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THE PRESIDENT HAS SEEN
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96 MAY 24 A9:22

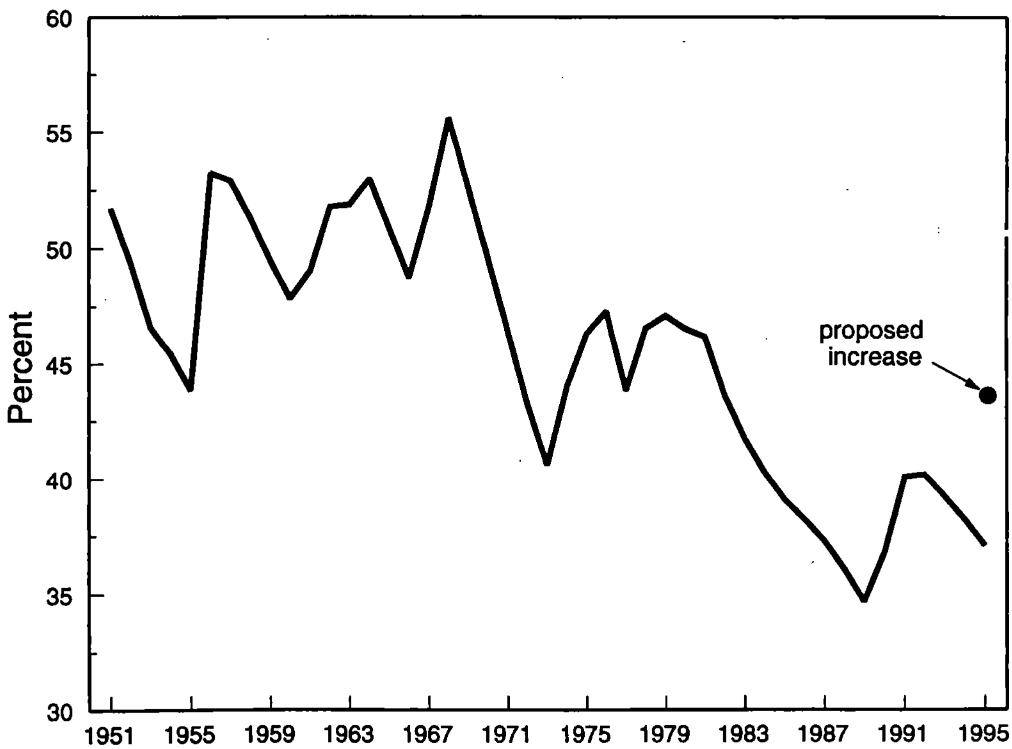
WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

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

May 24, 1996

CHART OF THE WEEK

Minimum Wage as a Percent of Average Hourly Earnings



Because the minimum wage was unchanged during the 1980s, its value relative to the average hourly earnings of production workers declined sharply and reached a four-decade low of 35 percent in 1989. Although an increase during 1990-91 briefly pushed the minimum wage to 40 percent of hourly earnings, its relative value has eroded since 1992. The Administration's proposed increase from $4.25 to $5.15 per hour would raise the minimum wage to roughly 45 percent of current average hourly earnings. A Special Analysis in this issue of the Weekly Briefing assesses the effect on inflation of an increase in the minimum wage.

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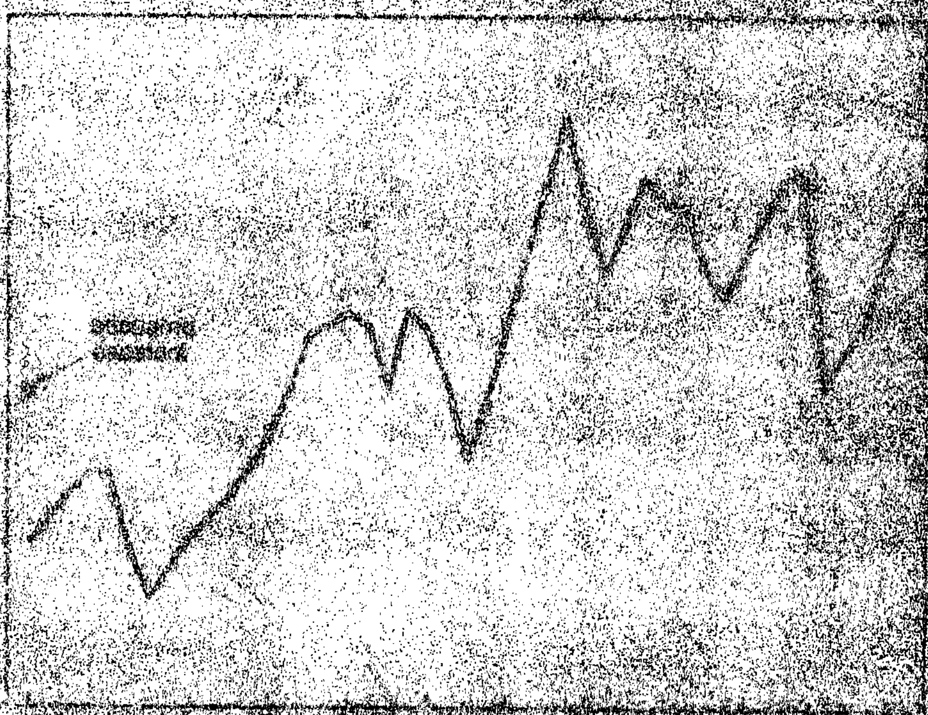
Weekly Economic Briefing
of the United States

