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# WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

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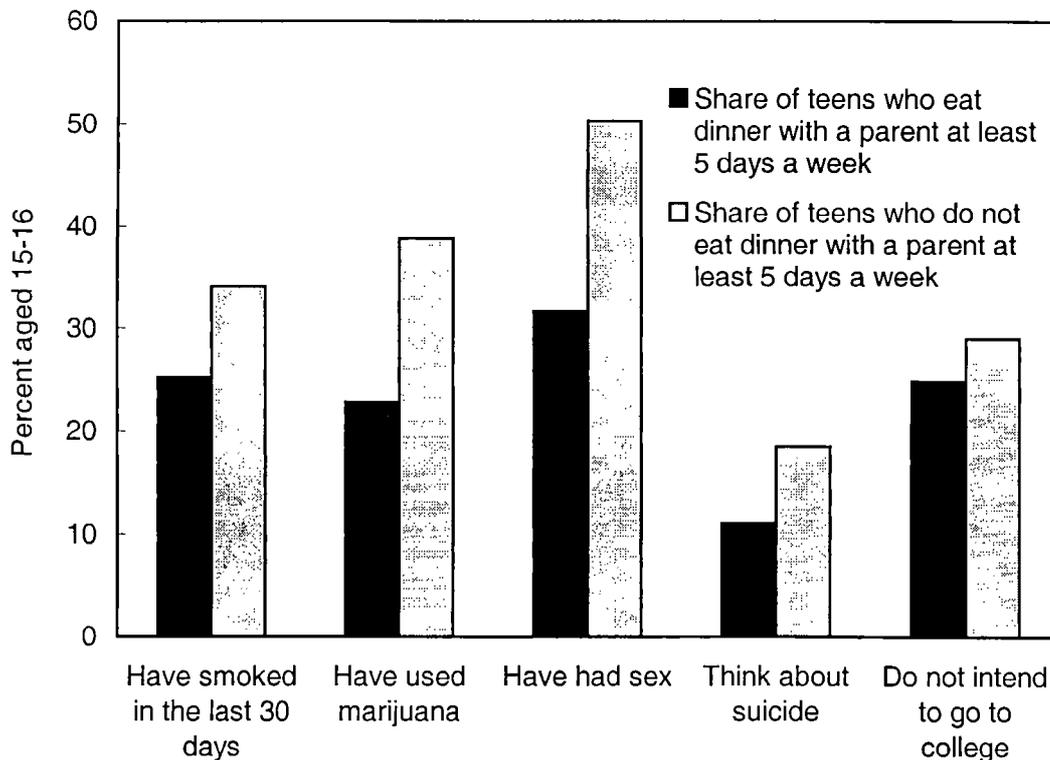
Prepared by the Council of Economic Advisers  
with the assistance of the Office of the Vice President

April 28, 2000

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Bailey  
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## CHART OF THE WEEK

### Parental Involvement and Teen Behavior



Teenagers who eat with a parent at least 5 times a week do better on a wide variety of indicators than those who do not. A CEA White Paper described in this *Weekly Economic Briefing* provides a range of evidence on the importance of parental involvement in influencing teens to make responsible decisions.

**PHOTOCOPY  
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*"O.K., guys, now let's go and earn that four hundred times our workers' salaries."*

5-2-00

## CURRENT DEVELOPMENT

### **GDP Scorecard: First Quarter 2000**

Real GDP is estimated to have increased at a 5.4 percent annual rate in the first quarter of 2000, with strong growth in consumption, fixed investment, and state and local government spending. Final sales (GDP less the change in private inventories) increased at a 6.9 percent annual rate, the fastest rate in over 15 years. Inflation, as measured by the price index for GDP, increased at a 2.7 percent annual rate in the fourth quarter, but the core GDP price index, which excludes food and energy components, increased at only a 2.1 percent annual rate.

