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THE PRESIDENT HAS SEEN
9-11-00

426310

WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

BE

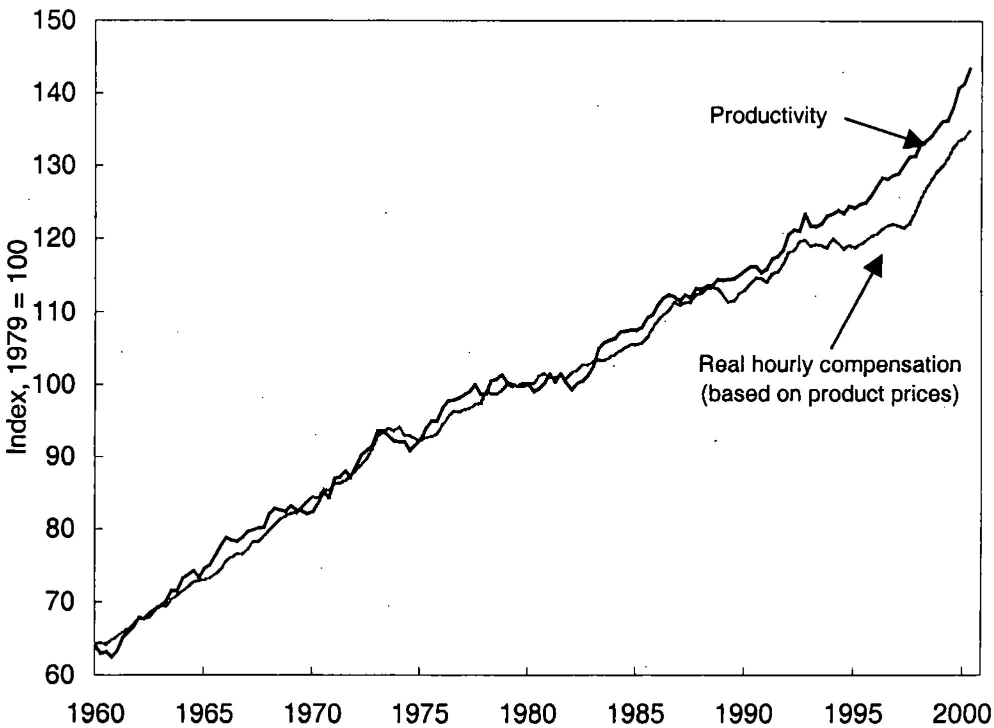
Prepared by the Council of Economic Advisers
with the assistance of the Office of the Vice President

September 8, 2000

copied entire report: Baily Podesta pg 1: Ballentine pg 7: Ricchetti pg 8: Sperling

CHART OF THE WEEK

Nonfarm Productivity and Real Hourly Compensation



In the long run, real hourly compensation paid by employers (compensation deflated by product prices) tends to track productivity. However, real hourly compensation grew more slowly than productivity for a while in the 1990s, and the resulting gap has not closed despite recent sharp increases in hourly compensation. Unless the resulting widening of the markup of prices over unit labor costs (and concomitant decline in labor's share of national income) is permanent, ongoing productivity gains imply further large gains in compensation.

d26310

cc R. Ballentine
How do we mitigate other gases?

9-11-00

copied Ballentine

SPECIAL ANALYSIS

Multi-Gas Approaches to Climate Change Mitigation

A recent study by an eminent climate change scientist suggests that global warming observed thus far has been due mostly to emissions of non-CO_2 greenhouse gases. The study does not imply that concern about CO_2 emissions may be misplaced—as some press coverage has suggested that it does. Nonetheless, along with recent economic analysis, it does bring attention to the view that climate change mitigation efforts should consider all six types of greenhouse gases targeted by the Kyoto Protocol.

