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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

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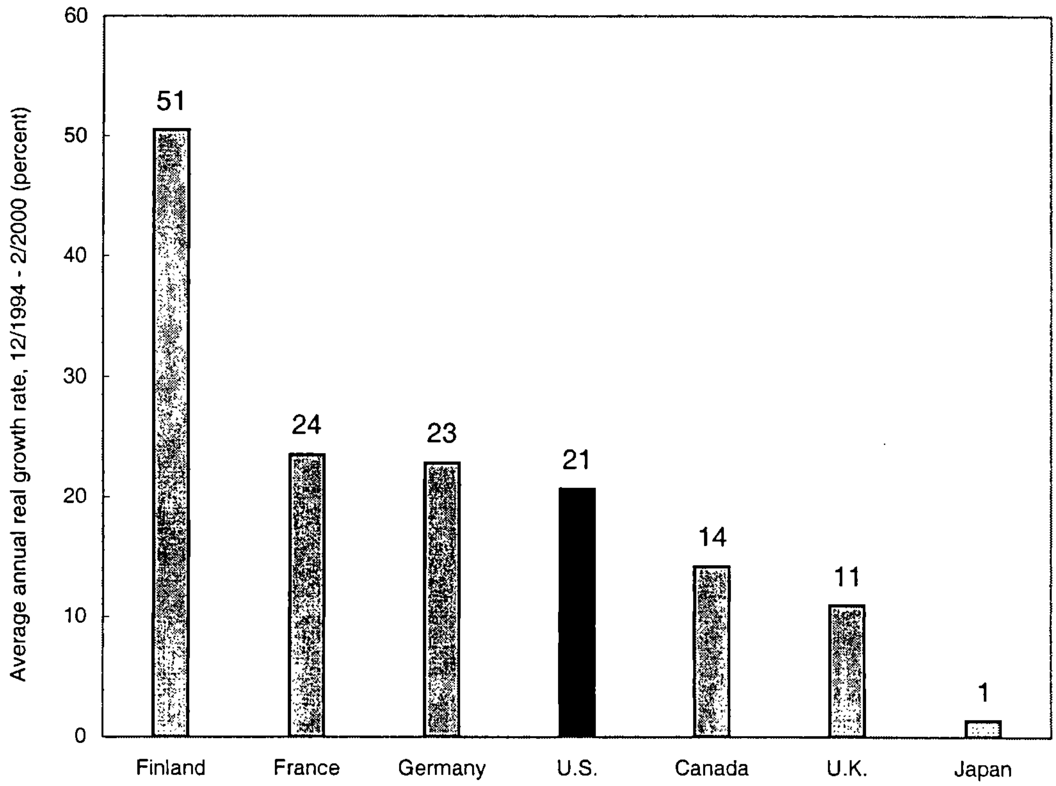
Baily
Podesta
Pg 2:
Sperling

March 31, 2000

CHART OF THE WEEK

U.S. Not Alone in Stock Market Boom



Stock markets have boomed in many developed countries over the last 5 years. In fact, real stock gains in Finland, France, and Germany exceeded those in the United States over that time. Finland's amazing stock market boom is primarily driven by the impressive performance of one technology firm, Nokia. In contrast, Japan's weak economy has contributed to a stagnant market.

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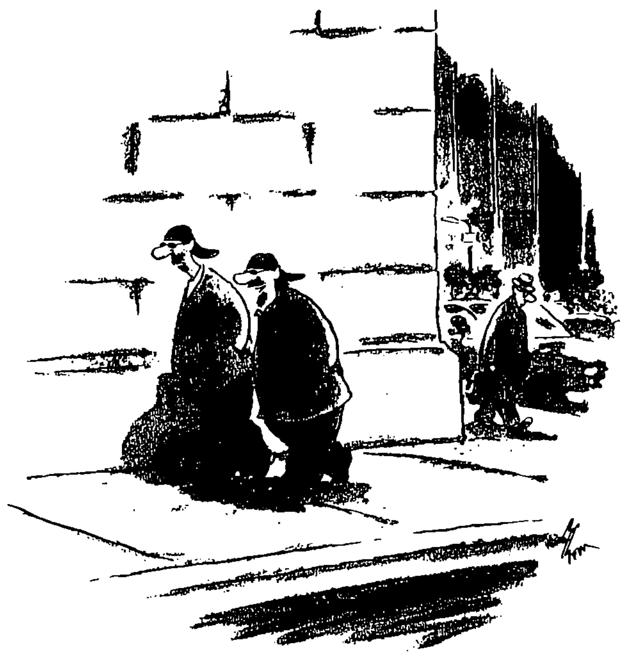
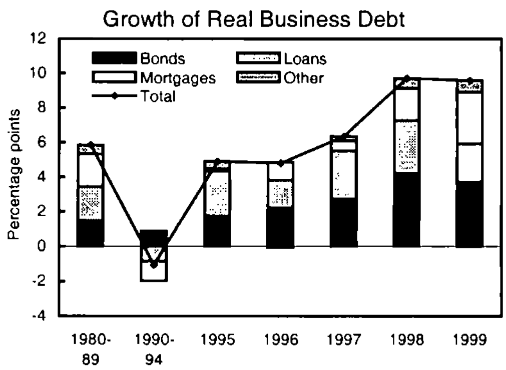


