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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

September 17, 1999

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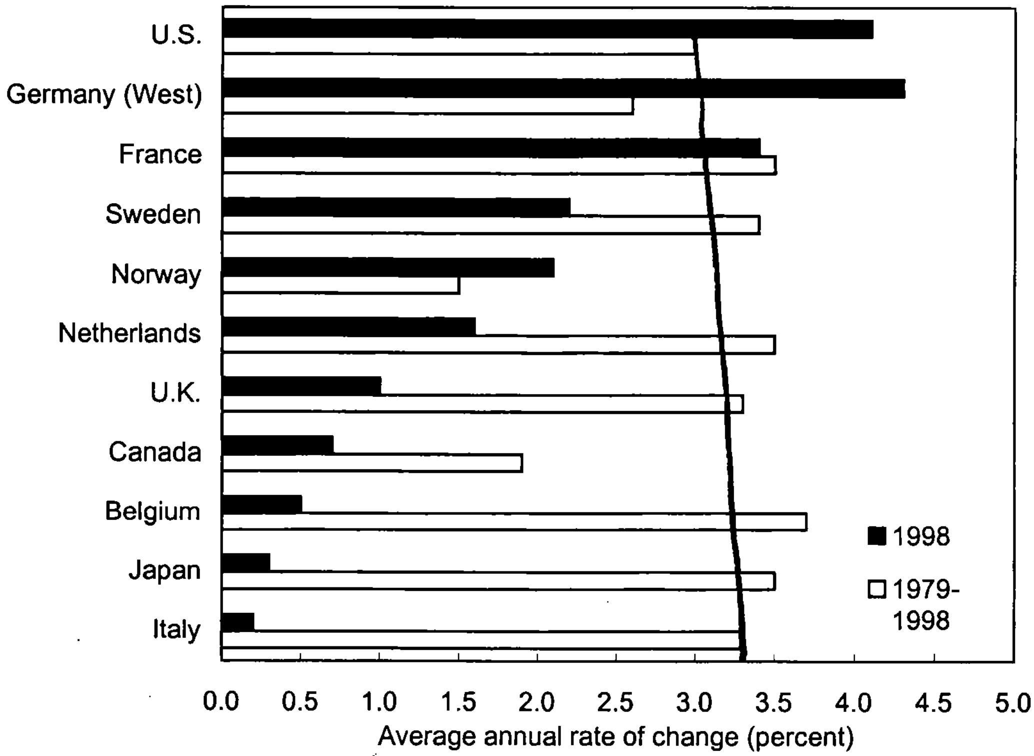
Baily
Podesta

CHART OF THE WEEK

Manufacturing Productivity Growth in Selected Countries



The latest international comparisons of manufacturing productivity from the Bureau of Labor Statistics show that labor productivity in U.S. manufacturing increased 4.1 percent in 1998, second only to Germany's 4.3 percent. The United States and Germany (together with Norway) were also the only countries to achieve faster growth in 1998 than their long-term trend growth rate. (The U.S. output series used for international comparisons is different from the one used in the standard quarterly series on productivity and costs.)

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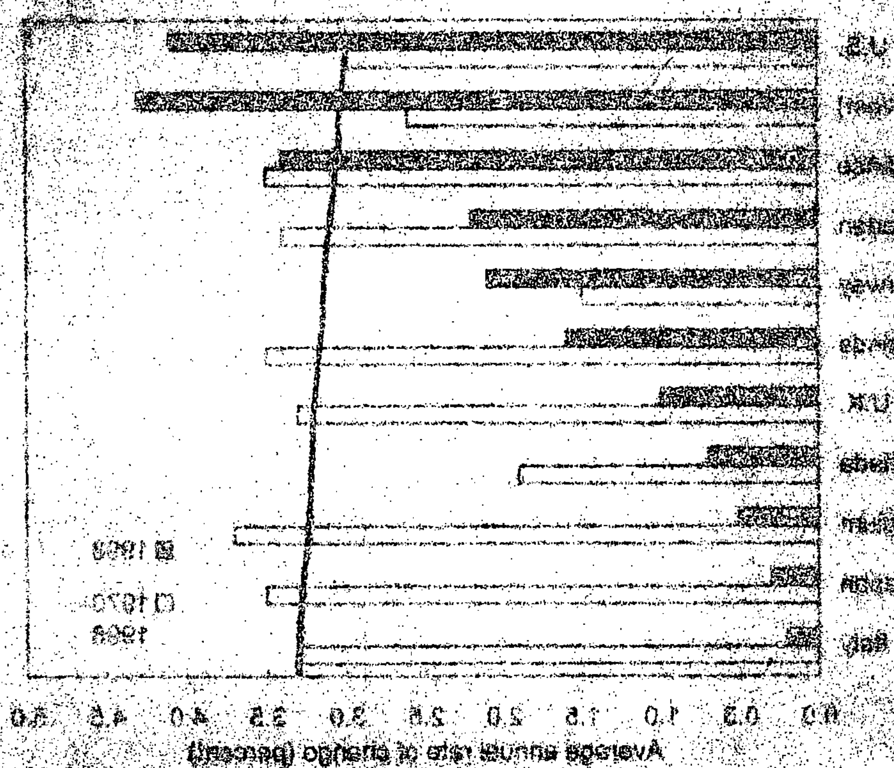

