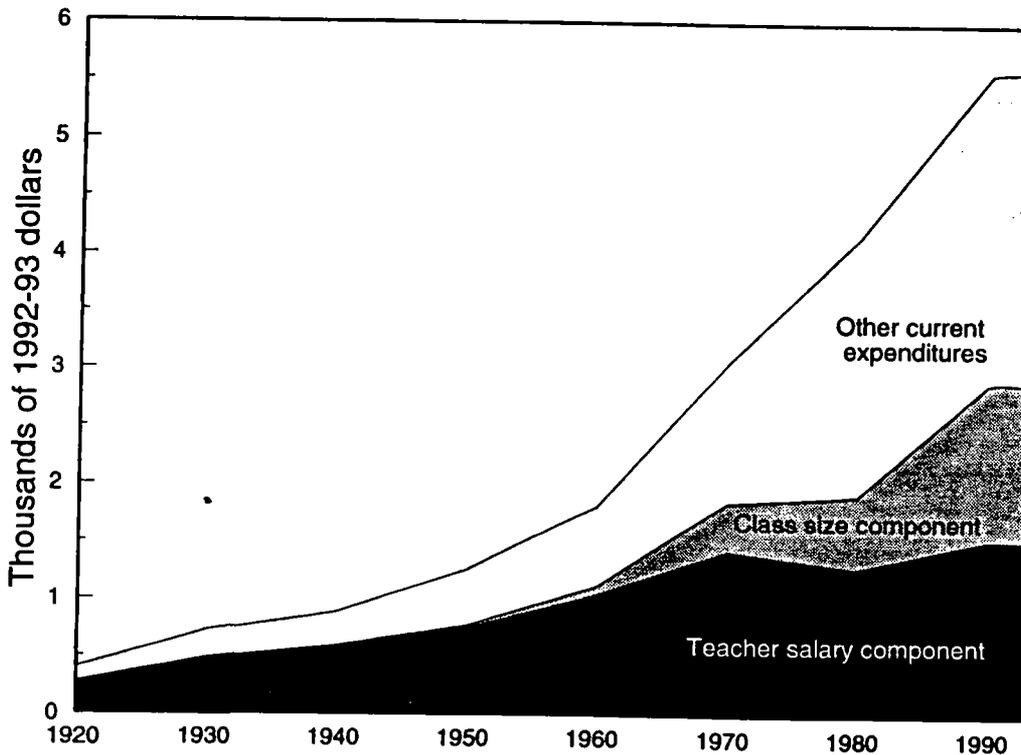
Prepared by the Council of Economic Advisers  
with the assistance of the Office of the Vice President

January 10, 1997

*cc: B. B. D.  
See: D. B. D.*

## CHART OF THE WEEK

### Trends in Public Educational Expenditures Per Student



Real (inflation-adjusted) public elementary and secondary educational expenditures per student have grown dramatically over the century. Both teachers' salaries and class size affect per-student expenditures on instructional staff. Teachers' salaries have grown quite slowly since 1960. Lower teacher-student ratios explain much of the rise in per-student expenditures on instructional staff. Other current expenditures have also increased substantially. These include administrative expenditures, teacher health and retirement benefits, purchases of books and supplies, and other classroom instructional expenses.

*Breakdown would be useful*

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*"At last! After all the debates and polls, it's back to real politics!"*

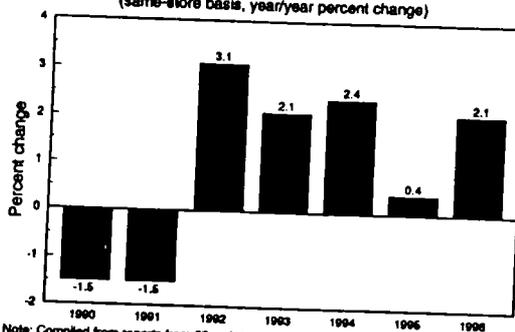
## CURRENT DEVELOPMENT

### Did Retailers Have a Merry Christmas?

General merchandisers make about 25 percent of their sales in the November-December Christmas season. Sales at chain stores suggest Santa was relatively jolly this year.

