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THE PRESIDENT HAS SEEN

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WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

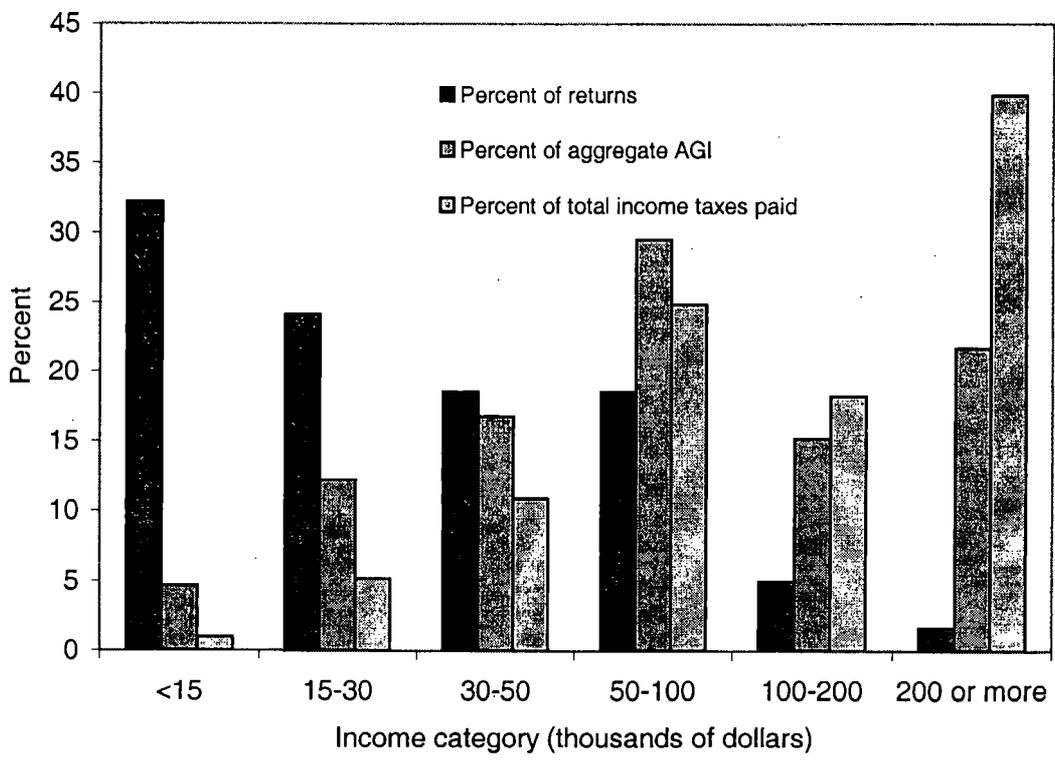
Prepared by the Council of Economic Advisers
with the assistance of the Office of the Vice President

July 7, 2000

*Copied
Bailey
Podesta
p.6 to Sperling*

CHART OF THE WEEK

Individual Income Tax Returns, 1998



Preliminary IRS data for 1998 show that nearly a third of all individual income tax returns had adjusted gross income (AGI) below \$15,000, accounting for roughly 5 percent of aggregate AGI. These filers paid about 1 percent of total income taxes. By contrast, the 1.7 percent of filers with an AGI of \$200,000 or more paid almost 40 percent of total income taxes.

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"We've found the problem. You folks don't own a car."

FINANCIAL MARKET UPDATE

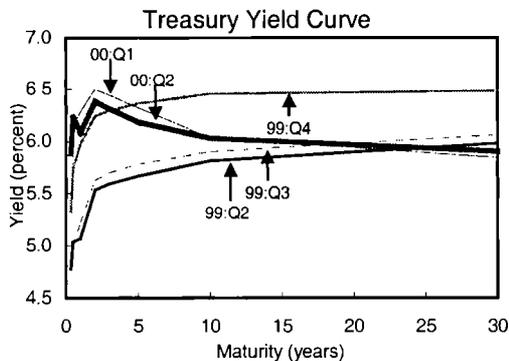
Yields Yawn, Stocks Slide, Dots Drop in Second Quarter

The Federal Open Market Committee raised the target federal funds rate 50 basis points to 6½ percent in May but made no further change last week. Still, interest rates ended the quarter about where they started it. The major stock indexes all declined in the quarter, with Internet stocks hit hard.