Component	Growth*	Comments
Total consumer expenditures	8.3%	First-quarter consumption surged, with durable goods purchases up nearly 27 percent at an annual rate. The saving rate fell to 0.7 percent.
Equipment and software	23.7%	Growth was the strongest it has been in 2 years, and solid gains were recorded in all major categories. Computer investment rebounded after briefly faltering late last year when businesses "locked down" computer systems purchases in preparation for Y2K.
Nonresidential structures	13.4%	Spending bounced back after declining 3.9 percent during 1999.
Residential investment	6.7%	Good weather contributed to solid growth, despite elevated mortgage rates. Housing indicators suggest some slowing in the second quarter.
Inventories (change, billions of 1996 dollars)	\$31.1	Inventory accumulation slowed in the retail trade sector following a sizable buildup in the fourth quarter of 1999. Robust final sales caused the inventory-to-sales ratio to decline further.
Federal purchases	-15.5%	Defense spending fell sharply, more than reversing a surge in the fourth quarter of 1999.
State & local purchases	7.4%	Spending continued to accelerate.
Exports	-0.2%	First-quarter exports were held down by the Boeing strike, which has since been settled. Even after accounting for the effect of the strike, however, growth was relatively weak.
Imports	9.5%	Growth was down somewhat from the pace of the last few years.
*Percent real growth in the first quarter at annual rates (except inventories). This advance estimate is subject to substantial revision—especially for exports, imports, and inventories, where the estimates are based on only 2 months of data.		

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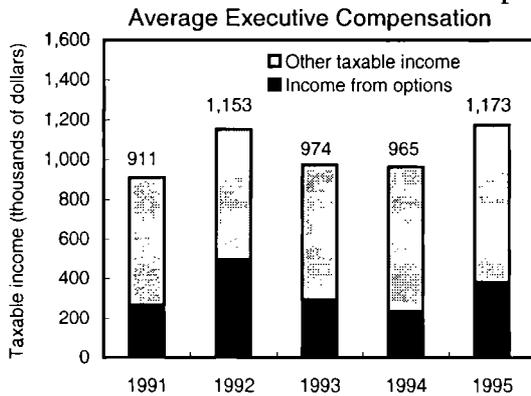
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SPECIAL ANALYSIS

**The Effect of Taxes on Executive Compensation**

The last two decades have seen major shifts in income tax policy toward the very wealthy, as marginal income tax rates were first lowered and then raised. Some studies of the Reagan-era tax cuts suggest that the lowering of the top marginal rate caused large increases in taxable income, which may have been caused by upper income taxpayers shifting compensation between taxable and nontaxable forms. Others have argued that these results are overstated, because other confounding changes occurred at that time. The responsiveness of taxable income to tax changes matters because attempts to get the wealthy to pay a greater share of the total tax burden are much more difficult if taxpayers alter their behavior substantially in response to higher marginal rates.

**Evidence from the rate increase in 1993.** To understand better how taxpayers respond to changes in top marginal rates, one study examined executive compensation data before and after the increase in top marginal tax rates in 1993. Data on salary and other types of compensation for high level company executives show that there was a sharp increase in taxable income reported by



these executives in 1992 (see chart). After the tax increase in 1993, total income dropped, which is consistent with the hypothesis that taxable income is sensitive to changes in the top marginal rates. A closer examination of the types of compensation received by executives, however, shows that this large swing in reported taxable income was caused by the stock options exercised

in 1992. Since the intent to raise tax rates on high income individuals was announced during the presidential campaign in 1992 before becoming law in 1993, executives apparently anticipated the rate increase and exercised their stock options before the increase became effective, causing a short-term boost in compensation.

**Analysis.** A statistical analysis confirms that the exercise of options explains between 90 and 95 percent of the changes in taxable income for high-level executives during the years surrounding the tax changes. Moreover, even though there was some increase in nontaxable forms of income, those increases do not explain the drop in taxable income between 1992 and 1993. More generally, other attempts (with other types of data) to examine previous changes in top marginal tax rates over the last 60 years suggest that the results from the mid-1980s tax cuts appear to be atypical, and that, more commonly, the responsiveness of taxable income to changes in the top marginal tax rate is relatively small.

## ARTICLE

### **Raising Responsible and Resourceful Youth**

In conjunction with the White House Conference on American Teenagers, the Council of Economic Advisers will release a White Paper analyzing trends in teen behavior and the role of parental involvement. The report outlines significant opportunities and challenges for teens in the 21st century and demonstrates that teens are more likely to take advantage of opportunities and avoid risks when their parents are involved in their lives.

**Trends in teenage behavior and outcomes.** The report analyzes a number of trends affecting teenagers. Many, such as teen pregnancy and birth rates, working while in school, and gun violence among teens, have been discussed in previous *Weekly Economic Briefings*. Additional findings include the following:

✓ Health and prosperity. Teenagers today live far healthier, more prosperous and promising lives than ever before. Life expectancy for 15-year olds today is 77 years compared with 62 at the beginning of the century. Such killers as typhoid, cholera, polio, and smallpox now pose only minimal threats to American teens' health. Per capita income has increased eight-fold over the course of the century, and girls and minorities now have vastly greater educational and occupational choices than ever before.