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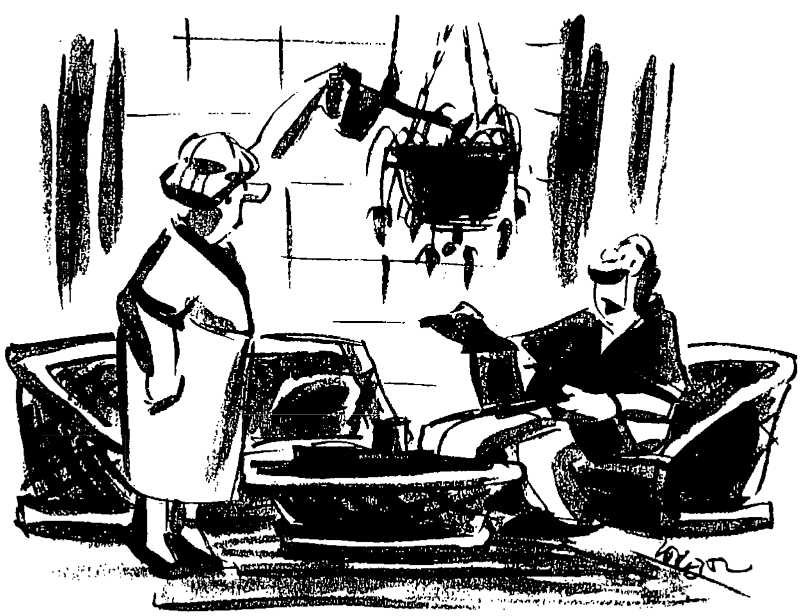


"Is this the year, Pumpkin? Goodbye, love boat, hello, elder hostel?"

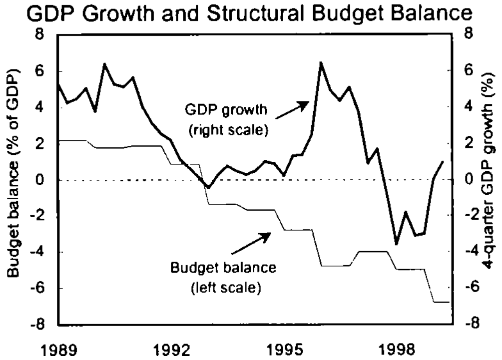
CURRENT DEVELOPMENT

Has Japan Turned the Corner?

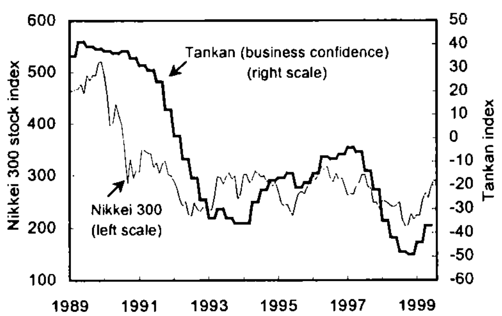
Japanese real GDP growth has recovered strongly in 1999 (see upper chart), following the longest downturn since the war. Despite hopeful signs, however, macroeconomic and structural concerns suggest a need for continued caution.

