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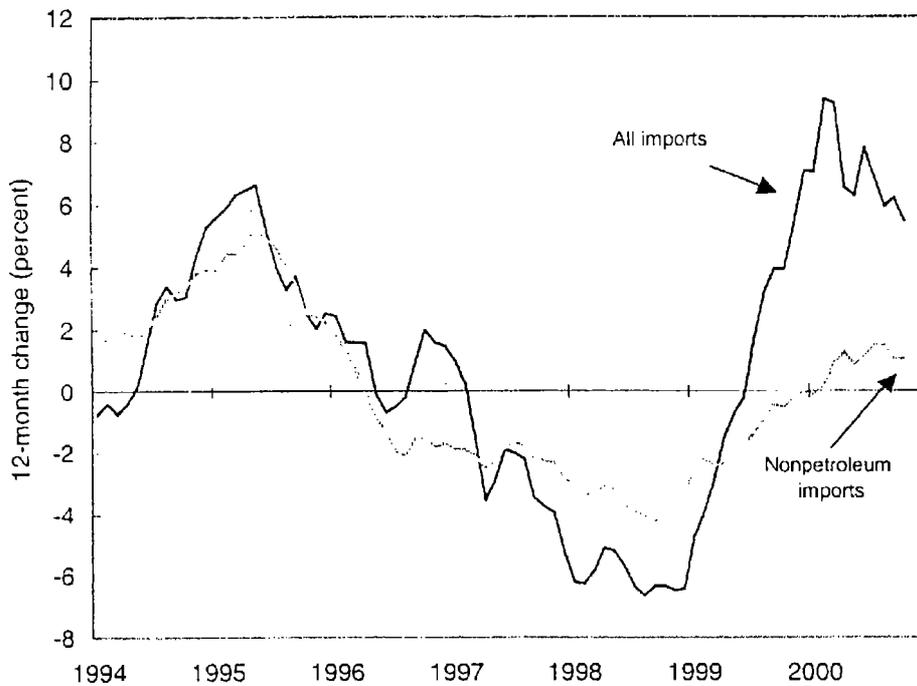
# WEEKLY ECONOMIC BRIEFING BE OF THE PRESIDENT OF THE UNITED STATES

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

November 17, 2000

## CHART OF THE WEEK

### Import Prices



Between 1997 and mid-1999 the prices of U.S. imports were falling and reduced overall inflation. More recently, import prices have been rising faster than prices generally. This change reflects sharp increases in oil prices, but nonpetroleum import prices are rising this year as well, for the first time since early 1996.

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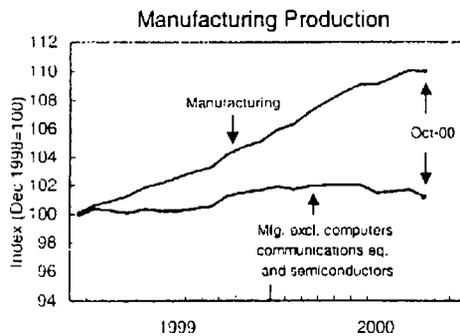
*"The days of the bartender-psychologist are over, but  
I can help if you have any software problems."*

## MACROECONOMIC UPDATE

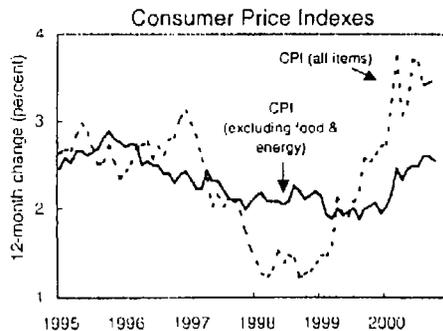
### More Signs of Moderation

Early indications of fourth quarter economic activity continue to suggest that growth has moderated from the very rapid 6 percent pace set between the second quarter of 1999 and the second quarter of this year. The economy appears to be growing at about the same roughly 3 percent annual rate estimated for the third quarter.

**Employment and production.** Payroll employment rose by 137,000 in October, and production-worker hours are on a pace to grow 1.2 percent at an annual rate in the fourth quarter. Manufacturing production was flat in October. While the high-tech sectors (computers, semiconductors, and communications equipment) continued to grow rapidly, output in the rest of the manufacturing sector peaked in June and has since fallen by an average of 0.3 percent per month (see upper chart).