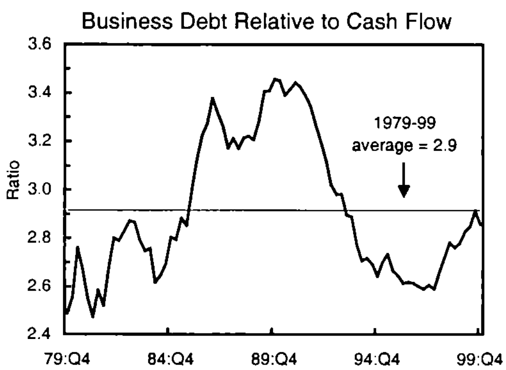
"Have you ever wanted something so bad that you'd actually save up the money to buy it?"

CURRENT DEVELOPMENT

The Financial Condition of Businesses

Business borrowing was robust in 1999 for the second straight year. But strong cash flow has kept the debt burden manageable. Other indicators suggest businesses generally enjoy good financial health.





Business debt is on the rise ... Real debt in the non-financial business sector climbed 9.6 percent in 1999, nearly the same rate as in 1998 (see upper chart). Commercial mortgage borrowing was especially strong last year, accounting for about a third of the total increase in business debt. Corporate bond issuance continued to soar, with bond financing accounting for about 40 percent of debt growth. Banks, however, tightened terms on business loans in 1999, according to Federal Reserve surveys, and bank loans accounted for a relatively low 23 percent of debt growth.

... but, the debt burden remains under control. Real cash flow increased 6.5 percent in 1999, marking the third consecutive year that cash flow growth lagged behind borrowing. As a result, the debt-to-cash flow ratio is up about 10 percent from its low mid-1990s level, and is now close to its long-run average (see lower chart). Low interest rates, however, have helped to keep the debt service burden from escalating. The ratio of interest payments to cash flow over the last few years has remained low and stable. Both ratios are well below their peaks reached in the 1980s.

Other indicators of business sector health. Delinquency rates and business failures remained at very low levels, although both picked up somewhat in 1999. However, the default rate on high-yield "junk" bonds reached levels not seen since the 1990-91 recession and more non-financial debt was downgraded than was upgraded in 1999, indicating some financing difficulties for some firms.

Businesses mirror households. Robust cash flow gains and low interest rates have allowed business debt to surge without a dangerous rise in debt burden. This pattern mirrors that of household finances reported in an earlier *Weekly Economic Briefing*. An economic downturn, coupled with higher interest rates, could push up the debt burden appreciably, but most likely not to the levels of the 1980s.

Gene
By JK

SPECIAL ANALYSIS

Who Feels the Pain of Higher Oil Prices?

With significant improvements in energy efficiency and structural change, the economy is much less dependent on oil today than it was a quarter century ago. Since 1974, U.S. petroleum consumption has increased 17 percent while the economy has grown nearly 120 percent. Nonetheless, the rise in oil prices over the past year has increased the costs to users of petroleum products.

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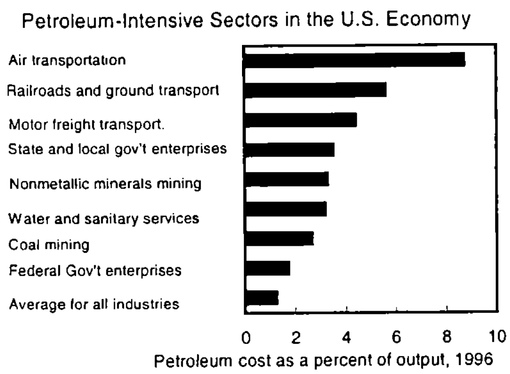
Impacts of gasoline prices on the typical household. The national average price for gasoline appears to have plateaued this month just above $1.50 per gallon. The average gasoline price this year will likely be about 30 cents per gallon higher than last year ($1.14 per gallon in 1999). The typical household will pay over $300 more to fill up its vehicles in 2000 than in 1999, representing more than a 25 percent increase. Nevertheless, gasoline cost as a share of a household's income has fallen significantly over the past 20 years. In 1980, the typical household spent 5 percent of its income to fuel its vehicles, while in 2000, fueling costs will require about 1.6 percent of the typical household's income.