Slowdown, decline, and rebound. Despite a brief upward blip in 1996, Japan has suffered lackluster economic performance throughout the 1990s. Faced with rising budget deficits, Japan implemented a sharp fiscal consolidation in 1997. But this coincided with the onset of the Asian financial crisis and the collapse of several major financial institutions. The country plunged into recession.

GDP Growth and Structural Budget Balance



Stock Market and Business Confidence Indexes



Despite the large budget deficit, Japan implemented a major fiscal stimulus package in late 1998. Monetary policy became more aggressive in early 1999, as already low short-term interest rates were cut to virtually zero. Structural reforms may also have helped the recovery. For example, Japan has put in place a comprehensive framework to deal with banking weaknesses, and announced a package of tax and regulatory measures to promote corporate restructuring. These steps may have contributed to a recent surge in stock prices and an improvement in (the still low levels of) business confidence in 1999 (see lower chart).

Risks remain. Japan is not necessarily out of the woods. For example, public investment boosted demand in late 1998 and early 1999, but declined in the second quarter and would be a drag on growth if it returns to normal levels as proejcted. Residential investment surged in the second quarter, reflecting tax breaks, but its rapid pace is not sustainable. In addition, non-residential investment remains weak, and yen strength could curtail net exports.

Observers also point to the need to further strengthen the financial system, encourage corporate restructuring, increase labor mobility, and accelerate deregulation. Without continuing structural reforms, combined with appropriate fiscal and monetary policy, Japan runs the risk that rising growth will turn out to be transitory. After all, Japan has already had a previous, sharp recovery of growth—which, unfortunately, ended abruptly with the recession of 1997 and 1998.

9-23-99

Gus
Ask [illegible] more this when poverty [illegible] announced
— BC

SPECIAL ANALYSIS

The Distribution of Family Income

In the current long economic expansion, labor market outcomes and family incomes have improved for traditionally disadvantaged groups. Income inequality, by contrast, has remained relatively high.

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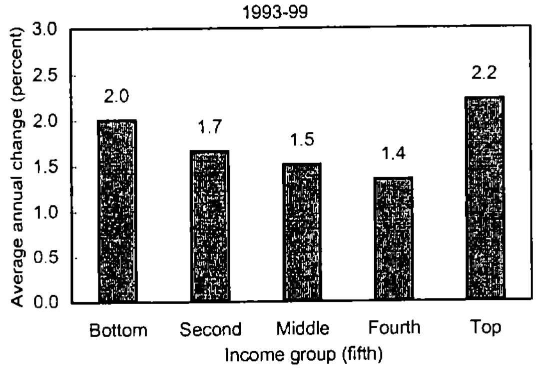
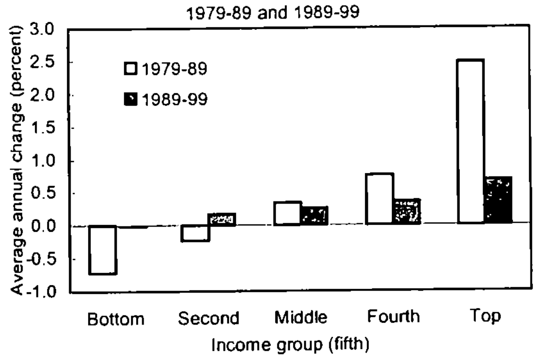
A rising tide... Since the economy began to pick up steam in 1993, growth in after-tax family income (adjusted for family size) has been strongest in the top and bottom fifths of the distribution, but it has also been solid in the middle (see upper chart). The chart is based on Congressional Budget Office calculations in which each family's income is expressed relative to the poverty rate for a family of its size. It includes CBO estimates for 1999.

Growth in After-Tax Adjusted Family Income
1993-99



Growth in After-Tax Adjusted Family Income
1979-89 and 1989-99



...but a dragging anchor. While the strong growth in family income at the bottom of the distribution during this expansion is encouraging, overall growth since since 1989 (the last high-employment year in the previous expansion) has been less so. The largest gains in after-tax adjusted family income have come at the top of the distribution, while the income of the bottom fifth of families remained the same (see lower chart).