✓ • Educational attainment. Today's teens are taking more courses in core academic subjects and more challenging courses than their counterparts in the 1980s. African-Americans and whites now complete high school at virtually the same high rate: almost 90 percent. Most young people enroll in post-secondary school within 20 months of graduating high school. However, while 90 percent of children from the richest 25 percent of families pursue post-secondary education, just 60 percent of students from the poorest 25 percent do. And of those going on to post-secondary studies, nearly three quarters of children from the richest families attend 4-year colleges, while over half of those from the poorest families attend vocational, technical, or 2-year institutions.

• Community service. Evidence suggests positive effects. One study found, for example, that teens who participated in community service programs had a 75 percent lower rate of school dropout, and a 43 percent lower rate of pregnancy.

• Nutrition. According to one recent estimate, only 5.5 percent of American teens are faced with concern over where their next meal will come from. But poor food choices lead to significant nutrition deficiencies and imbalances among today's teens. For example, some 60 percent of teen boys and 80

percent of teen girls are calcium-deficient. Obesity also appears to be a problem.

- Smoking. White teens are more likely to smoke than African-American teens. Suburban teens and those with more highly educated parents are more likely to smoke than teens living in cities or rural areas. Research suggests that the decline in cigarette prices over the early 1990s led to about one-third of the increase in smoking among high-school seniors.

**The importance of the parent-teen relationship.** The study presents evidence showing that parental involvement is a major influence in helping teens avoid risks such as smoking, drinking, drug use, unwanted pregnancies, violence, and suicide attempts, while increasing educational achievement and expected attainment. Significant differences were noted between teens who eat dinner with their parents at least five times a week (61 percent of teens aged 15 or 16) and those who do not (see the Chart of the Week) and between those who reported feeling “close” to their mother and/or father (81 percent of 15-16 year olds) and those who did not. These results persist after taking account of differences in teens’ gender, poverty status, and family structure. The report includes data for other age ranges, but the following results for 15-16 year olds are representative:

- Smoking, drinking, and drug use. Forty-two percent who do not feel close to at least one of their parents smoke, compared with 26 percent who do feel close to at least one parent. Over 34 percent who do not regularly eat dinner with a parent smoke, compared with just 25 percent who do eat dinner regularly with a parent. The prevalence of drinking is nearly twice as high among those who do not feel close to a parent and among those who do not eat regularly with a parent, compared with those who do. Over 50 percent of 15-16 year olds who are not close to their parents have used marijuana, compared with just 24 percent of those who are close to their parents.
- Violence. Less than 30 percent of teens aged 15-16 who eat dinner with their parents have been in a serious fight, compared with more than 40 percent of those who do not regularly eat dinner with their parents.
- Sexual activity. Over 50 percent of those who do not eat dinner with their parents have had sex by age 15-16. By contrast, only 32 percent of teens who do eat dinner with their parents have ever had sex.
- Suicide. Those who do not feel close to their parents are more than three times as likely to think about suicide as those who feel close; those who do not dine with their parents regularly are twice as likely to have attempted suicide.
- Educational achievement. Teens of all ages who eat dinner regularly with their parents and feel close to their parents have higher grade point averages than those who do not. They are more likely to intend to go to college, and they are less likely to have been ever suspended from school.

## BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

**Internet Traffic May Be a Clue to Internet Stock Valuation.** A recent study confirms the common perception that traditional financial information appears to be of little use in explaining the value of Internet stocks. In particular, the study found that, for a sample of e-tailers and portal/content companies (including AOL and Yahoo), bottom-line financial information explained almost none of the variation in the market value of these stocks and that the relationship between net income and market value was actually negative. The study did, however, find that gross profits (which do not subtract marketing and R&D expenses from revenue) were positively related to stock prices, as were measures of Internet usage such as unique visitors to a web site or the number of pages viewed. The study concludes that usage data seem to capture some of the same information as gross profits but retain some independent explanatory power for how investors value Internet stocks. This suggests that information about revenue and customer base is more important than net income, at least in the fledgling stages of these companies.