Impacts of gasoline prices on motor vehicle purchases. In 1999, more than 16.8 million cars and light trucks (including SUVs) were sold in the United States. So far this year, the pace of new vehicle purchases is even higher; light weight vehicle sales in February exceeded an annual rate of 19 million units. In recent years, the average fuel economy of all new motor vehicles purchased has fallen as consumers have shifted away from more fuel-efficient automobiles to less fuel-efficient light trucks. The costs to fuel vehicles vary significantly. For example, assuming an average of 11,300 miles traveled per year, it will cost the typical driver this year more than $1800 to fuel a Ferrari 550, about $1000 for a Jeep Grand Cherokee, about $850 for a Dodge Caravan, more than $600 for a Toyota Camry, and less than $400 for a Volkswagen New Beetle. Still, the recent high gasoline prices do not appear to have influenced America's love affair with SUVs despite their high fuel costs.



Impacts of oil prices on airlines. The air transportation industry spends 7 times as much for petroleum products per unit of economic output than the average industry (see chart). However, between 1987 and 1996, the air transportation sector reduced the petroleum intensity of its output by 22 percent. This reflects in part the significant improvement in fuel economy of airplanes manufactured by Boeing. High oil prices would not appear to provide a competitive advantage to either Boeing or Airbus, the two largest airplane manufacturers in the world, because of the similar fuel economies of their comparable models. While fuel costs are an important component of operating costs for airlines, they do not always serve as a good predictor of changes in airfares.

Impacts of diesel prices on motor freight. Expenditures on petroleum products represent less than 4½ percent of economic output for the motor freight transportation and warehousing industry. However, fuel costs of small carriers may make up more than three times as much of their operating costs as large carriers. With the average price for diesel estimated to be nearly 30 cents per gallon higher this year than last, tractor-trailer operators will likely have to pay over $3,000 more to fuel their trucks this year compared to last year.

Impacts of oil prices on state and local governments. Petroleum products represent nearly 7 percent of all input costs for state and local governments. Higher oil prices can increase the costs of operating various government vehicle fleets, such as police cars, fire trucks, and school buses. For example, with the increase in diesel prices, the costs of operating a school bus will increase on average by more than $250 this year over last year.

Conclusion. While the recent increase in oil prices appears to have less effect on the economy than previous hikes in oil prices, those who rely on petroleum products have experienced a significant increase in costs. Improvements in energy efficiency and higher incomes have helped many consumers adapt to higher fuel prices.

ARTICLE

The Experience of Foreign Investors in China

China's WTO accession will give foreign firms the right to distribute products in China directly. A recent study draws on extensive interviews with managers and professionals in foreign (disproportionately American) firms in China and sheds light on the potential benefits of these rights. Foreign investors find the murky legal environment a challenge; nevertheless, the study highlights the steady trend towards increased transparency and reliance on the rule of law. WTO accession will further this trend.

The murky legal environment. The study notes that China had no legal system in the Western sense in 1977. Shortly after its founding, the People's Republic of China had declared all previous laws invalid—but never replaced them with a new code of law. Instead, China relied on often secret decrees, bureaucratic regulations, and personal orders of various officials. In the late 1970s, China began promulgating new laws and codes. Although numerous gaps still remain, China has by now published and circulated the major laws affecting foreign enterprises.

Even with this progress, the legal system is clearly in transition. Existing laws are often ambiguous, so that the distinction between what is permissible and what is not often depends less on clearly stated codes, and more on personal relationships with influential officials. Businesses find these legal ambiguities to be a source of risk, since official interpretations might change. On the other hand, they see a need to move aggressively to avoid being boxed out by competitors.

Legal hurdles to selling in China. Many of the firms in the study invested in China to gain access to the Chinese market. However, they continue to face significant obstacles in selling their products there. Foreign firms face severe legal limitations on their ability to provide distribution and other services (such as after-sales maintenance). Because these services are so crucial to selling their products in China, foreign firms have become more deeply involved in distribution than the law might suggest is possible. For example, they work hard to exploit subtle loopholes in ambiguous laws; they may also let a Chinese firm technically provide the needed services—with the foreign firm in fact providing all the actual management and marketing.