This pattern is similar to, but not so severe as, the pattern that prevailed in the 1980s. One reason is that changes in Federal taxes in the 1980s aggravated income inequality, while they have ameliorated it in the 1990s. It is also possible that some of the growth in the current expansion represents an improvement in the long-term trend—though we are still far from the 1948-73 trend, when strong productivity and real wage growth contributed to an approximate doubling of average family income and the gains were shared up and down the distribution.

Conclusion. Official Census Bureau statistics on money income and poverty for 1998 are due to be released at the end of this month. While the Census Bureau, unlike the CBO, does not adjust for taxes or family size, its data are likely to reveal the same trends as the CBO estimates: rising incomes in this expansion but not yet to levels substantially above previous peaks at lower income levels. Evidence on whether long-term trends in inequality may have improved is likely to be inconclusive.

ARTICLE

9-20-99

Asset Transfers and Medicaid Receipt

About 35 percent of 65 year-olds will use a nursing home at some point during the remainder of their lifetimes, according to one estimate. Medicaid is the main source of government support for such care. However, it is a needs-based program and is unavailable to individuals who have not first exhausted their own resources.

Policymakers have been concerned individuals have an incentive to transfer their assets to other family members in order to qualify for support. Past research had found little evidence of such asset shifting, but a recent study, using improved data, finds that those who believe they are more likely to enter nursing homes do indeed transfer assets with greater frequency and in larger amounts than others.

The high cost of care. An average nursing home stay now costs more than $40,000 per year, and many people mistakenly believe that Medicare will cover the costs of their long-term care. In fact, however, nearly 50 percent of the costs of long-term care are paid out-of-pocket by nursing home patients and their families, and most of the remaining costs are borne by *Medicaid*. Because costs are so high, spend-down (the process by which individuals first exhaust their own assets before qualifying for Medicaid) typically occurs very rapidly. Using a sample of Massachusetts residents over age 66, one study estimated that 63 percent of those living alone would become Medicaid-eligible within 13 weeks after entering a nursing home.

Evidence of asset transfers. Previous efforts to examine the extent to which people transfer assets to others as a means of qualifying for Medicaid used data on individuals who were already in nursing homes or were very likely to enter them, and hence whose transfer behavior might already have occurred. (Current rules prohibit the transfer of assets within 3 years of entering a nursing home, the so-called "look back" period.) The new study makes use of a nationally representative survey of individuals above age 70 that contains, among other key information, individuals' assessments of the likelihood that they will enter a nursing home within 5 years and the amount of money already transferred to others. It finds that a household with average net worth and a self-assessed 60 percent probability of entering a nursing home within 5 years will make transfers that are 21 percent higher than a household with average net worth and the average self-assessed probability of entering a nursing home (19 percent). In addition, among those who made transfers of more than $1,000 the average amount transferred was over $6,000.

Costs to Medicaid. The recent research suggests that the cost savings to the Medicaid program could be larger than previously thought. It is estimated that close to 12 million households might transfer assets for the purpose of qualifying for Medicaid. If everyone transferred assets at the same rate as the study

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population, these 12 million households would make $3.5 billion in transfers, representing 15 percent of Federal Medicaid spending on nursing homes in 1993. Of course, not all of these transfers represent a loss to the Medicaid system since some of the individuals who transfer money to qualify for Medicaid do not actually need nursing home care, and the study suggests that the actual loss to the Medicaid system from these transfers is likely to be less than half of this amount.

Implications. Although the new evidence suggests that asset transfers are large enough to raise Medicaid costs, efforts to control costs by tightening rules regarding transfer behavior have been unpopular. Alternative approaches might examine ways to control rising long-term care costs, increase the availability of long-term care insurance, and create positive incentives for individuals who can afford it to share responsibility for payment.

yes

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

Long-Term Temps Are a Rare Breed. Although popular perceptions may be otherwise, employment in the temporary help services industry is relatively small (about 1 to 2 percent of the labor force). Moreover, only a small fraction of temps represent long-term jobholders, according to a recent analysis of Bureau of Labor Statistics data by a private foundation. In fact, 54 percent of all temps leave their jobs within 6 months. And while 38 percent of new temps cite inability to find a permanent job as their reason for temping, this percentage drops to below 6 percent for those with more than 48 months of tenure. Those with longer tenure are also considerably more likely to prefer their current arrangement. This study emphasizes the positive side of temporary work for some, while previous analyses in the *Weekly Economic Briefing* (November 14, 1997 and September 11, 1998) have also recognized that lower wages and changeable work settings may create problems for other temporary workers.