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

May 24, 1996

Minimum Wage as a Percent of Average Hourly Earnings



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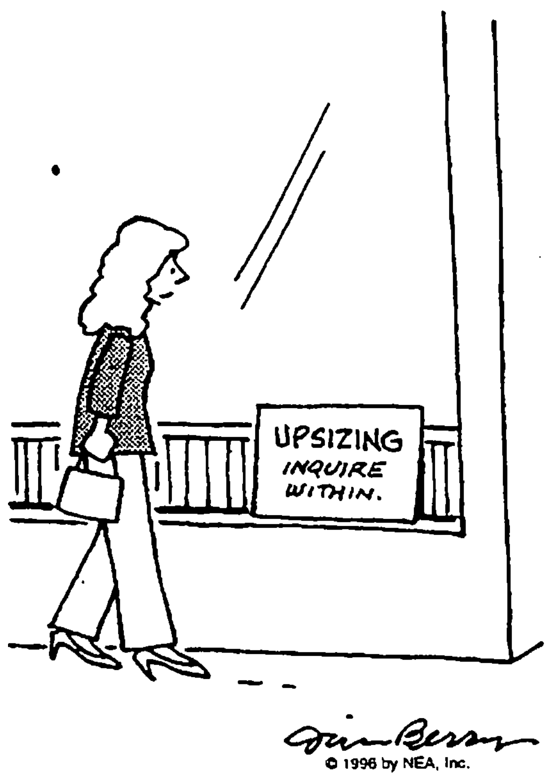

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SPECIAL ANALYSIS

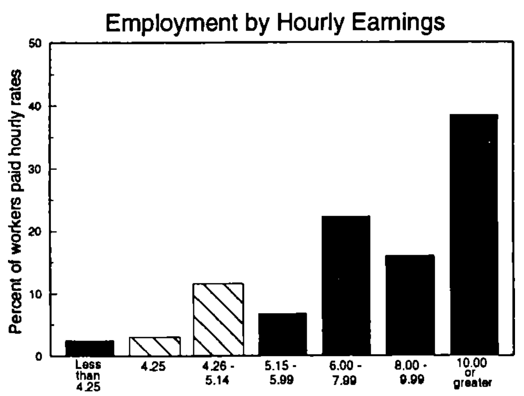
Minimum Wage Increase Should Have Small Effect on Inflation

The proposed 90-cent increase in the minimum wage would, if enacted, have a small but perceptible effect on the rate of price inflation. Economists disagree about whether a modest increase in the minimum wage would reduce employment, but they generally agree that such an increase would raise inflation a bit.

Analysis. The magnitude of the rise in inflation following an increase in the minimum wage depends on two factors:

- The size of the increase in labor costs.
- The amount of the increase in labor costs passed-through into prices rather than taken out of profits.

Effect on wages. We estimate that an increase in the minimum wage from $4.25 to $5.15 per hour would raise wage costs for the workforce as a whole by about 0.4 percent. The rise in wage costs occurs mainly because an increase in the minimum wage directly affects most of the 14 percent of workers paid on an hourly basis who presently receive a wage between $4.25 and $5.14 (see chart). Workers exactly at the minimum would get a 90-cent raise, while workers above the current minimum would get a raise at least to $5.15, and probably a bit more to maintain some premium. We assume these workers get half of the premium they currently earn and that this "ripple" effect also occurs for workers making up to $6 per hour. Workers making less than the current minimum and not covered by the law likely would get no increase.