The emerging impact of CO_2. So far, the effects of CO_2 on the climate have been counteracted by another product of fossil fuel combustion: aerosols such as SO_2. While CO_2 has a warming effect on the climate, aerosol concentrations in the atmosphere have a cooling effect. As a result, the observed climate change may mainly reflect the additional warming effect of the non-CO_2 greenhouse gases: methane, nitrous oxide, SF_6, HFCs, and PFCs. Over time, however, the counteracting effect of aerosols is likely to decline. First, aerosols have a much shorter residence time in the atmosphere than CO_2, hence existing concentrations of aerosols will diminish faster than those of CO_2. Second, many countries are actively reducing aerosol emissions because of their adverse health effects. Thus, the ratio of aerosol emissions to CO_2 emissions will decline in the future, and the observed impact of CO_2 will grow relative to that of other greenhouse gases.

Cost-effective reduction strategies. While the relative importance of non-CO_2 gases will subside over time, the new scientific study complements recent economic analysis emphasizing the importance of considering abatement opportunities for all six greenhouse gases. Most economic analyses have only focused on CO_2 abatement. This is partly because CO_2 accounts for the vast majority of the U.S. greenhouse gas emissions (85 percent in 1995, weighted by warming potential). Furthermore, emissions patterns and abatement opportunities for the other five greenhouse gases are not so well understood. Nevertheless, new evidence indicates that incorporating reductions of other greenhouse gases into a climate change mitigation strategy would be cost-effective. A recent economic analysis, which does not take the possibility of international permit trading into account, finds that a strategy involving all six greenhouse gases could reduce U.S. compliance costs by roughly 50 percent relative to the cost of abatement strategies that only target CO_2. Reductions of non-CO_2 emissions would make up roughly a quarter of overall reductions.

The effects of trading. When international permit trading is allowed, the inclusion of all six gases in abatement strategies would lead to additional savings, compared with focusing just on carbon. However, the magnitude of those savings is unknown. If an international market for carbon permits existed, the United States would pursue all emissions reduction options that cost less per ton of carbon equivalent than the price of a permit and then buy permits for the remaining emissions that exceed its target. Cost savings from considering all six gases could be realized in two ways. First, to the extent that some non-CO_2 gases can be abated at less than the permit price, the United States will need to buy fewer permits. Second, incorporation of all six gases into abatement strategies worldwide could lower the price of the permits we do buy.

Conclusion. Recent scientific and economic evidence has focused attention on the contribution of non-CO_2 greenhouse gases to climate change. But even though a multi-gas strategy may yield significant cost savings, efforts to mitigate CO_2 emissions remain paramount. After all, reductions in CO_2 emissions would most likely still account for a large fraction of overall emissions reductions in a multi-gas strategy.

THE PRESIDENT HAS SEEN
9-11-00

SPECIAL ANALYSIS

Gifts to Children and Estate Tax Avoidance

The majority of parents name their children as beneficiaries in their wills, and for very wealthy parents the amount bequeathed can be reduced substantially by the estate tax. One of the simplest ways to reduce this tax burden is to take advantage of a provision in the tax code that allows certain tax-free transfers while the parents are still alive. Recent studies suggest, however, that this provision is significantly underutilized. Apparently, many wealthy parents are willing to forego substantial tax savings in order to hold on to their wealth until they die.

Tax-saving incentives. Yearly gifts of up to $10,000 per recipient per year to relatives or non-relatives can be made without affecting the lifetime gift and estate tax exemption of $675,000 (scheduled to rise to $1 million in 2006). Aggregated over a number of years such transfers can be substantial. For instance, a married couple with two married children and four grandchildren could each transfer $80,000 per year to these heirs (including their children's spouses) for a total of $160,000. If the combined life expectancy for the couple is 30 person-years (typical for a couple in their late 60s), the potential reduction in their taxable estate is $2.4 million. At a top marginal tax rate of 55 percent, such strategic giving would save $1.32 million in taxes and thus increase transfers to heirs by that amount.