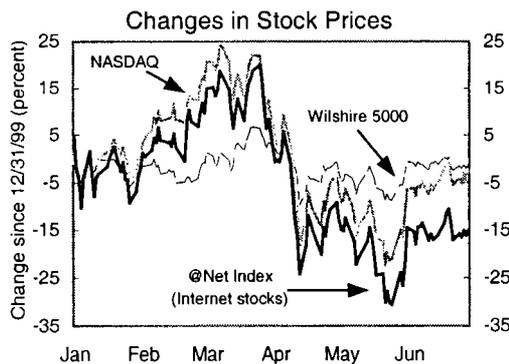
Interest rates. The Fed began tightening a year ago, and Treasury yields at all maturities rose in the second half of 1999 (see upper chart). This year, yields continued to rise at the short end, but they

declined at the long end in the first quarter, producing an inverted yield curve. Although rates rose temporarily around the time of the Fed's tightening in May, the Treasury yield curve ended the second quarter about where it was at the end of the first. Short rates are considerably higher than they were a year ago, while long rates are roughly the same. In contrast to yields on

Treasuries, which may be affected by supply issues surrounding the retirement of Federal debt, private borrowing costs have stayed up this year and remain higher than they were a year ago. The rate on a 30-year mortgage, for example, was 7.6 percent in June 1999, 8.2 percent this January and 8.3 percent this June.



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Stock prices. Broad market indexes reached record levels in March, but then dropped sharply (see lower chart). Internet stocks suffered a large decline in April and May, and despite bouncing back some in June, remain about 15 percent below where they started the year. Analysts are beginning to question whether the bloom is now off the rose of Internet

stocks. Broader indexes such as the S&P 500 and Wilshire 5000 are just a touch below where they were at the start of the year.

7-9-00

SPECIAL ANALYSIS

Widows Waiting to Wed?

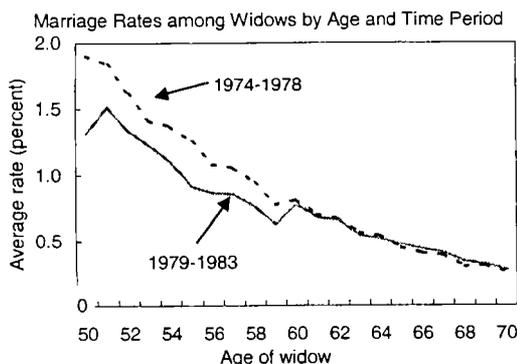
A growing body of evidence finds that the implicit incentives in government programs affect decisions about whether and when to marry, cohabit, or divorce. For example, a new study finds that Social Security rules penalize widows who remarry before age 60 and that this penalty affects their marriage decisions.

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Social Security rules. Surviving spouses of individuals who worked in Social Security covered employment are eligible for *widow* benefits when they reach age 60 if they are unmarried at that point. That is, a widow who remarries before age 60 has no claim to the widow benefits (so long as the remarriage remains intact), and therefore faces a marriage penalty. However, a widow who remarries after reaching age 60, retains full claim on these benefits. The current system reflects a series of law changes that have reduced the size of the marriage penalties in Social Security. Since January 1979, widows who remarry after age 60 are able to claim the full widow benefit.

A marriage penalty example. Consider a 60-year-old widow who has a life expectancy of 22.9 years (the value used by the Social Security Administration) and is considering marrying a man 2 years older who has a life expectancy of 17.5 years. Suppose further that she never worked but her deceased husband and her prospective husband each did. Finally, suppose that both men's earnings histories would entitle them to \$1,000 per month of benefits. The study calculates that by waiting until she reaches age 60 to remarry, the widow could raise the present discounted value of her expected benefits at age 60 from about \$88,000 to about \$152,000. This increase occurs for two reasons: first, she would be entitled to the widow's benefit from her first marriage, which she would begin receiving immediately (even if her new husband had not yet retired); and second, she would continue to receive a widow's benefit rather than the (smaller) spousal benefit she would get if she had remarried before age 60.

Marry now, marry later? To see if this incentive affects behavior, the study examined age-specific marriage rates of widows around age 60 both before and after the 1979 law change.



after the 1979 law change. A simple examination of marriage rates by age shows that before the law took effect in 1979, marriage rates declined relatively smoothly with age, but that since 1979 there is a pronounced drop in the marriage rate around age 59 and a sharp increase at age 60 (see chart). Confounding this picture in part are the secular declines in marriage that have been taking place over time and other changes unrelated to Social Security.

PHOTOCOPY
WJC HANDWRITING



However, a statistical analysis that tries to isolate the effects of the law change confirms this basic story and suggests that marriage rates for all ages are higher after age 60 than they would have been without the change in Social Security rules.