Effect on prices. The increase in labor costs of 0.4 percent likely would exceed the increase in prices because labor costs represent roughly two-thirds of total production costs. Thus, a 90-cent increase in the minimum wage would raise prices by about 0.25 percent. If, as likely, the increase occurs in two installments, 50 cents this year and 40 cents next year, the increase in inflation each year would be about half of the full effect, roughly 0.125 percentage point. To the extent that firms do not raise prices as much—either because they accept a reduction in their profits or because productivity of their workers increases—the inflation increase would be smaller. Most importantly, the effect of a minimum-wage increase on inflation is only temporary since it is a one-time increase in wage costs.

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5/23/96

Q (GS) If these sell well — a good Educ. savings tool → special instrument

SPECIAL ANALYSIS

Indexing Treasury Bonds May Lower Borrowing Costs

The Treasury Department recently announced plans to issue "inflation-protection" bonds that will have their returns linked to inflation. These bonds would allow people who are saving for a specific goal—such as their retirement or their children's education—to maintain the purchasing power of their savings. Because no U.S. investment presently meets this need, the new securities will fill an important void in U.S. financial markets. Besides protecting investors from inflation, these bonds may also benefit the Treasury by lowering its borrowing costs.

Analysis. When investors purchase bonds, they require that the return include compensation both for expected inflation over the bond's lifetime and the risk that actual inflation may exceed what was expected—an "inflation risk premium." An inflation-protection bond has its return periodically adjusted for price changes, thereby eliminating the risk that investors will lose money if actual inflation exceeds the rate expected. As a result, these bonds need not pay an "inflation premium" to attract investors, thereby lowering Treasury borrowing costs compared to conventional bonds.

Estimates of the "inflation premium" vary widely, but much evidence suggests a premium in the range of 0.5 to 0.75 percentage point, depending on the maturity of the bond and variability of inflation. Because Treasury borrows on such a large scale, a small reduction in the returns paid to investors translates into significant taxpayer savings in interest payments on the debt even if only a portion of Treasury securities are indexed for inflation. For example, if Treasury could eventually replace just half of its roughly $400 billion of 10 to 30-year debt with inflation-protection securities paying 0.5 percentage point less than conventional securities, the savings would amount to $1 billion a year. In this case, the total of such securities would be roughly 7 percent of the currently outstanding public debt, below the 15-percent level that has been reached in the United Kingdom where inflation-protection bonds have been issued since 1981.

Market may take a while to develop. Evidence from other countries suggests that it takes time for an inflation-protection bond market to develop, so the size of Treasury offerings initially will be limited by investor enthusiasm for the product, and may reduce savings if investors demand a premium to hold such relatively "illiquid" bonds. Recognizing this, the Treasury will start with small initial auctions generating comparatively small savings. Auctions may begin later this year, with a first-year offering possibly in the range of $2 to $4 billion. Assuming a 0.5 percentage point reduction in the interest cost compared to conventional securities, an offering of this size would entail savings of about $10 to $20 million per year over the life of the bonds.

ARTICLE

What Does the Unemployment Rate Really Measure?

The unemployment rate recently dropped to 5.4 percent. While this is clearly very good news, some observers argue that the official unemployment rate understates the unemployment problem, because it omits many people who would like to work more but are not counted in the official definition of unemployment.

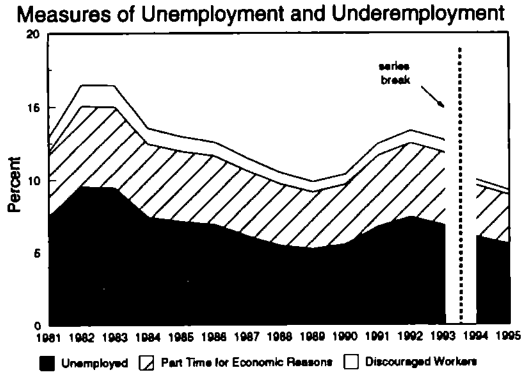
The official unemployment rate. The official measure of unemployment includes only those who have no job, are available for work, and have actively sought work in the past 4 weeks. Those who are not employed and who have not sought work in the past 4 weeks are considered to be out of the labor force. Last month, 7.3 million people were officially classified as unemployed.