Taxpayer responses. At first glance, the wealthy do seem to respond to these incentives to make "early bequests." One recent study showed, for example, that while 30 percent of parents with wealth below the estate tax limits made a cash transfer to a child in the past year, nearly 60 percent of parents with greater wealth did so. Other work indicates that the magnitude of the transfer increases with the expected tax rate, suggesting that individuals are responding to the cost of leaving a bequest.

However, despite the increased probability of making transfers to children, the vast majority of wealthy parents fail to take full advantage of this tax-savings device. First, as the results above imply, 40 percent of wealthy parents did not make any transfers to their children. Other research has found an even larger fraction of non-givers. Second, only 7 percent of wealthy parents transferred $10,000 to each of their children, and even fewer, just 3 percent, took full advantage of the exclusion and transferred an amount greater than or equal to $10,000 for each child, spouse of a child, and grandchild. Finally, even among those who made some transfer, the fraction transferring an amount at least equal to the tax-exempt limit was only 5 percent.

Why do people voluntarily pay taxes? Assuming that wealthy individuals intend eventually to transfer assets to their heirs, why do they, in effect, voluntarily pay additional taxes by waiting until they die for the transfer to take place? Since nearly one-half of the wealthy parents who are giving less than

$10,000 per child reported that they had used a financial planner, lack of information is unlikely to be an explanation for the shortfall in giving. One reason might be that the elderly enjoy holding wealth for the respect or power it confers; giving up wealth before their deaths could result in a reduction in the position they hold in their family or society. Another explanation might be that some elderly are concerned about giving away "too much," and having insufficient wealth should they live much longer than expected or incur substantial medical bills or other expenses. This second explanation is unlikely to hold for those with extremely large estates, but it could certainly justify the behavior of those with wealth near the taxable limits.

Conclusion. Both early bequests and estate taxes reduce the control the elderly have over the distribution of their assets; in one case the timing of the transfer is affected, in the other, the amount. Perhaps surprisingly, wealthy individuals are willing to forego substantial tax savings in lieu of *inter vivos* giving. One set of projections indicates that the amount of wealth subject to tax could be reduced by 23 percent if the opportunities for tax-free giving to children were fully exploited. Similar estimates show that by maximizing early bequests to children, spouses of children, and grandchildren, the number of estates owing taxes could be reduced by nearly 80 percent and the total amount owed by 65 percent relative to the situation with current giving patterns. Nevertheless, these opportunities go unexploited, suggesting either that the estate tax is less of a concern to many people than current rhetoric would suggest or that wealthy individuals have other reasons for holding on to their wealth that are more important than avoiding taxes.

9-11-00

JP
can we speed this up before we go?

ARTICLE

Third-Generation Wireless Technology

A new wireless technology, "third generation" or 3G, offers exciting possibilities for U.S. consumers and businesses. However, the United States is currently a year or two behind many other countries in the allocation of spectrum to this technology, and delay is costly.

Advantages of 3G. The new technology combines two of the fastest growing technologies of the 1990s, digital wireless telephones and the Internet. Today's digital wireless phones can access the Internet, but at speeds so slow that special software—or complete redesigns of existing websites—are required to make the content accessible. Third-generation devices, by contrast, transmit data at much higher speeds, essentially creating "broadband" connections to the Internet or other communications networks. At these speeds, 3G technology lets consumers access the full power of the Internet through wireless devices such as phones, handheld computers, devices embedded in automobiles, and other as-yet-undeveloped applications.

Quantifying the benefits of new technologies. Like many new technologies, 3G may well bring substantial benefits to its producers and consumers, as well as spillover benefits to sellers and buyers of related goods and services. First, firms producing and distributing 3G devices and applications will likely earn significant profits. The exact size of these profits is uncertain. However, the recently completed auctions for 3G spectrum in Germany and the UK provide a measure of the order of magnitude of possible producer benefits. These auctions raised $46 and $35 billion, respectively, representing total payments in excess of $500 per inhabitant in these two countries. If U.S. firms were to bid as much per capita, a U.S. auction could raise as much as $135 billion.