**Keeping Fathers Involved.** Poor, urban, unmarried fathers are more likely to be involved in their children's lives if they are employed or have at least a high school education, according to a recent summary of research on fatherhood. Interviews with poor fathers in Philadelphia and Chicago suggest that mothers were often less supportive of a father's contact with his children when he could not support them, and fathers often separated themselves from their families out of shame. For instance, many fathers felt spending quality time with their children required money. Related findings showed that the level of fathers' involvement over time was closely related to the quality of their relationship with their children's mother. These findings suggest that providing job training and employment services to non-custodial fathers, as well as services designed to improve parents' relationships may be good ways to increase both child-support payments and fathers' involvement with their children.

**Generational Differences in Medicare.** A new study calls attention to differences in rates of return on Medicare for different generations and the impact of possible reforms. The study allocates payroll taxes, premiums, general revenue financing, and Medicare expenditures across cohorts and estimates future payments and expenditures based on the Trustees' assumptions. As with Social Security, rates of return are highest for generations born earliest, but Medicare rates of return are consistently higher than those of Social Security. Whereas the cohort born in 1910 earned a 27.6 percent rate of return (compared with 8.4 percent in Social Security), today's youngest workers can expect to earn a 2.2 percent rate of return (compared with 1.9 percent in Social Security). The study observes that this rate of return is above the steady-state return for a pay-as-you-go system (estimated to be about 1 percent), indicating that the burden on future generations is growing. Cutting benefits to achieve balance rather than raising payroll taxes would have a substantially larger negative effect on current middle-aged cohorts than on future generations, because the former have mostly already paid into the system. Raising payroll taxes would have the opposite effect.

## INTERNATIONAL ROUNDUP

**OECD Confirms Steel Market Recovery.** The OECD Steel Committee recently released a favorable market outlook for the year 2000, confirming the recovery of the global steel market. The latest OECD estimates show an increase in steel consumption of over 2 percent for the OECD area in 2000 and continued demand growth in China, the Asian crisis economies, and the Newly Independent States. Strong economic growth should boost demand in motor vehicles, construction, machinery, and other steel consuming sectors. Steel product prices, which had mostly stopped falling or had begun to recover in the second half of 1999, should continue to rise throughout the year 2000. These favorable trends are expected to reduce commercial conflicts, which peaked towards the end of 1998 and the beginning of 1999. U. S. steel imports are expected to fall by 8 percent in 2000, in part as a result of the anti-dumping and countervailing duty measures imposed in 1999, and as demand recovers in other steel consuming countries. In addition, crude steel production could hit 100 million tons for the first time since 1981. Increased production and higher prices should lead to improved performance in 2000 for the main steel enterprises after a difficult period in 1998-99.

**EU to Liberalize “Local Loops.”** The European Commission this week adopted a Recommendation calling on all member states to enact legal and regulatory measures to open competition in “local loops,” the physical circuits that connect homes and companies to telecommunications operators. Such measures would mean that incumbent telephone companies would have to allow new competitors to use the incumbents’ local loops. The objective of this proposal is to increase competition and technological innovation, stimulating the provision of services such as broadband multimedia and high-speed Internet. The adoption of this Recommendation marks the first step towards the goal set by the Lisbon European Council in March to bring about a substantial reduction in the cost of Internet access. The liberalization of local loops should take place by December 31, 2000, according to the Commission.

**ODA Fell in the 1990s but Became Better Allocated.** Net Official Development Assistance (ODA) from the Development Assistance Committee (DAC) countries fell from 0.33 percent of combined GNP in 1990 to 0.24 percent in 1998. Despite the decrease in total aid, however, the 1990s saw a significant shift in the allocation of aid in favor of countries with better economic policies, according to a recent World Bank study. The distribution of aid was much more sensitive to good country policies (measured by an index incorporating 20 indicators of economic policy) in 1997-98 than in 1990. Much of this improved allocation resulted from sharp cuts in aid to countries with poor policies with only modest cuts in aid to countries with good policies. For the one-third of countries with the worst economic policies, net ODA fell sharply from an average of \$44 per capita in 1990 to \$16 in 1997-98, whereas in the best one-third it fell from \$39 to \$28. Several countries, including Kenya, Nigeria, Pakistan, Togo, and Zaire (Congo) experienced cuts of at least 50 percent in their aid per capita.

## RELEASES THIS WEEK

### **Gross Domestic Product**

According to advance estimates, real gross domestic product grew at an annual rate of 5.4 percent in the first quarter of 2000.