Alternative measures of unemployment. The Bureau of Labor Statistics (BLS) publishes a number of alternative measures of unemployment and underemployment. The broadest one now includes two other groups of workers:

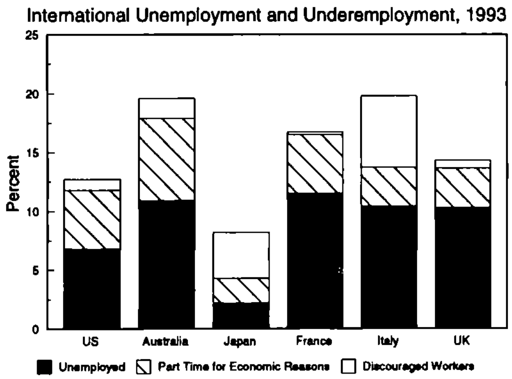
> Marginally attached workers are persons who want a job, are explicitly available for work, and have looked for work sometime in the prior year, but are not currently looking. This category includes discouraged workers—those who are not currently seeking work because they believe they would not be successful. Last month, 1.5 million people were classified as being marginally attached workers.
>
> Persons employed partime for economic reasons are workers who have to settle for part-time work because of cut-backs in hours or because they cannot find full-time jobs. These workers can be viewed as underemployed. Last month, 4.3 million workers were classified in this category.

Analysis. The "best" measure of unemployment will depend on what question is being asked. The official unemployment rate clearly omits some people who would work if they could find a job, and does not include those who are underemployed. On the other hand, some people who are classified as unemployed may not have a strong attachment to the labor force. For example, those who report that they asked a friend about job opportunities, but made no other efforts to find work, could be counted as seeking a job and classified as unemployed.

Measures of Unemployment and Underemployment



Changes over time. Regardless of the "best" measure of unemployment, the various measures generally have moved together (see chart). For example, the relationship between the official unemployment rate and a measure of labor underutilization that also includes discouraged workers and people working partime for economic reasons has been very stable over time (except for a break in 1994 that resulted from a revision in the employment survey that changed the definition of discouraged worker).



International Comparisons. To the extent that the official unemployment rate in the United States understates the magnitude of unemployment, the same is true in other countries. Even using a broad measure of labor underutilization, the United States still had a lower rate of labor underutilization in 1993 than most other industrialized countries (see chart). The U.S. rate likely is even lower today relative to these countries because economic growth since 1993 has been stronger here than in Europe or Japan.

THE PRESIDENT HAS SEEN
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BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

Tomato Price Increase Leads Rise in Food Prices. A sharp increase in the price of tomatoes accounted for nearly 10 percent of the overall rise in the consumer price index during March and April. This compares with a contribution from higher retail prices of grain products of less than 1 percent and a contribution from higher energy prices of about 40 percent. The retail price of tomatoes was 64 percent higher in April than in February following a winter cold snap and heavy March rains that reduced supplies of Florida tomatoes. Prices during the spring season typically are volatile because the major source of supply shifts from Mexico to Florida at that time of year. The poor weather interrupted supplies from Florida, causing the price to increase.

Cities Face Teacher Shortage. Urban classrooms across the country are suffering from a lack of certified teachers, forcing them to hire thousands of non-certified teachers. The findings come from a study released this week by the Council of Great City Schools, which surveyed 39 of the nation's largest urban public school systems. The problem has become quite urgent in the last few years, as urban schools have seen an increase in enrollments—particularly among children whose first language is not English—and have had difficulty recruiting new teachers to replace the aging corps. The need is greatest for teachers in special education, math, science, and bilingual education. More than three-quarters of the schools report that they are filling the void in the short run by hiring non-certified teachers, usually under emergency or provisional licenses or as long-term substitutes.

Census Bureau Paints Picture of Boomers in Their Golden Years. A recently released report from the Census Bureau details the changes in the characteristics of the elderly population likely to occur when the first baby-boomers reach retirement age. Just as they have been redefining norms since childhood, the boomers are expected to remake the golden years. They are well-educated, which correlates with better health in later life. More women will have been in the labor force long enough to have built up their own retirement savings, which is expected to improve living standards and reduce the poverty rate among elderly women. But, since the boomers have divorced more and had fewer children, they will be more likely to be residing alone and less likely to have family caregivers, two key factors that often help keep many elderly out of nursing homes.

INTERNATIONAL ROUNDUP

Private Capital Flows to Emerging Economies Remain Strong. According to the Institute of International Finance, the world's 31 major emerging economies will attract $200 billion in net private capital flows this year, roughly the same as last year. The composition of these flows, however, will change considerably, with commercial bank lending falling to 25 percent from more than 40 percent last year, bond finance rising from 11 to over 20 percent, and equity investment increasing its share slightly to over 50 percent. Bond finance is expected to return to its 1994 level of about $44 billion this year after falling to $23 billion in 1995 when the bond market worldwide was adversely affected by the Mexican crisis. The spread between interest rates on bonds issued by emerging economies and those issued by industrial economies is expected to fall as confidence in emerging markets continues to strengthen. Although private lending is projected to be unchanged, a drop in official lending this year should result in a 12 percent reduction in overall external financing for these economies.