Consumers of 3G technologies can also reap substantial gains. Economists often measure consumer benefits in terms of "consumer surplus," the difference between the prices consumers actually pay and the maximum amounts they would be willing to pay for particular goods or services. Again, the gains from 3G are unknown, but one prominent economist estimated that the consumer surplus created by the introduction of analog or "first-generation" (1G) cellular service was in the range of $31 billion to $50 billion *per year* in constant 1994 dollars.

Costs of delay. Each year of delay in introducing 3G will deprive consumers of whatever surplus that technology will generate. Other costs of delay may be equally important but even harder to quantify. History suggests that first-mover advantages are important in developing services and applications that use new technologies. Knowledge spillovers among firms and between firms and academic institutions are particularly important in high-technology industries. One recent study used patent citations to show that these spillovers tend to be geographically localized, even after controlling for pre-existing research activity.

In the technology sector much of the relevant knowledge is "tacit" rather than explicit, making close social ties (such as those between entrepreneurs and venture capitalists) all the more important. Consequently, location is often important in the early stages of these industries. Silicon Valley is an obvious example. Moreover, a vibrant cluster of startups devoted to developing commercial applications for 3G and existing digital wireless technologies has emerged in Finland—which allocated its 3G spectrum in March 1999. (The box provides further examples of wireless Internet applications developed outside the United States.) Because location is so important, delays in creating a domestic market for 3G applications can be very costly.

Use of the spectrum by the DoD and other incumbents. Domestic 3G spectrum auctions will not take place until fall 2002 at the earliest. One reason the U.S. lags behind other economies is that portions of the relevant spectrum are currently in use, most notably by the Department of Defense. Other agencies such as the FAA and private firms also use smaller parts of this spectrum. To the extent that it is expensive for the DoD or others to convert equipment to use other communication bands, their concerns would have to be addressed before 3G spectrum auctions could be accelerated.

Conclusion. 3G applications promise substantial benefits, but in the United States, parts of the spectrum suitable for 3G applications are already in use. In judging the costs of delaying 3G development it is important to take into account not only the expected revenues from auctioning spectrum licenses, but also the expected consumer benefits from using the technology.

Innovation in Mobile Services

The following are drawn from recent press accounts:

i-mode. DoCoMo, a subsidiary of Nippon Telephone and Telegraph (NTT) has launched a service known as i-mode in Japan. This service recently surpassed 10 million subscribers. Subscribers receive an i-mode phone with which they can send and receive e-mail as well as access Web sites that have been tweaked to fit on tiny screens. With a thumb-controlled joystick, subscribers can tap into online news, browse through restaurant guides, buy tickets on Japan Airlines, and trade stocks via DLJdirect.

Phones operating as electronic wallets. Using WAP (wireless application protocol), several firms have turned phones into electronic wallets, allowing customers to pay for goods and services via their mobile phone bill rather than via credit cards or cash. Finnish consumers can make vending machine purchases via their mobile phones. A Finnish bank is launching a service that will allow users to pay rent, phone, or electricity bills via their mobile phones. An Estonian firm allows users to pay for parking spaces via their mobile phones.

9-11-00

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

Flexible Schedules Are Growing More Popular. More than 25 million workers (27.6 percent of all full-time workers) reported keeping flexible hours in 1997, almost double the proportion working flexible schedules in 1991, according to a recent study. White workers were more likely than black or Hispanic workers to have flexible work arrangements, a variation only partially explained by occupational differences. Men and women were about equally likely to have flexible work arrangements. However, men were increasingly likely to have such arrangements the older they were, while women were less likely. The study also looked at work outside traditional business hours, such as evening or night shifts. In 1997 more than 15 million workers (16.8 percent) had such arrangements, which was about the same proportion as in 1985 and 1991. Most said that they did so because of the nature of their work; protective service providers, for example, were the most likely to work alternative shifts. Men were more likely than women, and black workers were more likely than either white or Hispanic workers to work nontraditional hours. For all these groups, the likelihood of maintaining such a work schedule generally declined with age.