Conclusion. This analysis of the widow benefit in Social Security provides strong evidence that economic incentives can affect the decision to marry. It also provides a clear example of how policy changes can have consequences beyond those directly intended by the change.

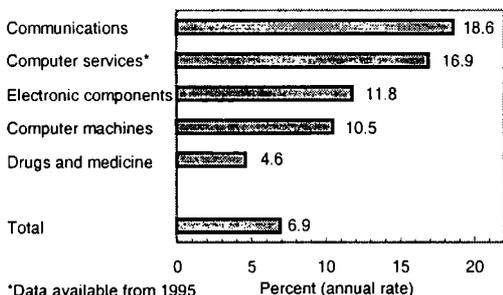
ARTICLE

R&D Fuels New Economy

Industrial research and development has been a key factor behind the technological innovation that has been the defining feature of the New Economy. Recent trends in both basic research and overall R&D suggest a continued rapid pace of innovation and productivity growth.

R&D and the New Economy. Companies in industries associated with information technologies have sharply increased their spending on research and development over the last several years (see upper chart). The dramatic evolution of the technological landscape—including the expansion of the Internet,

Real Growth of Non-Federal Funds For Industrial R & D, 1993-1998

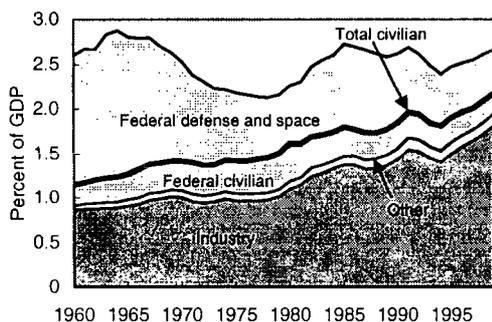


unlocking the genetic code, and the opening of the electromagnetic spectrum—has expanded the opportunities for research and development of new products. The resulting investments have spurred the creation of new and vastly more powerful consumer and business equipment—including the hardware and software that powers the Internet—which have contributed to the acceleration in productivity and

the transformation of many aspects of the economy. Interestingly, R&D is no longer restricted to manufacturing: the nonmanufacturing sector now accounts for about 30 percent of non-Federal R&D spending, with computer-related services the largest category.

Industrial R&D on the rise. Looking more broadly, R&D spending as a share of GDP is slightly below its mid-1960s peak, but the ratio of civilian R&D

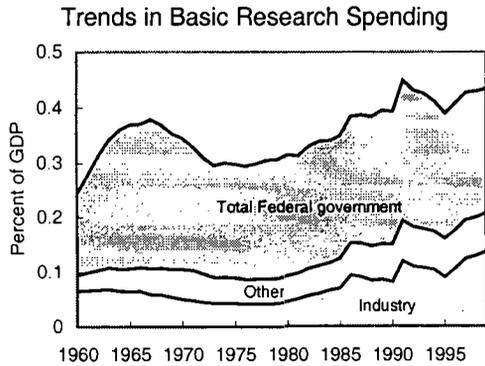
Sources of R&D Funding



spending—which excludes Federal defense and space R&D—to GDP is at an all-time high (see lower chart). Growth in company-financed R&D, which has been rising as a share of GDP for the past 5 years, accounts for more than 100 percent of the recent increase in the R&D intensity of the economy. Economic research emphasizes the close empirical connection between industrial R&D and productivity. Thus, the recent

strength in industrial R&D portends well for the pace of innovation and productivity over the next few years.

Industrial basic research is hot, too. Basic research plays a key role in determining the long-run pace of innovation and growth. Total funding of basic research as a share of GDP is at a near-record level (see chart). In the past, industry funded a rather small share of basic research, averaging about 17 percent



during the 1960s and 1970s. The Federal government has been the largest source of basic research funds, providing about 70 percent of funding over the same period. In the 1980s and 1990s, however, industry has increased its spending on basic research, and in 1998 it funded about 30 percent. The Federal government funded only about half of basic research in 1998, but this decline in the government share has mainly

resulted from the rise in other sources of basic research spending. In fact, Federal spending on basic research as a share of GDP has been relatively stable over the past three decades. About one-half of Federal basic research funding goes to life sciences (biology and medicine) and nearly 20 percent goes to physical sciences (with physics receiving about half).

Implications. Fundamental improvements in the technological landscape have contributed to a surge in industrial R&D investment that has been one of the engines driving the New Economy. Still, there is convincing evidence that the social return to R&D is much higher than the private return, and that private R&D investment is too low. Properly designed policies could increase the incentive for private R&D investment, inducing an even more rapid pace of research, innovation, and productivity growth.