How Do Layoffs Affect Stock Prices? Layoffs may be getting more attention in the press than they used to, but a recent study finds that the total number of layoff announcements follows the business cycle quite closely. What has changed, according to the study, is the stock market's reaction to layoff announcements: on average, a layoff announcement is more likely to be associated with a rise in the price of the company's stock than it used to be. One possible explanation for this change is that reductions in force designed to improve efficiency are becoming more common relative to those designed to deal with reductions in demand for the company's product. The study found that layoffs associated with reorganization have, in fact, increased dramatically and that the fraction associated with plant closings has declined. It also found that layoffs due to plant closings received a negative stock market reaction while those due to reorganization were generally positively received. However, the authors were more confident in documenting that stock market reactions to layoffs have become less negative over time than they were in attributing this change to any particular cause.

Attending Elite Colleges May Have Little Payoff—Except for Minorities. A new study finds that attending a more selective (higher average SAT score) college does not appear to boost future earnings, contrary to previous findings. The study uses 1995 earnings data for about 14,000 students who entered college in 1976. Because factors affecting college admission may also affect future earnings, the study groups together students who were accepted and rejected from a similar set of schools, and then compares, within groups, the outcomes of those who chose to attend a more selective college with those who chose a less selective one. Post-college earnings were found to be similar for those who attended elite colleges and those who could have, but did not—except for students from more disadvantaged backgrounds, whose earnings were raised by attending a more selective college. An implication of the study is that efforts to attract qualified students from more disadvantaged family backgrounds to elite colleges could improve matching of these students' abilities to their future jobs, without adversely affecting that matching for others, on average.

9.20.99

INTERNATIONAL ROUNDUP

Asian Recovery Exceeds Forecasts. After strong first-quarter regional growth of 4.8 percent (relative to year earlier levels), reinforced by continued strong growth in the second quarter, the Asian Development Bank raised its forecasts for most countries in the 14 "Developing Asia" economies. The faster-than-expected recovery in 1999, from 1 percent growth in the last quarter of 1998, has been fueled by domestic demand stimulated by expansionary policies and increased global demand for semi-conductors and electronic products. The implementation of corporate and financial sector reforms has helped raise industrial production and exports in most of the crisis-affected economies and, in many cases, reverse capital outflows. However, the recovery has not been evenly spread, with South Korea, Taiwan, Singapore, the Philippines, and Thailand leading the way, while Hong Kong, Malaysia, and Indonesia are lagging behind. Despite an overall positive forecast, the Asian Development Bank notes several factors that could moderate the effectiveness of the reforms in the region, including debt and structural problems of Korean Chaebols, the slow pace of bank restructuring and consolidation, and the problems associated with China's banking and state-owned enterprise sectors.

Israel Moves Toward ILO Core Labor Standards. Although Israel has made progress in ratifying International Labor Organization core labor standards, progress still needs to be made in order to protect some groups of workers from abuses, according to a WTO-commissioned report by the International Confederation of Free Trade Unions (ICFTU). The report found that, while most Israeli workers are able to exercise their basic trade union rights, the government has at times forced striking workers to return to work in arbitrarily defined "essential" public services. The report also found that significant discrimination against women and Israeli Arabs remains despite legislative improvements in recent years, due in part to lack of resources for enforcement. Also, while child labor is a relatively minor phenomenon, it is reported to be a problem for some groups of the population. The ICFTU recommends that Israel amend its law on the definition of "essential" public services, remove the penalty of forced labor for those engaging in an illegal strike, extend full freedom of association and collective bargaining rights to all workers including those from the West Bank and Gaza, and provide adequate resources for implementing its laws regarding discrimination against women and Israeli Arabs.

UK sees record lows in unemployment, inflation. Unemployment as measured in the United Kingdom fell by 22,300 in August to a 19-year low of 4.2 percent of the workforce. (The unemployment rate approximating U.S. concepts is nearly 2 percentage points higher.) The number of people employed in the UK rose to a record high in the May-July period, increasing by almost 300,000 from the same period last year. Average earnings also increased in July by 4.6 percent, up from 4.4 percent in June. At the same time, inflation fell to its lowest level since the mid-1960s, standing at just over 1 percent.