copied Ricchetti

Race and Wealth. A new study of wealth holding in 1998 continues to find a sharp racial divide, with the average net worth of blacks only 18 percent that of whites and median black net worth only 12 percent that of whites. These percentages are even lower for financial net worth (which excludes assets like houses and cars). More than a quarter of black households had zero or negative net worth, double the comparable percentage of whites. Growth in the median net worth of blacks between 1983 and 1998 was encouraging, but average net worth fell slightly. Turning to Hispanics, the study found that average net worth in 1998 was higher than that of blacks (but still only 25 percent that of whites), while median net worth was smaller than that of blacks (zero for nonfinancial net worth). This difference suggests sharp disparities in the distribution of net worth among Hispanic households. Indeed, 36 percent of Hispanic households reported zero or negative net worth, and the median net worth of Hispanics stagnated between 1983 and 1998 even though average net worth grew.

In Hollywood, R is for Risk. At least one critic of Hollywood's fascination with trashy movies has suggested that they also are a poor investment. And a recent economic study supports this view. The study finds that a studio executive who wanted to trim the "downside" risk and increase the "upside" possibilities in the studio's film portfolio could do so by shifting production dollars out of R-rated movies and into G, PG, and even PG-13 movies. The study reports that more than half of all movies released in the past decade are R-rated and only 3 percent are G-rated; about a fifth are rated PG and a quarter PG-13. While the number of R-rated movies that are box-office successes is high, this reflects the large number that are made rather than their superior probability of success. In fact, according to the study, only about 6 percent of R-rated movies are financially successful, while the success rate for all other types is twice that high.

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9-11-00

INTERNATIONAL ROUNDUP

Countries Still Face Barriers to E-Readiness. Apart from the major developed economies, many countries still face barriers to participating fully in the digital economy, according to a new study. The study assesses 42 countries based on five characteristics: network infrastructure, e-leadership (government and industry commitment to developing the networked world), protection of intellectual property and information security, human capital, and e-business climate. While Latin America has shown improvements in promoting its digital economy and has strong human capital, weak infrastructure and lack of investment incentives are concerns. Similarly, Asia's inadequate information security remains the region's greatest drawback. Also, eight of the ten Asian economies examined received the lowest possible infrastructure rating. Central and Southern Europe is the most e-ready region considered, ranking high in information security but with its strength lying primarily in its human capital. Overall, however, 25 countries, representing 3.6 billion people, still require substantial infrastructure improvements.

copied Sperling

Internet Use Increases Trade. A recent study provides formal evidence that the spread of the Internet has led to increased international trade. Poor countries appear to gain more from expanded Internet access than rich countries: doubling the number of Internet hosts in a country raises exports by around 10 percent for a developing economy, somewhat more than the approximate 8 percent gain of an industrial nation, suggesting that access to the Internet can compensate for infrastructure shortcomings that may hinder trade. In other words, bridging the international digital divide between rich and poor countries has measurable economic benefits. The Internet was found to have had no effect on international trade in 1995 or 1996, but increasing effects in each subsequent year. The results cover only trade in goods and do not include items such as financial services, music, computer software, or education, all potentially important components of e-commerce. If anything, then, the effect of the Internet on international trade is likely to be larger than what is suggested by these initial results.

Gene Sperling

Study Assesses Causes of Low Earnings in the EU. About 15 percent of paid employees in the EU had low monthly earnings (60 percent of their country's median monthly earnings), according to a recent study using 1996 household data. About 37 percent of these employees worked full time (at least 30 hours a week) but earned low wages. Another 43 percent had wages such that that they would not have experienced low earnings if they had worked at least 30 hours a week, but they worked less (some by choice and some because they could not find full-time work). The rest had hourly pay near or below the low-wage threshold and did not work full time. The study also found substantial cross-country differences in the proportions of workers with low earnings and the reasons for those low earnings. The UK, for example, had the highest overall proportion of employees with low earnings (21 percent) but more than half were part-time workers. Belgium and the Netherlands also had high proportions of part-time workers. By contrast, low pay tended to be much more important in "southern" countries.