**Christmas-season sales.** Sales at the major chains were 3.2 percent higher in nominal terms during the 1996 Christmas season than they were during the 1995 Christmas season. After adjusting for inflation

Christmas-Season Real Spending at Chain Stores  
(same-store basis, year/year percent change)



Note: Compiled from reports from 80 major chains by the Bank of Tokyo-Mitsubishi.

using a consumption goods deflator, real sales were up about 2.1 percent from a year earlier (see chart). This growth is much better than 1995's and in the same solid range as in 1993 and 1994. (These trends are based on sales in stores that have been open for at least a year.) The figures for this Christmas season were also consistent with 12-month changes reported earlier in the year.

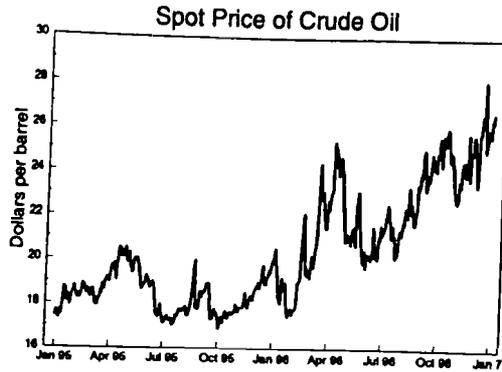
**Other signs of strength.** Chain stores comprise only about 2 percent of non-auto retail spending. More complete data on retail sales will become available with next week's report from the Commerce Department. Meanwhile, most of the data that have arrived in the past month—employment, housing starts, merchandise trade, construction, and Purchasing Managers' Index—have been stronger than expected. Private forecasters are raising their estimates for fourth quarter growth. So too is CEA—to about 3½ percent at an annual rate.

## CURRENT DEVELOPMENT

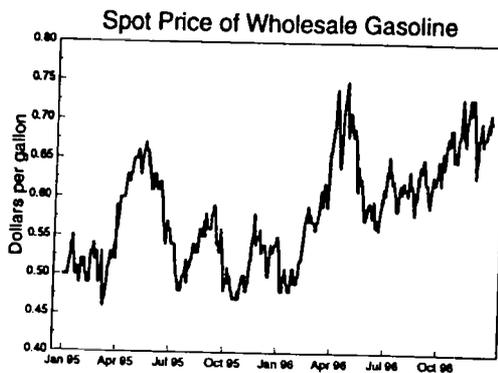
### Energy Prices and Inflation

Energy price increases fueled an unexpected 0.5 percentage point jump in producer prices in

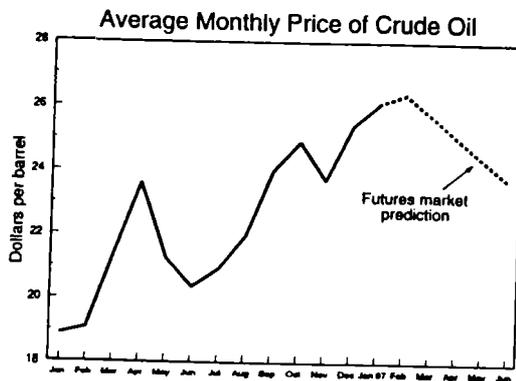
December. Overall, the producer price index (PPI) is not pointing to rising inflation—the core PPI, which excludes volatile food and energy components, rose only 0.6 percent over 1996. But energy prices are proving troublesome.



**Analysis.** The energy price component of the PPI jumped 3.1 percent in December. Sharp price increases for gasoline (5.2 percent) and fuel oil (4.9 percent) reflect increases in the price of crude oil (see top chart) and may be influenced by cold weather in Europe.



Futures markets correctly predicted that this spring's spikes in crude oil and wholesale gasoline prices would not persist. But the more gradual and persistent rise in these prices since July has defied futures market predictions. A post-Gulf-War high for crude oil was touched recently. Once again, the futures market is predicting a decline in crude oil prices (see bottom chart). This time the prediction may be fulfilled, since Iraqi oil is finally starting to come on line.