**Demand.** Motor vehicle sales have softened and goods consumption in the fourth quarter appears to have decelerated from its earlier pace. Lower-rated corporate borrowers are facing higher yields and banks appear to have tightened their lending standards, but business investment is unlikely to be stifled by a lack of funds. High-quality borrowers still seem to have access to credit and profits remain high.



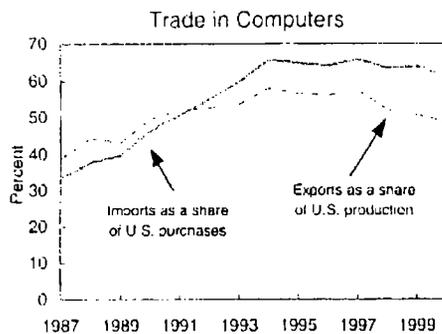
**Labor markets and inflation.** Core inflation remains low but is inching up (see lower chart). The Federal Open Market Committee did not change interest rates at this week's meeting, but it did note that labor markets are unusually tight. The Fed continues to see a risk of heightened inflationary pressures.

## SPECIAL ANALYSIS

### **The Role of Trade in Supporting the New Economy**

The importance of the production and adoption of computers in stimulating higher productivity growth and improved economic performance in the U.S. economy is widely recognized. Perhaps less widely noted is the importance of globalization in driving the production and adoption of computers. U.S. computer firms benefit from lower prices for components used in production and from scale economies as they export to global markets. Lower prices for computers are also good for consumers and stimulate investment.

**Two-way trade in computers is substantial.** Globalization is important for both domestic purchasers and domestic producers of computers (including peripherals and parts). The \$47 billion of computer exports in 1999 represented about half of



total U.S. computer production (see chart). Domestic purchases of computers have grown at a 12.5 percent annual rate since 1992, and U.S. imports of computers were \$81 billion in 1999. Imports now account for more than 60 percent of the value of new U.S. computer purchases—nearly twice the level in 1987. Thus, sales abroad are an important source of demand for the particular computers,

peripherals, and parts that U.S. producers make, while purchases from abroad are a major source of the particular computers, peripherals, and parts that U.S. purchasers buy.

**The gains from a global supply chain.** Globalization helps U.S. firms to compete better. In some cases, this is because they lower costs by purchasing components where they are produced most cheaply rather than having to make everything themselves. This sort of specialization can improve efficiency and lead to lower prices. As well, a firm can divide its own production across locations in order to take advantage of different countries' relative efficiencies. Among U.S. producers of computer hard disks, for example, most research and development has remained in the United States, while production has shifted to countries in Asia in order to take advantage of low costs of raw materials. But assembly has remained almost entirely within firms rather than being outsourced, and U.S. firms remain among the world leaders in both innovation and sales. This leadership runs counter to the argument that manufacturing at home is necessary to maintain competitiveness: globalization has not "hollowed-out" the U.S. hard disk industry but instead allowed it to thrive.

**Booming investment in computers.** The availability of efficient foreign computer and part suppliers has led to lower computer prices and booming

computer investment. American companies and consumers have been eager and able to buy computers of a given capability at increasingly lower prices or buy much more powerful computers at the same price. Together with favorable economic conditions, this has fueled a computer and software investment boom. Investment in information processing equipment and software as a share of total investment in equipment and software increased from 29 percent in 1987 to 54 percent in 1999.

**The role of policy.** Trade policy has facilitated the growth of trade in high-technology products. The Information Technology Agreement eliminated tariffs on the vast majority of trade in semiconductors, computers, software, telecommunications equipment, and other high-technology products; the United States is now seeking to expand the Agreement to cover additional products.

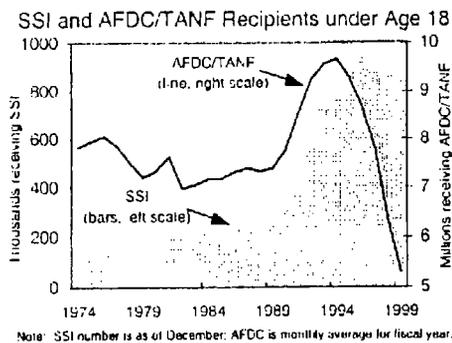
**Conclusion.** The United States has gained in both directions from two-way intra-industry trade in computers. Producers with access to global markets can produce computers more cheaply and consumers can buy computers more cheaply.