RELEASES THIS WEEK

Productivity

According to revised estimates, nonfarm business productivity rose at an annual rate of 5.7 percent in the second quarter of 2000. Manufacturing productivity rose 5.4 percent.

MAJOR RELEASES NEXT WEEK

Producer Prices (Thursday)
Retail Sales (Thursday)
Industrial Production and Capacity Utilization (Friday)
Consumer Prices (Friday)

U.S. ECONOMIC STATISTICS

	1970-1993	1999	1999:4	2000:1	2000:2
Percent growth (annual rate)					
Real GDP (chain-type)	2.9	5.0	8.3	4.8	5.3
GDP chain-type price index	5.2	1.6	1.6	3.3	2.6
Nonfarm business (NFB) sector:					
Productivity (chain-type)	1.7	4.1	8.0	1.9	**5.7**
Real compensation per hour:					
Using CPI	1.0	2.2	1.3	0.0	**1.7**
Using NFB deflator	1.5	3.3	2.9	1.1	2.9
Shares of Nominal GDP (percent)					
Business fixed investment	11.4	12.9	13.0	13.4	13.7
Residential investment	4.5	4.3	4.3	4.3	4.2
Exports	8.2	10.6	10.8	10.8	11.0
Imports	9.2	13.4	13.9	14.2	14.6
Personal saving	6.6	1.6	1.1	0.1	0.2
Federal surplus	-2.8	1.3	1.5	2.4	2.4

	1970-1993	1999	June 2000	July 2000	August 2000
Unemployment Rate (percent)	6.7**	4.2**	4.0	4.0	4.1
Payroll employment (thousands)					
increase per month			57	-51	-105
increase since Jan. 1993					21989
Inflation (percent per period)					
CPI	5.8	2.7	0.6	0.2	N.A.
PPI-Finished goods	5.0	2.9	0.6	0.0	N.A.

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

New or revised data in **boldface**.

FINANCIAL STATISTICS

	1998	1999	July 2000	August 2000	Sept. 7, 2000
Dow-Jones Industrial Average	8626	10465	10663	11015	11260
Interest Rates (percent per annum)					
3-month T-bill	4.78	4.64	5.96	6.09	6.02
10-year T-bond	5.26	5.65	6.05	5.83	5.76
Mortgage rate, 30-year fixed	6.94	7.43	8.15	8.03	7.94
Prime rate	8.35	8.00	9.50	9.50	9.50

INTERNATIONAL STATISTICS

Exchange Rates	Current level September 7, 2000	Percent Change from Week ago	Percent Change from Year ago
Euro (in U.S. dollars)	0.874	-1.6	-17.4
Yen (per U.S. dollar)	105.1	-1.5	-5.2
Major currencies index (Mar. 1973=100) (trade-weighted value of the U.S. $)	99.97	0.5	6.5

International Comparisons [1/]	Real GDP growth (percent change last 4 quarters)	Unemployment rate (percent)	CPI inflation (percent change in index last 12 months)
United States	6.0 (Q2)	4.1 (Aug)	3.5 (Jul)
Canada	5.3 (Q2)	6.8 (Jul)	3.0 (Jul)
Japan	0.7 (Q1)	4.7 (Jul)	-0.5 (Jul)
France	3.4 (Q2)	9.8 (May) [2/]	1.7 (Jul)
Germany	3.6 (Q2)	8.3 (Jul)	1.9 (Jul)
Italy	3.0 (Q1)	10.8 (Apr)	2.7 (Jul)
United Kingdom	3.1 (Q2)	5.5 (May)	3.2 (Jul)

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.