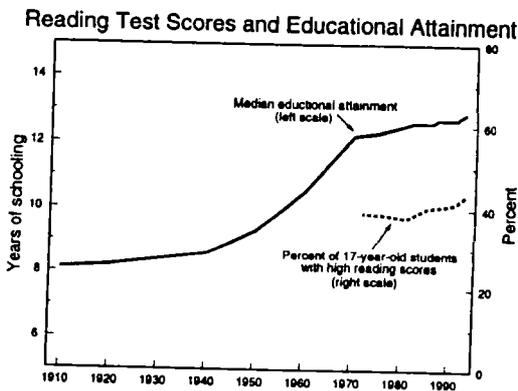
**Implications.** Increases in crude oil prices tend to show up relatively quickly in wholesale prices and then more slowly in retail prices. Even if crude oil prices begin to fall, retail energy prices may still show the effects of the recent rise for a month or so. Retail gasoline prices have been falling since about Thanksgiving but are still 13 cents per gallon higher than a year ago. Retail prices for home heating oil are about 15 cents per gallon higher than this time last year.

## SPECIAL ANALYSIS

### Educational Expenditures and Student Performance

Thirty years ago, the Coleman report concluded that spending more on education does not improve student performance as measured by test scores. Although additional evidence has accumulated supporting the Coleman position, new research suggests that greater spending can increase students' educational attainment and raise their earnings when they enter the labor market.

*of a lower spend*



**“There is no effect.”** Real expenditures per pupil in public elementary and secondary schools have grown over many decades (see Chart of the Week). Despite continued growth in expenditures, we have seen little improvement in either test scores or educational attainment during the last 25 years (see chart).

This lack of relationship between spending and outcome trends has produced a popular view that simply spending more money on education is unlikely to produce better results. More careful analyses, beginning with the Coleman report, have tried to separate the effects of school expenditures from other factors that affect outcomes (like family income) and also have found no relationship between school spending and test scores. Dozens of research papers over the past 30 years have supported the original Coleman finding.

**“There is so an effect.”** New research has focused on educational attainment and wages rather than test scores as outcome measures. This reflects the economist's view of education as an investment in human capital, so that greater spending should produce higher returns in the form of greater productivity and higher market wages. Research along these lines indicates that, among workers now in the same labor market, those who were educated in states with higher per capita education spending also tend to earn higher wages.

*may mean to measure costs higher than*

**Analysis.** Those who adhere to the original Coleman Report finding question how school spending could improve educational attainment and wages without improving test scores. One possible explanation is that test scores are a highly imperfect measure of student performance that are not closely related to the true benefits of education. Also, completely removing the effects of confounding factors and identifying causal relationships is often a controversial exercise. Participants in this academic debate frequently allege statistical bias in their adversaries' approaches.

If additional expenditures have diminishing effects on student achievement, then the two sets of findings may not be as inconsistent as they appear to be. Earlier in the century, greater differences existed in educational expenditures across regions. Because current wages depend upon education received years ago, those exposed to greater resources in youth may earn substantially more now. The smaller cross-regional differences that exist today may be too small to produce marked differences in outcomes.

**Implications.** After years of research, the academic literature is still unable to determine conclusively whether additional school spending improves student performance. How resources are spent may be at least as important as how much is spent. Policies that attempt to enhance learning without spending more money, such as charter schools, are certainly an appropriate alternative under these circumstances.

... expenditures, ...

... found no relationship ...

... effect." More ...

## SPECIAL ANALYSIS

### **Mergers and Acquisitions: Evaluating Competitive Effects**

Large announced mergers in the telecommunications, electricity, and defense industries contributed to a reported record \$659 billion of merger and acquisition activity in 1996. This activity merits a review of how Federal antitrust authorities determine whether a particular merger threatens competition.

**Defining the market.** The major concern is "horizontal" mergers, in which two firms that used to compete against one another in the same market are combined into one. To explain how to determine whether a merger raises this concern, the Antitrust Division of the Justice Department first issued "Horizontal Merger Guidelines" in 1982. These were most recently revised, and reissued jointly with the Federal Trade Commission, in 1992. The first steps in evaluating a proposed merger involve identifying the relevant market and identifying the firms in it. Consider, for example, a merger of two hospitals in the town of Mudville.