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

Employees in Small Firms Differ from Those in Large Firms. Firms with fewer than 500 employees employed about 58 percent of private-sector workers in 1998, according to a recent study. However, these small businesses employed a disproportionately large share (63 percent) of the part-time workers. Small firms also employed a larger share of white and Hispanic employees than large firms. Conversely, 13 percent of large-firm employees were black, compared with only 10 percent of small-firm employees. A larger share of large-firm employees were middle-aged (35-55), but small firms employed a larger share of workers aged 55 and older. Small firms were more likely to hire less-educated workers: 52 percent of the small firm workforce had a high school diploma or less, compared with only 45 percent in large firms. In large firms, a greater share of employees had at least some college than in small firms. For older workers, workers looking for part-time employment, and less educated workers, greater job opportunities appear to be available in small firms than in large firms.

Exploring the Link between Cars and Jobs. Differences in car ownership rates among whites, blacks, and Latinos may explain some of the gap in unemployment rates between these groups, according to a recent study. The study found that, overall, whites are more likely to be employed than blacks or Latinos but that this gap nearly disappears among people with cars. In fact, the probability of being employed is even higher among blacks with cars than it is among whites with cars. The differences in employment rates between people with cars and people without cars are 38 percentage points for blacks, 31 percentage points for Latinos, and 22 percentage points for whites. While the difference between car owners and non-car owners is reduced by controlling for characteristics such as age, sex, and education, the relative differences by race and ethnicity are not. The effect of car ownership on the black employment rate was found to be greatest in metropolitan areas where blacks live farthest from job opportunities and where people rely most on private cars to commute to work. Although statistical difficulties make it hard to draw strong conclusions about causation, the study finds that raising car ownership rates among blacks and Latinos to that of whites would reduce the black/white and Hispanic/white unemployment rate gaps.

NCLR Issues Report on Latino Workers. *Moving up the Economic Ladder: Latino Workers and the Nation's Future Prosperity*, is part of the National Council of La Raza's State of Hispanic America series and represents a cooperative effort with academic researchers. The report describes the growing importance of Hispanic workers to the U.S. economy, but it also shows that economic restructuring and the trend toward low-quality jobs have hurt Latino workers. Echoing the recent CEA White Paper on Hispanic educational attainment, the report highlights the payoff to attending and completing college in improving wages. At present, however, Hispanic men especially have a stagnant position in the labor force—in part, according to the report, because the employment networks they rely on (kinship and friendship) reinforce their concentration in low-wage work.

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INTERNATIONAL ROUNDUP

Organizations See Mixed Progress toward Development Goals. World poverty can be significantly reduced by 2015 if developing and industrialized countries implement their commitments to attack the root causes of poverty, according to a report jointly authored by the UN, IMF, OECD, and World Bank. In assessing progress toward seven interrelated development goals set during world conferences in the 1990s, the report concludes that, while there has been progress, much more needs to be done. The report found, for example, that more than 100 million children will not be enrolled in school in 2015 if current trends prevail; the proportion of people living on less than \$1 per day fell rapidly in parts of Asia (notably China), but little or not at all in Africa; the gender gap in school enrollment is narrowing, but not fast enough to reach the goal of eliminating disparities by 2005; for every country that has decreased infant and under-age-5 child mortality rates fast enough to reach the goals, 10 lagged behind and one country moved backwards; and by 1997 fewer than half the countries in the world had strategies for environmental sustainability.

ILO Assesses Unemployment Insurance and Other Social Protection. Three-quarters of the 150 million people unemployed around the world lack any unemployment protection, according to the new *World Labor Report 2000* from the International Labor Office (ILO). The report emphasizes the need to build and strengthen the social safety net everywhere, but especially in developing countries. The report notes that for those who work in the rural or urban informal sectors in developing countries—including 750 to 900 million underemployed workers—hardly any unemployment protection exists at all. It also argues that even the world's richest countries in Europe and North America reduced protection provided by unemployment insurance in the 1990s.

UN Ranks United States Third in Human Development. Canada and Norway achieved the top rankings in the latest UN Human Development Index (HDI), with the United States placing third, according to the UN's *Human Development Report 2000*. The HDI, a measure combining life expectancy, adult literacy rates, gross school enrolment ratios, and GDP per capita, measures average achievement in basic human development across 174 countries in 1998. It reveals widespread regional differences, with East Asia (excluding China) and Latin America having much higher HDIs than sub-Saharan Africa. Dramatic differences also exist between countries with similar levels of income. Belize, for example, with a GDP per capita of \$4,566 ranks 58th, while Tunisia, with a slightly higher GDP per capita of \$5,404, ranks 101st. The source of this discrepancy lies in Belize's higher adult literacy rate (92.7 versus 68.7 percent) and longer life expectancy at birth (74.9 versus 69.8 years). Twenty-two countries from Africa and the former Eastern Bloc have experienced reversals in human development since 1990 due mainly to the AIDS epidemic, economic stagnation, and conflicts.