### **Employment Cost Index**

The employment cost index for private industry workers increased 4.6 percent for the 12-month period ending in March.

### **Advance Durable Orders**

Advance estimates show that new orders for durable goods increased 2.6 percent in March, following a decrease of 2.0 percent in February.

### **Consumer Confidence**

Consumer confidence, as measured by The Conference Board, declined 0.2 index points in April, to 136.9 (1985=100).

## MAJOR RELEASES NEXT WEEK

NAPM Report on Business (Monday)

Leading Indicators (Tuesday)

Productivity (Thursday)

Employment (Friday)

## U.S. ECONOMIC STATISTICS

	1970- 1993	1999	1999:3	1999:4	2000:1
<b>Percent growth</b> (annual rate)					
Real GDP (chain-type)	2.9	4.6	5.7	7.3	<b>5.4</b>
GDP chain-type price index	5.2	1.6	1.1	2.0	<b>2.7</b>
<u>Nonfarm business (NFB) sector:</u>					
Productivity (chain-type)	1.7	3.6	5.0	6.4	N.A.
Real compensation per hour:					
Using CPI	1.0	1.7	2.1	0.8	N.A.
Using NFB deflator	1.5	3.0	4.0	2.1	N.A.
<b>Shares of Nominal GDP</b> (percent)					
Business fixed investment	11.4	12.6	12.7	12.5	<b>12.9</b>
Residential investment	4.5	4.4	4.4	4.4	<b>4.4</b>
Exports	8.2	10.8	10.8	10.9	<b>10.8</b>
Imports	9.2	13.5	13.8	14.0	<b>14.2</b>
Personal saving	6.6	1.7	1.5	1.3	<b>0.5</b>
Federal surplus	-2.8	1.2	1.4	1.2	N.A.
<hr/>					
	1970- 1993	1999	January 2000	February 2000	March 2000
<b>Unemployment Rate</b> (percent)	6.7**	4.2**	4.0	4.1	4.1
<b>Payroll employment</b> (thousands)					
increase per month			394	7	416
increase since Jan. 1993					21213
<b>Inflation</b> (percent per period)					
CPI	5.8	2.7	0.2	0.5	0.7
PPI-Finished goods	5.0	3.0	0.0	1.0	1.0

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

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New or revised data in **boldface**.

## FINANCIAL STATISTICS

	1998	1999	February 2000	March 2000	April 27, 2000
<b>Dow-Jones Industrial Average</b>	8626	10465	10542	10483	10888
<b>Interest Rates</b> (percent per annum)					
3-month T-bill	4.78	4.64	5.55	5.69	5.59
10-year T-bond	5.26	5.65	6.52	6.26	6.23
Mortgage rate, 30-year fixed	6.94	7.43	8.33	8.24	8.13
Prime rate	8.35	8.00	8.73	8.83	9.00

## INTERNATIONAL STATISTICS

<b>Exchange Rates</b>	<b>Current level</b>	<b>Percent Change from</b>	
	<b>April 27, 2000</b>	<b>Week ago</b>	<b>Year ago</b>
Euro (in U.S. dollars)	0.908	-3.1	-14.7
Yen (per U.S. dollar)	106.4	0.9	-11.5
Major currencies index (Mar. 1973=100) (trade-weighted value of the U.S. \$)	98.08	1.5	3.0

<b>International Comparisons</b> <sup>1/</sup>	<b>Real GDP growth</b>	<b>Unemployment rate</b>	<b>CPI inflation</b>
	(percent change last 4 quarters)	(percent)	(percent change in index last 12 months)
United States	5.0 (Q1)	4.1 (Mar)	3.7 (Mar)
Canada	4.7 (Q4)	6.8 (Feb)	3.0 (Mar)
Japan	0.0 (Q4)	4.9 (Feb)	-0.6 (Feb)
France	3.1 (Q4)	10.0 (Feb)	1.5 (Mar)
Germany	2.3 (Q4)	8.6 (Feb)	1.9 (Mar)
Italy	2.1 (Q4)	11.2 (Jan) <sup>2/</sup>	2.5 (Mar)
United Kingdom	3.0 (Q4)	5.9 (Dec)	2.6 (Mar)

1/ For unemployment data, rates approximating U.S. concepts as calculated by the U.S. Department of Labor, Bureau of Labor Statistics, except as noted in footnote 2.

2/ Data from OECD standardized unemployment rates.