- What is the relevant market? A market is defined as a group of products and a geographic area in which these products are purchased or sold, where a hypothetical monopolist could profitably impose a "small but significant nontransitory increase in price," or SSNIP (for example, an increase in price of 5 percent that lasts for a year). Products that buyers consider to be close substitutes should be treated as being in the same market. If analysis suggested that a hypothetical Mudville hospital monopolist could not get a SSNIP to stick because doctors or patients would extensively turn to hospitals in another city or to outpatient clinics, those hospitals and clinics would be treated as being in the relevant market.
- Who is in the market? Do the merging firms compete with each other in a relevant product market and geographic area? And who else competes with them? An important concept here is "supply substitutability," that is, whether a firm would change product lines if other firms attempted a SSNIP. If doctors began performing more procedures in their offices following a rise in Mudville hospital rates, those offices would have to be included in the market as well.

The bone of contention in most merger cases is this process of "market definition." To defend a merger, firms argue either that the relevant markets are sufficiently broad as to include so many competitors that collusion is impossible (Mudville patients would go anywhere in the state), or so narrow that the merging firms do not really compete in any relevant market (east side Mudvillians would not trek over to that west side hospital).

**Evaluating the threat to competition.** Once the relevant markets and firms are identified, analysts calculate numerical measures of concentration to determine whether the market currently looks competitive and whether it will continue to look

competitive after the merger. If Mudville patients would turn to a dozen different hospitals, a merger between two of them is not likely to reduce competition. But mergers in highly concentrated markets can reduce competition, especially if the merging firms are among those with the largest market shares, for example, the two largest of only four Mudville hospitals.

Market concentration alone, however, is not a foolproof predictor of competitive harm. The Guidelines identify a number of further issues to be assessed before concluding that a merger is anticompetitive:

- Behavior. The major innovation in the 1992 Guidelines was an explicit discussion of anticompetitive harms and the factors making them more or less likely. The two major harms were unilateral market power of the merged firms, (will the merging Mudville hospitals raise prices themselves?), and other coordinated interaction among all the firms in the market (will the merger lead to price fixing by the all the Mudville hospitals?). Unless a plausible story of anticompetitive behavior can be told, concentration alone is not sufficient to judge a merger anticompetitive.
- Potential entry. Even if concentration is high, a merger will produce no competitive harm if new firms would enter the market in response to an increase in price by the merging firms. The Mudville merger would cause little harm if it were reasonable to expect new hospitals would be built there in response to a SSNIP. Successful entry depends very much on how much irreversible investment firms have to "sink" to become successful. The greater are these sunk costs, the less likely entry is to take place in a timely and significant way.
- Efficiencies. A particularly controversial issue is when, if ever, antitrust authorities should take possible cost savings into account as a mitigating factor in assessing competitive harms. Merging hospitals frequently cite gains from sharing equipment or scale economies. Under the Guidelines, the antitrust authorities will consider efficiency gains, but only if they cannot be achieved through means other than merger, such as through limited partnerships or internal expansion.
- Exiting assets. One Mudville hospital might claim that it will go out of business if the other hospital does not buy it. Mergers in which one firm buys a competitor are not harmful if that competitor would have failed and left the market anyway. But if a third firm with a lesser presence in the market than the acquiring firm would have purchased the exiting firm's assets and kept them in the market, this "failing firm" defense for a merger need not be compelling.

**Few cases need not mean lax enforcement.** Effective merger guidelines encourage substantial self-policing: firms do not undertake mergers that would fail the test of the guidelines and they take action in advance of merging (perhaps via spinoffs) to avoid raising concerns. In an ideal world with ideal guidelines, the number of merger cases that had to be brought should be small.

## BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

**States Compete for Business Relocations.** Between 1991 and 1995, more than 56,000 businesses moved across state lines, relocating more than a million jobs. The biggest gains went to the South Atlantic and Mountain states, while New York, California, and the District of Columbia suffered the biggest losses—a total net outflow of 7,675 businesses and over 180,000 jobs. Low wages in Southern states drew manufacturing jobs to that region, while Virginia and Maryland saw relocations from the District. Mountain states offered various incentives to migrating businesses: Colorado is home to the best-educated workforce outside of the Northeast and Nevada charges the lowest tax rate in the nation. The concentration of job losses among a few states suggests that poor local conditions, rather than better opportunities elsewhere, may often inspire business migration.