Large Increase in Energy Demand Predicted for Developing Economies. A recent DRI/McGraw-Hill report predicts a strong increase over the next two decades in developing countries' demand for energy. The developing country share of world primary energy demand will rise from 45 percent last year to 56 percent in 2015. China's energy market, equivalent to 40 percent of the U.S. market today, will grow to represent 70 percent of the U.S. market over the next 20 years. Total Asian energy demand will be more than 50 percent higher than North American demand by 2015. Global oil demand is projected to rise from 66 million barrels per day in 1995 to 100 million barrels per day in 2015, with OPEC expected to meet 75 percent of the new demand and a strong recovery in exports of the former Soviet Union expected to fuel Western Europe. Demand for natural gas also is expected to rise rapidly. While natural gas will displace coal in more advanced developing economies, growing energy demand in less advanced economies should maintain coal's worldwide market share.

Hazel

RELEASES THIS WEEK

Advance Durable Orders

****Embargoed until 8:30 a.m., Friday, May 24, 1996****

Advance estimates show that new orders for durable goods decreased 1.9 percent in April, following an increase of 2.6 percent in March.

MAJOR RELEASES NEXT WEEK

Consumer Confidence—Conference Board (Tuesday)
Gross Domestic Product (Thursday)

U.S. ECONOMIC STATISTICS

	1970–1993	1995	1995:3	1995:4	1996:1
Percent growth (annual rate)					
Real GDP (chain-type)	2.7	1.3	3.6	0.5	2.8
GDP chain-type price index	5.3	2.6	2.2	2.2	2.5
Nonfarm business (NFB) sector:					
Productivity (chain-type)	1.5	0.7	1.7	−1.0	2.6
Real compensation per hour:					
Using CPI	0.6	1.3	2.2	0.4	0.0
Using NFB deflator	1.3	2.2	2.4	2.4	1.6
Shares of Nominal GDP (percent)					
Business fixed investment	10.9	10.2	10.2	10.2	10.3
Residential investment	4.5	4.0	4.0	4.0	4.0
Exports	8.2	11.1	11.1	11.3	11.2
Imports	9.2	12.5	12.5	12.4	12.5
Personal saving	5.1	3.3	3.2	3.6	3.6
Federal surplus	−2.7	−2.2	−2.2	−2.1	N.A.

	1970–1993	1995	Feb. 1996	March 1996	April 1996
Unemployment Rate	6.7**	5.6**	5.5	5.6	5.4
Payroll employment (thousands)					
increase per month			631	178	2
increase since Jan. 1993					8545
Inflation (percent per period)					
CPI	5.8	2.5	0.2	0.4	0.4
PPI-Finished goods	5.0	2.3	−0.2	0.5	0.4

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

FINANCIAL STATISTICS

	1994	1995	March 1996	April 1996	May 23, 1996
Dow-Jones Industrial Average	3794	4494	5612	5580	5762
Interest Rates					
3-month T-bill	4.25	5.49	4.96	4.95	5.04
10-year T-bond	7.09	6.57	6.27	6.51	6.68
Mortgage rate, 30-year fixed	8.35	7.95	7.62	7.93	8.01
Prime rate	7.15	8.83	8.25	8.25	8.25

INTERNATIONAL STATISTICS

Exchange Rates	**Current level May 23, 1996**	**Percent Change from**	
		Week ago	**Year ago**
Deutschemark-Dollar	1.541	+0.4	+6.5
Yen-Dollar	106.8	+0.1	+22.2
Multilateral $ (Mar. 1973=100)	88.68	+0.3	+4.8

International Comparisons	**Real GDP growth (last 4 quarters)**	**Unemployment rate**	**CPI inflation (last 12 months)**
United States	1.8 (Q1)	5.4 (Apr)	2.9 (Apr)
Canada	0.6 (Q4)	9.3 (Mar)	1.5 (Mar)
Japan	2.2 (Q4)	3.1 (Mar)	0.1 (Mar)
France	0.3 (Q4)	12.5 (Jan)	2.3 (Mar)
Germany	0.8 (Q4)	7.0 (Feb)	1.5 (Mar)
Italy	2.3 (Q4)	12.0 (Jan)	4.5 (Mar)
United Kingdom	1.9 (Q1)	8.3 (Mar)	2.7 (Mar)