## SPECIAL ANALYSIS

### SSI and the Welfare of Children

In the early 1990s, the number of people receiving benefits rose dramatically in both AFDC and the Supplemental Security Income (SSI) program, which serves needy disabled, aged, and blind individuals. In contrast to what happened in welfare, however, the number of SSI recipients kept rising until 1996 and has not declined much since. Particularly noteworthy is the rise in the number of children receiving federally administered SSI benefits, from 308,589 in 1990 to 847,063 in 1999, an increase of 174 percent over the decade.

**Defining disability.** To qualify for SSI, a child must not only have a low family income but also be classified as disabled, and trends in the number of children



receiving SSI appear to have been heavily influenced by changes in the definition of disability. Liberalizations in 1990-91 (including expanding mental health conditions to include attention deficit and eating disorders) were followed by a sharp increase in the number of children receiving SSI (see chart). The definition of disability was then narrowed somewhat in 1996 as part of welfare reform. The resulting decline in recipients was substantially smaller than the decline in the number of children receiving TANF, 11 percent in federally administered SSI between 1996 and 1999, compared with 39 percent in TANF.

**Shifting caseloads.** Recent research has shown that changes in the law to expand the definition of child disabilities were not the only factor driving the increase in enrollment after 1990; some of the rise was due to a transfer of children from the AFDC/TANF rolls to SSI. One study that examined the trends from 1990 to 1996 concluded that at least one-third of the increase in child enrollment in SSI (or over 200,000 children) represented a shift in cases from AFDC.

**Incentives to shift.** Both families and the states gain financially from moving children from traditional welfare to SSI. Average SSI benefits are substantially greater than those for AFDC/TANF. An analysis of 1996 benefit schedules for AFDC and SSI found, for example, that total benefits for a family with one parent and two children could more than double (from \$389 per month to \$802 per month) if one child were classified as disabled and enrolled in SSI. Furthermore, because SSI benefits are paid primarily by the Federal government, states can free up money within their TANF block grant by shifting eligible children into SSI. These incentives existed under AFDC as well, since Federal matching rates for AFDC benefits ranged from 50 to 79 percent.

The potential savings to states from shifting not just children, but adults as well, can be substantial. One study found, for example, that between July 1, 1994, and June 30, 1995, disability advocates moved nearly 19,000 individuals in Pennsylvania onto SSI, saving the state \$69 million in that year alone.

**Implications.** The transfer of cases from AFDC/TANF to SSI costs the Federal government money and may slightly exaggerate the number of people actually moved off welfare. However, it will likely also have repercussions for the future well-being of the children involved, and the net effects on these children are not obvious. On the one hand, the economic incentives to enroll in SSI may encourage the identification of children with disabilities and therefore allow them to receive help (as well as increase their family incomes). With access to special education classes at school, these children might have a better future than they would otherwise. On the other hand, classifying children as disabled who might not otherwise be so labeled, may reduce the quality of the education they receive. If these children do not receive adequate schooling and/or training, they may have little choice but to remain on the SSI rolls as disabled adults or suffer with very low incomes if they do not later qualify for benefits.

**Conclusion.** One of the provisions of the 1996 welfare reform legislation was the imposition of time limits for welfare receipt. As these time limits become binding, it appears likely that some of those losing TANF benefits will be shifted to SSI. It is therefore important that we understand the motives behind this movement and the effects on children.

## BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

**FERC Proposes Changes for California Electricity Markets.** In a special meeting, the Federal Energy Regulatory Commission (FERC) proposed changes to prevent a recurrence of this summer's California electricity price spikes. These changes include modifying market rules to promote advance purchases of electricity, thereby dampening price swings and stabilizing revenue streams for electricity producers. Other proposals alter the operating rules of the electricity auction market, reducing the potential for price manipulations. However, the commission warned that unless California increases generation and transmission facilities and develops ways to apprise consumers of rapid changes in electricity prices, consumers will continue to face high prices caused by inadequate supplies of electricity.