Conclusions. WTO accession will alleviate the need for creative efforts to circumvent restrictions on distribution and services, and reduces uncertainty about whether current legal interpretations will change. Clear rules benefit Chinese firms as well as foreigners. Nevertheless, complete reliance on a rule of law will take time, since the necessary institutions, skills, and culture are not yet developed. As the study notes, China is in a transition that will take decades to complete."

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BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

Job Corps Does Good. Participation in the Job Corps raises initial education and earnings outcomes and reduces arrests and incarcerations, especially for those aged 16 and 17, according to a recent study. A sample of youths eligible for Job Corps were randomly assigned to either a program group or a control group in the mid-1990s and then followed for 30 months. Job Corps led to more education and training, higher GED attainment, and large increases in vocational certification relative to the control group, even though many control group members participated in other education and training activities. Arrests, convictions, and incarcerations were about 20 percent lower and average earnings were significantly higher for Job Corps participants. Self-reported alcohol and illegal drug use and family formation were unaffected by program participation. A full cost-benefit analysis of this more-than-$1-billion-per-year program awaits completion of a 48-month follow-up study.

Asian Crisis Hit States' Manufacturing Exports. A recent study finds that most states' exports to East Asia declined during the East Asian crisis, but the severity of the decline varied across states. East Asian markets accounted for 30 percent of U.S. merchandise exports prior to the crisis. Six states had manufacturing exports to East Asia of more than $1,000 per capita prior to the crisis, and 19 states exported more than $500 per capita. In general, western states—especially Alaska, Arizona, and California—were more dependent on East Asian markets, and were hit hardest by the trade shock. Overall, forty states experienced declines in exports to East Asia from 1997 to 1998, with seven states and the District of Columbia seeing exports to East Asia fall by more than 30 percent.

Another Look at Adolescent Fertility. As reported in a previous *Weekly Economic Briefing*, the birth, pregnancy, and abortion rates for teens aged 15-19 have declined in recent years. A study released by the National Center for Health Statistics examines these and related trends in greater depth. One of the interesting findings is related to changes in the rates of teens having their second child. The teen birth rate for a first child declined 10 percent between 1991 and 1997 (with most of the decline occurring in the final 2 years). The rate of second births to teenagers has fallen even more sharply, 21 percent since 1991. This decline was especially evident for African-American teenagers, for whom the second birth rate dropped 28 percent. The study also finds that among the factors accounting for the overall falling teenage pregnancy rates are decreased sexual activity, increased condom use, and the adoption of injectable and implant contraceptives. The switch from the pill to Depo-Provera and Norplant among African-American teenage mothers may be an important factor in the recent sharp decline in their second birth rates during the 1990s.

INTERNATIONAL ROUNDUP

EU Sets Strategic Economic Goals. European Union leaders agreed to a broad set of economic and social initiatives that are intended to strengthen employment, promote innovation, and prepare for the transition to a knowledge-based economy. One goal is to raise the employment rate from 61 percent today (compared to 74 percent in the United States) to 70 percent by 2010, while increasing the employment rate of women from 51 percent (67 percent in the United States) to 60 percent. Proposed policies include a Europe-wide database on jobs and learning opportunities, promotion of training for the service sector, and improved childcare provision. The Council advocated the completion of a single EU market, by eliminating barriers to trade in services and liberalizing public utilities. In the area of information technology, the Council called for adopting pending legislation on the legal framework for electronic commerce and introducing greater competition in local access networks before the end of 2000 to substantially reduce the costs of Internet access. The latter proposal would be similar in many respects to the U.S. Telecommunications Act of 1996. The Council also urged the Member States to ensure that all schools have access to the Internet by the end of 2001.

Combating TB. Last week, 20 countries heavily burdened by Tuberculosis (TB) participated in a Ministerial Conference on TB and Sustainable Development, hosted by the World Bank and the World Health Organization. Around 8 million people annually become sick with TB, and about 2 million die each year from the disease, 98 percent of which are in developing countries. Moreover, inadequate supplies of drugs, ineffective treatment, and poor management increase the risk of an outbreak of drug-resistant TB, which is extremely costly to treat. A proven cost-effective strategy of fighting TB called DOTS (Directly Observed Treatment, Short-course), which stresses close observation of dosages, has been available for many years. The DOTS program costs between $10 to $20 per patient, and has a cure rate of about 80 percent (compared with 45 percent for non-DOTS areas). As of 1998, 119 countries have adopted DOTS, and 43 percent of the global population had access to this program; still, only 21 percent of estimated global TB cases received DOTS. The Conference set a goal of providing DOTS to 70 percent of TB cases by 2005.