**Waivers Preserve Food Stamp Benefits for Areas with Insufficient Jobs.** Last year's welfare reform legislation restricted food stamp receipt to 3 months in any 3-year period for 18- to 50-year-olds with no children, unless they are engaged in work-related activity or sufficient jobs are not available for them. Since the law went into effect, 18 states have requested waivers from this provision due to lack of jobs in selected areas of the state. The waivers have been approved in whole or in part in 9 states and are pending in 8 more. The basis for the states' request include: an unemployment rate higher than 10 percent, an unemployment rate 20 percent above the national average, and insufficient jobs based on a variety of other criteria. Rhode Island even requested a waiver for the entire state because 90 percent of affected clients live in "labor surplus" areas, as defined by the Bureau of Labor Statistics. Bigger states requesting waivers for certain areas include New York, Pennsylvania, New Jersey, Illinois, Ohio and Texas. In Illinois, a waiver request for the entire city of Chicago has already been approved. These waivers should ease the burden of the food stamp cuts for some individuals. However, they may also create perverse incentives to move from low- to high-unemployment areas.

**Simple Hygiene Advances Let U.S. Population Surge.** The U.S. population has ballooned from 81 million in 1900 to a projected 276 million in 2000. A new demographic study finds that if the advances in public health over the past 96 years had not occurred, the population today would be only half its current size. Mortality reduction in the first half of the century was concentrated among children and young adults. Most likely, the reduction did not result from sophisticated medical treatments but rather from simple changes in hygiene and public health such as cleaner water, the sterilization of food, washing hands, and isolating sick patients. As a result, children who would have died survived and had children of their own, causing the jump in population. In the second half of the century, medical advances affected mainly older people who had already had children, which had a great effect on the number of very old people, but a smaller effect on the overall population. If health progress had stopped in 1950, the U.S. population would only be 6 percent smaller than it is today—but its demographic composition would be different.

## INTERNATIONAL ROUNDUP

**Israeli Security Measures and Trade Sanctions Alter Gaza Trade.** Exports from the Gaza Strip were down almost 10 percent in the third quarter of 1996 compared to the same period in 1995. This export decline was due primarily to tightened security procedures and a ban on Gaza-produced construction materials. The ban on the export of Gaza-produced paving and floor tiles, which arose from Israeli concerns about hidden explosives, led to a 30 percent drop in exports of construction material from Gaza. The Gaza Strip's GDP is expected to decline by an additional 5 to 10 percent, after having fallen about 8 percent in 1995.

**Summit Statement Attacks High Levels of European Unemployment.** European Union leaders committed themselves to the fight against unemployment in a statement released at the conclusion of last month's European Summit in Dublin. Expressing optimism that falling interest rates, fiscal consolidation by member states, and low wage and price increases will lead to sustained growth and increased employment opportunities throughout the EU, the declaration highlighted the need to push policies to increase employment. Specifically, the EU leaders emphasized the need to accelerate the implementation of the single market, invest in human resources, and enhance training incentives for employers. A key question, however, is whether a sufficient monetary response will be forthcoming quickly enough to prevent fiscal contraction from raising unemployment in the short run. The average EU unemployment rate was 10.9 percent in the third quarter, up slightly from the same quarter of 1995. Spain had the highest unemployment rate, 22.1 percent, and Luxemburg had the lowest, 3.1 percent. France reached a postwar high 12.7 percent unemployment rate in November.

**Affirmative Action Under Fire in South Africa.** A key part of a two-and-a-half-year effort to employ non-whites in professional jobs in South Africa was abandoned last week in the face of a rising number of accusations of reverse discrimination. The "Jobs for South Africa" project, originally designed to provide 10,000 public sector jobs for non-whites, received close to 2 million applications, but filled only 25 percent of the vacancies. Meanwhile, the Ministries of both Labor and Justice have been accused of passing up qualified whites in efforts to appoint less-qualified blacks to high level positions. Hearings on cases against both agencies will take place this year. Only 20 percent of blacks hold a higher education qualification, compared to 73 percent for white males and 67 percent for white females. This educational disparity makes it difficult to eliminate disparities in income and employment levels in the short term. Modest progress has been achieved recently, as average black, "colored," and Indian household incomes all rose somewhat faster than average income for whites between August 1995 and August 1996.

## RELEASES THIS WEEK

### **Employment and Unemployment**

**\*\*Embargoed until 8:30 a.m., Friday, January 10, 1997\*\***

In December, the unemployment rate was unchanged at 5.3 percent. Nonfarm payroll employment rose by 262,000.