**Share of Workers Looking for a New Job Is Smaller Than in 1995.** The proportion of the employed workforce actively seeking a new job fell to 4.5 percent in 1999, down from 5.6 percent in 1995 when the Bureau of Labor Statistics began collecting such data. These declines in the job search rate have occurred for both men and women, and for every age group except those aged 65 and older. Job-search rates are highest among those aged 20-24, and decline steadily with age thereafter. Within each age group, the likelihood of job search declines with tenure in the current job. The likelihood of job search rises steadily with education level: 2.7 percent of employed workers without a high school degree are looking for work, compared with 5 percent of college graduates. Benefits also appear to play a role in job search. Workers without health insurance are more than twice as likely to be looking for new jobs as workers with health insurance. Among those with health insurance, workers with employer-based coverage are less likely to be looking for a new job than workers with other types of health insurance. Workers not covered by retirement plans were more likely to be looking for new jobs than workers who were covered by an employer-provided retirement plan. Government workers were less likely than private-sector workers to be looking for new jobs.

**Study Offers a Picture of Segregation in School Activities.** Although schools have become less racially segregated since the 1960s, the amount of segregation within schools may be greater than the racial composition of the schools would suggest. This appears to be the case for high school extracurricular activities, according to a new study analyzing yearbook pictures of 8,875 teams and organizations in 194 public and private high schools. Whereas the percentage of non-white students enrolled in the sample schools was 25.1 percent, the membership of clubs and teams was 21.2 percent, reflecting a lower rate of participation by nonwhites. Moreover, racial composition varied widely among activities, so that the average white participant in extracurricular activities was in a group that was only 15.6 percent nonwhite. Nevertheless, the study notes, this degree of interracial contact appears to be greater than what would occur if the only source of contact outside of class arose from friendships. Finally, the South showed no more segregation in these organizations than the rest of the country.

## INTERNATIONAL ROUNDUP

**Liberalizing Trade Has Net Benefits for the Poor.** Trade liberalization benefits the poor overall, according to a survey of the economic literature undertaken for the WTO. The gains arise largely because trade is a major positive factor in economic development. The impact is enhanced when liberalization is combined with other macroeconomic measures that promote stronger competition, stable and less arbitrary policy intervention, and greater use of the market. The report also cites evidence that imports foster an increase in the performance and output of domestic markets as previously insulated firms innovate or imitate importers in order to gain market share. The report notes, however, that policymakers face a difficulty in embracing trade liberalization unconditionally because the gains from trade for the poor are widespread and diffuse, while the losses, though often substantially smaller, are usually more concentrated. For instance, transitional unemployment will most likely have the largest impact among the poor, who lack resources to tide them over even a short transition period. This suggests the value of an adjustment-assistance program as part of trade liberalization.

**IT Is Becoming More Important in European Growth.** The importance of “new economy” activities to economic growth in the European Union was low in the first half of the 1990s, but it has increased over time, according to a new study. The gains come primarily from the expanding role of computers, but the study finds substantial cross-country variation in the amount of investment in new technologies. Between 1991 and 1997, IT investment made an average annual contribution of 0.59 percentage point to growth in the UK and the Netherlands, slightly below the 0.64 percentage point estimated for the United States and Canada. Finland, Ireland, and Denmark have seen some of the most dramatic increases in the contribution of IT in the second half of the 1990s. However, IT has played a much smaller role in France, Germany, Belgium, and Sweden and its contribution was at best marginal in Spain and Italy. In fact, the average annual contribution of IT to growth in Italy fell from 0.25 percentage point in 1991-95 to 0.17 percentage point in 1996-97. The paper notes that many countries outside the United States have been slow to improve their official statistics to incorporate new economy activities. Thus, it relied on private data to supplement or even substitute for official data in making these cross-country comparisons.

**The Private Sector Is Growing Quickly in China.** With rapid growth in the last 15 years, China’s private sector may now be larger than the state sector, according to a new study. Between 1985 and 1997, the share of the private sector in national industrial output rose from 2 percent to more than 34 percent. Including agriculture as part of the private sector (because the sector consists mainly of independent farmers) raises the share of the private sector to 51 percent of GDP. Growth in the private sector is particularly notable because it receives so little capital—less than 1 percent of working capital loans between 1991 and 1997. Even as restrictions on the private sector have been eased, the government has continued to direct credit toward state-owned enterprises, which also receive preferential access to equity markets.