RELEASES THIS WEEK

Employment and Unemployment

****Embargoed until 8:30 a.m., Friday, July 7, 2000****

In June, the unemployment rate was 4.0 percent; it was 4.1 percent in May. Nonfarm payroll employment increased by 11,000.

Leading Indicators

The composite index of leading indicators decreased 0.1 percent in May following no change in April.

NAPM Report on Business

The Purchasing Managers' Index decreased 1.4 percentage points in June to 51.8 percent. (A reading above 50 percent indicates that the manufacturing economy is generally expanding.)

MAJOR RELEASES NEXT WEEK

Producer Prices (Friday)

Retail Sales (Friday)

Industrial Production and Capacity Utilization (Friday)

U.S. ECONOMIC STATISTICS

	1970- 1993	1999	1999:3	1999:4	2000:1
Percent growth (annual rate)					
Real GDP (chain-type)	2.9	4.6	5.7	7.3	5.5
GDP chain-type price index	5.2	1.6	1.1	2.0	3.0
<u>Nonfarm business (NFB) sector:</u>					
Productivity (chain-type)	1.7	3.7	5.0	6.9	2.4
Real compensation per hour:					
Using CPI	1.0	1.7	2.0	0.9	0.2
Using NFB deflator	1.5	2.9	4.0	1.8	1.8
Shares of Nominal GDP (percent)					
Business fixed investment	11.4	12.6	12.7	12.5	13.0
Residential investment	4.5	4.4	4.4	4.4	4.4
Exports	8.2	10.8	10.8	10.9	10.9
Imports	9.2	13.5	13.8	14.0	14.3
Personal saving	6.6	1.7	1.5	1.3	0.2
Federal surplus	-2.8	1.2	1.4	1.2	2.1
<hr/>					
	1970- 1993	1999	April 2000	May 2000	June 2000
Unemployment Rate (percent)	6.7**	4.2**	3.9	4.1	4.0
Payroll employment (thousands)					
increase per month			410	171	11
increase since Jan. 1993					22099
Inflation (percent per period)					
CPI	5.8	2.7	0.0	0.1	N.A.
PPI-Finished goods	5.0	2.9	-0.3	0.0	N.A.

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

New or revised data in **boldface**.

Employment and unemployment data **embargoed until 8:30 a.m., Friday, July 7, 2000.**

FINANCIAL STATISTICS

	1998	1999	May 2000	June 2000	July 6, 2000
Dow-Jones Industrial Average	8626	10465	10580	10583	10481
Interest Rates (percent per annum)					
3-month T-bill	4.78	4.64	5.79	5.69	5.85
10-year T-bond	5.26	5.65	6.44	6.10	6.05
Mortgage rate, 30-year fixed	6.94	7.43	8.52	8.29	8.16
Prime rate	8.35	8.00	9.24	9.50	9.50

INTERNATIONAL STATISTICS

Exchange Rates	Current level July 6, 2000	Percent Change from	
		Week ago	Year ago
Euro (in U.S. dollars)	0.953	0.1	-7.0
Yen (per U.S. dollar)	107.4	2.2	-11.9
Major currencies index (Mar. 1973=100) (trade-weighted value of the U.S. \$)	97.08	0.6	0.3

International Comparisons ^{1/}	Real GDP growth	Unemployment rate	CPI inflation
	(percent change last 4 quarters)	(percent)	(percent change in index last 12 months)
United States	5.1 (Q1)	4.0 (Jun)	3.1 (May)
Canada	4.9 (Q1)	6.8 (Apr)	2.4 (May)
Japan	0.7 (Q1)	4.9 (Apr)	-0.7 (May)
France	3.3 (Q1)	9.8 (Mar)	1.5 (May)
Germany	2.3 (Q1)	8.4 (Apr)	1.4 (May)
Italy	3.0 (Q1)	11.3 (Jan)	2.4 (May)
United Kingdom	3.0 (Q1)	5.8 (Feb)	3.1 (May)

U.S. unemployment data **embargoed until 8:30 a.m., Friday, July 7, 2000.**

^{1/} For unemployment data, rates approximating U.S. concepts as calculated by the U.S. Department of Labor, Bureau of Labor Statistics.