### **Producer Price Index**

The producer price index for finished goods rose 0.5 percent in December. Excluding food and energy, producer prices rose 0.1 percent. For the 12-month period ending in December, the producer price index for finished goods rose 2.8 percent; excluding food and energy, producer prices rose 0.6 percent.

## MAJOR RELEASES NEXT WEEK

Consumer Prices (Tuesday)  
Retail Sales (Tuesday)  
Industrial Production and Capacity Utilization (Friday)  
U.S. International Trade in Goods and Services (Friday)

## U.S. ECONOMIC STATISTICS

	1970- 1993	1995	1996:1	1996:2	1996:3
<b>Percent growth (annual rate)</b>					
Real GDP (chain-type)	2.7	1.3	2.0	4.7	2.1
GDP chain-type price index	5.3	2.5	2.3	2.2	2.0
<u>Nonfarm business (NFB) sector:</u>					
Productivity (chain-type)	1.5	-0.1	1.9	0.6	-0.3
Real compensation per hour:					
Using CPI	0.6	1.0	0.2	0.1	1.1
Using NFB deflator	1.3	1.7	2.0	2.0	2.0
<b>Shares of Nominal GDP (percent)</b>					
Business fixed investment	10.9	10.2	10.4	10.3	10.6
Residential investment	4.5	4.0	4.1	4.2	4.1
Exports	8.2	11.1	11.3	11.3	11.1
Imports	9.2	12.4	12.5	12.6	12.7
Personal saving	5.1	3.4	3.6	3.2	3.9
Federal surplus	-2.7	-2.2	-2.1	-1.7	-1.6
<hr/>					
	<b>1970- 1993</b>	<b>1995</b>	<b>Oct. 1996</b>	<b>Nov. 1996</b>	<b>Dec. 1996</b>
<b>Unemployment Rate</b>	6.7**	5.6**	5.2	5.3	5.3
<b>Payroll employment (thousands)</b>					
increase per month					
increase since Jan. 1993			261	127	262
					11176
<b>Inflation (percent per period)</b>					
CPI	5.8	2.5	0.3	0.3	N.A.
PPI-Finished goods	5.0	2.3	0.4	0.4	0.5

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

New or revised data in **boldface**.  
 Employment and unemployment data **embargoed until 8:30 a.m., Friday,  
 January 10, 1997.**

## FINANCIAL STATISTICS

	1995	1996	Nov. 1996	Dec. 1996	Jan. 9, 1997
<b>Dow-Jones Industrial Average</b>	4494	5743	6318	6436	6626
<b>Interest Rates</b>					
3-month T-bill	5.49	5.01	5.03	4.91	5.00
10-year T-bond	6.57	6.44	6.20	6.30	6.52
Mortgage rate, 30-year fixed	7.95	7.80	7.62	7.60	7.85
Prime rate	8.83	8.27	8.25	8.25	8.25

## INTERNATIONAL STATISTICS

<b>Exchange Rates</b>	<b>Current level Jan. 9, 1997</b>	<b>Percent Change from</b>	
		<b>Week ago</b>	<b>Year ago</b>
Deutschemark-Dollar	1.578	2.4	9.4
Yen-Dollar	116.2	0.6	10.8
Multilateral \$ (Mar. 1973=100)	89.58	1.3	5.1

<b>International Comparisons</b>	<b>Real GDP growth (last 4 quarters)</b>	<b>Unemployment rate</b>	<b>CPI inflation (last 12 months)</b>
United States	2.2 (Q3)	<b>5.3</b> (Dec)	3.3 (Nov)
Canada	1.6 (Q3)	10.0 (Oct)	2.0 (Nov)
Japan	3.2 (Q3)	3.4 (Oct)	0.5 (Oct)
France	1.4 (Q3)	12.8 (Sept)	1.6 (Nov)
Germany	1.9 (Q3)	7.4 (Oct)	1.5 (Nov)
Italy	0.7 (Q2)	11.9 (Jul)	2.7 (Nov)
United Kingdom	2.4 (Q3)	7.9 (Oct)	2.7 (Nov)

U.S. unemployment data embargoed until 8:30 a.m., Friday, January 10, 1997.