## RELEASES THIS WEEK

### **Housing Starts**

**\*\*Embargoed until 8:30 a.m., Friday, November 17, 2000\*\***

Housing starts were virtually unchanged in October at 1.532 million units at an annual rate.

### **Consumer Price Index**

The consumer price index rose 0.2 percent in October. Excluding food and energy, consumer prices also rose 0.2 percent.

### **Industrial Production and Capacity Utilization**

The Federal Reserve's index of industrial production declined 0.1 percent in October following an increase of 0.4 percent in September. Capacity utilization fell 0.4 percentage point to 82.1 percent.

### **Retail Sales**

Advance estimates show that retail sales increased 0.1 percent in October following an increase of 0.9 percent in September. Excluding sales in the automotive group, retail sales rose 0.4 percent following an increase of 0.7 percent.

## MAJOR RELEASES NEXT WEEK

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

## U.S. ECONOMIC STATISTICS

	1970- 1993	1999	2000:1	2000:2	2000:3
<b>Percent growth (annual rate)</b>					
Real GDP (chain-type)	2.9	5.0	4.8	5.6	2.7
GDP chain-type price index	5.2	1.6	3.3	2.4	2.0
<u>Nonfarm business (NFB) sector:</u>					
Productivity (chain-type)	1.7	4.1	1.9	6.1	3.8
Real compensation per hour:					
Using CPI	1.0	2.2	-0.2	2.2	3.2
Using NFB deflator	1.5	3.3	1.1	4.0	4.3
<b>Shares of Nominal GDP (percent)</b>					
Business fixed investment	11.4	12.9	13.4	13.7	13.8
Residential investment	4.5	4.3	4.3	4.2	4.1
Exports	8.2	10.6	10.8	11.0	11.3
Imports	9.2	13.4	14.2	14.6	15.0
Personal saving	6.6	1.6	0.1	0.2	-0.2
Federal surplus	-2.8	1.3	2.4	2.4	N.A.
<hr/>					
	1970- 1993	1999	August 2000	September 2000	October 2000
<b>Unemployment Rate</b> (percent)	6.7**	4.2**	4.1	3.9	3.9
<b>Payroll employment</b> (thousands)					
increase per month			-79	195	137
increase since Jan. 1993					22358
<b>Inflation</b> (percent per period)					
CPI	5.8	2.7	-0.1	0.5	<b>0.2</b>
PPI-Finished goods	5.0	2.9	-0.2	0.9	0.4

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

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New or revised data in **boldface**.

## FINANCIAL STATISTICS

	1998	1999	September 2000	October 2000	Nov. 16, 2000
<b>Dow-Jones Industrial Average</b>	8626	10465	10968	10441	10656
<b>Interest Rates</b> (percent per annum)					
3-month T-bill	4.78	4.64	6.00	6.11	6.17
10-year T-bond	5.26	5.65	5.80	5.74	5.68
Mortgage rate, 30-year fixed	6.94	7.43	7.91	7.80	7.73
Prime rate	8.35	8.00	9.50	9.50	9.50

## INTERNATIONAL STATISTICS

<b>Exchange Rates</b>	<b>Current level</b>	<b>Percent Change from</b>	
	<b>November 16, 2000</b>	<b>Week ago</b>	<b>Year ago</b>
Euro (in U.S. dollars)	0.853	-0.5	-17.3
Yen (per U.S. dollar)	109.1	1.6	3.1
Major currencies index (Mar. 1973=100) (trade-weighted value of the U.S. \$)	103.5	0.7	11.0

<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	5.3 (Q3)	3.9 (Oct)	3.4 (Oct)
Canada	5.3 (Q2)	6.8 (Sep)	3.2 (Sep)
Japan	0.8 (Q2)	4.7 (Sep) <sup>2/</sup>	-0.8 (Sep)
France	3.4 (Q2)	9.5 (Sep) <sup>2/</sup>	2.2 (Sep)
Germany	3.6 (Q2)	8.2 (Sep)	2.5 (Sep)
Italy	2.4 (Q3)	10.6 (Jul)	2.6 (Sep)
United Kingdom	2.9 (Q3)	5.3 (Jul)	3.3 (Sep)

<sup>1/</sup> 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.

<sup>2/</sup> Data from OECD standardized unemployment rates.