RELEASES THIS WEEK

Housing Starts

****Embargoed until 8:30 a.m., Friday, September 17, 1999****

Housing starts were about unchanged in August at 1.676 million units at an annual rate. For the first 8 months of 1999, housing starts are 5 percent above the same period a year ago.

Industrial Production and Capacity Utilization

The Federal Reserve's index of industrial production rose 0.3 percent in August following an increase of 0.7 percent in July. Capacity utilization rose 0.1 percentage point to 80.8 percent.

Consumer Price Index

The consumer price index increased 0.3 percent in August. Excluding food and energy, consumer prices rose 0.1 percent.

Retail Sales

Advance estimates show that retail sales rose 1.2 percent in August following an increase of 1.0 percent in July. Excluding sales in the automotive group, retail sales rose 0.7 percent following an increase of 0.4 percent.

MAJOR RELEASES NEXT WEEK

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

U.S. ECONOMIC STATISTICS

	1970-1993	1998	1998:4	1999:1	1999:2
Percent growth (annual rate)					
Real GDP (chain-type)	2.7	4.3	6.0	4.3	1.8
GDP chain-type price index	5.4	0.9	0.8	1.6	1.5
Nonfarm business (NFB) sector:					
Productivity (chain-type)	1.5	2.6	4.1	3.6	0.6
Real compensation per hour:					
Using CPI	0.6	2.5	2.0	2.9	1.5
Using NFB deflator	1.3	3.7	3.4	3.0	3.7
Shares of Nominal GDP (percent)					
Business fixed investment	10.9	11.0	11.0	11.0	11.2
Residential investment	4.5	4.3	4.5	4.6	4.7
Exports	8.2	11.3	11.3	10.9	11.0
Imports	9.2	13.0	13.1	13.2	13.7
Personal saving	5.2	0.3	-0.0	-0.5	-0.9
Federal surplus	-2.7	0.9	0.8	1.4	1.6

	1970-1993	1998	June 1999	July 1999	August 1999
Unemployment Rate (percent)	6.7**	4.5**	4.3	4.3	4.2
Payroll employment (thousands)					
increase per month			281	338	124
increase since Jan. 1993					19403
Inflation (percent per period)					
CPI	5.8	1.6	0.0	0.3	**0.3**
PPI-Finished goods	5.0	0.0	-0.1	0.2	0.5

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

New or revised data in **boldface**.

FINANCIAL STATISTICS

	1997	1998	July 1999	August 1999	Sept. 16, 1999
Dow-Jones Industrial Average	7441	8626	11052	10935	10737
Interest Rates (percent per annum)					
3-month T-bill	5.06	4.78	4.55	4.72	4.57
10-year T-bond	6.35	5.26	5.79	5.94	5.90
Mortgage rate, 30-year fixed	7.60	6.94	7.63	7.94	7.82
Prime rate	8.44	8.35	8.00	8.06	8.25

INTERNATIONAL STATISTICS

Exchange Rates	**Current level**	**Percent Change from**	
	September 16, 1999	**Week ago**	**Year ago**
Euro (in U.S. dollars)	1.042	-1.2	N.A.
Yen (per U.S. dollar)	105.1	-2.7	-22.1
Major currencies index (Mar. 1973=100) (trade-weighted value of the U.S. $)	93.11	-0.3	-3.6

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	3.9 (Q2)	4.2 (Aug)	2.3 (Aug)
Canada	3.7 (Q2)	7.7 (Jul)	1.8 (Jul)
Japan	1.1 (Q2)	4.9 (Jul)	-0.1 (Jul)
France	2.1 (Q2)	11.3 (Jun)	0.3 (Jun)
Germany	0.6 (Q2)	7.1 (Jul)[2/]	0.6 (Jul)
Italy	0.9 (Q1)	12.1 (Apr)	1.7 (Jul)
United Kingdom	1.2 (Q2)	6.1 (May)	1.3 (Jul)

1/ For unemployment data, rates approximating U.S. concepts as calculated by the U.S. Department of Labor, Bureau of Labor Statistics.
2/ Rate for former West Germany. Using OECD standardized unemployment data, the unemployment rate for unified Germany for July was 9.1 percent.