Japan to Cut Retirement Benefits. Japan's parliament voted this week to reduce retirees' pensions and raise the retirement age to stabilize the long-term funding of the public pension system. This reform will cut public pension benefits for new retirees by 5 percent on April 1 and will gradually raise the age at which retirees start to receive benefits from 60 to 65 by 2025. Japan's public pension account is expected to run a deficit this year. An aging society and low birth rate will only exacerbate this problem. While there were 4.2 working age people for every person age 65 or over in 1998, this ratio is expected to drop to 2.2 in 2025 and to 1.7 in 2050. Some economists have argued that the new reforms do far too little, as the current pay-as-you-go pension system is unsustainable and needs a drastic overhaul.

RELEASES THIS WEEK

Gross Domestic Product

According to revised estimates, real gross domestic product grew at an annual rate of 7.3 percent in the fourth quarter of 1999.

Consumer Confidence

Consumer confidence, as measured by The Conference Board, declined 4.1 index points in March, to 136.7 (1985=100).

MAJOR RELEASES NEXT WEEK

NAPM Report on Business (Monday)
Leading Indicators (Tuesday)
Employment (Friday)

U.S. ECONOMIC STATISTICS

	1970-1993	1999	1999:2	1999:3	1999:4
Percent growth (annual rate)					
Real GDP (chain-type)	N.A.	**4.6**	1.9	5.7	**7.3**
GDP chain-type price index	N.A.	1.6	1.3	1.1	2.0
Nonfarm business (NFB) sector:					
Productivity (chain-type)	1.7	3.6	0.6	5.0	6.4
Real compensation per hour:					
Using CPI	1.0	1.7	1.4	2.1	0.8
Using NFB deflator	1.5	3.0	2.9	4.0	2.1
Shares of Nominal GDP (percent)					
Business fixed investment	11.4	12.6	12.6	12.7	12.5
Residential investment	4.5	4.4	4.5	4.4	4.4
Exports	8.2	10.8	10.7	10.8	10.9
Imports	9.2	13.5	13.4	13.8	14.0
Personal saving	6.6	1.7	1.8	1.5	1.3
Federal surplus	-2.8	**1.2**	1.3	1.4	**1.2**

	1970-1993	1999	December 1999	January 2000	February 2000
Unemployment Rate (percent)	6.7**	4.2**	4.1	4.0	4.1
Payroll employment (thousands)					
increase per month			309	384	43
increase since Jan. 1993					20823
Inflation (percent per period)					
CPI	5.8	2.7	0.2	0.2	0.5
PPI-Finished goods	5.0	3.0	0.1	0.0	1.0

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

New or revised data in **boldface**.

FINANCIAL STATISTICS

	1998	1999	January 2000	February 2000	March 30, 2000
Dow-Jones Industrial Average	8626	10465	11281	10542	10980
Interest Rates (percent per annum)					
3-month T-bill	4.78	4.64	5.32	5.55	5.71
10-year T-bond	5.26	5.65	6.66	6.52	6.06
Mortgage rate, 30-year fixed	6.94	7.43	8.21	8.33	8.23
Prime rate	8.35	8.00	8.50	8.73	9.00

INTERNATIONAL STATISTICS

Exchange Rates	**Current level March 30, 2000**	**Percent Change from**	
		Week ago	**Year ago**
Euro (in U.S. dollars)	0.959	-1.0	-10.6
Yen (per U.S. dollar)	105.5	-1.8	-12.1
Major currencies index (Mar. 1973=100) (trade-weighted value of the U.S. $)	95.44	-0.5	-0.3

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	4.6 (Q4)	4.1 (Feb)	3.2 (Feb)
Canada	4.7 (Q4)	6.8 (Jan)	2.7 (Feb)
Japan	0.0 (Q4)	4.7 (Dec)	-0.9 (Jan)
France	3.2 (Q4)	10.4 (Dec)	1.4 (Feb)
Germany	2.3 (Q4)	8.7 (Jan)	1.8 (Feb)
Italy	2.1 (Q4)	11.1 (Oct) [2]	2.4 (Feb)
United Kingdom	3.0 (Q4)	5.9 (Nov)	2.3 (Feb)

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.