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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

January 7, 2000

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Pg 7 - Reed/Echaveste/Podesta
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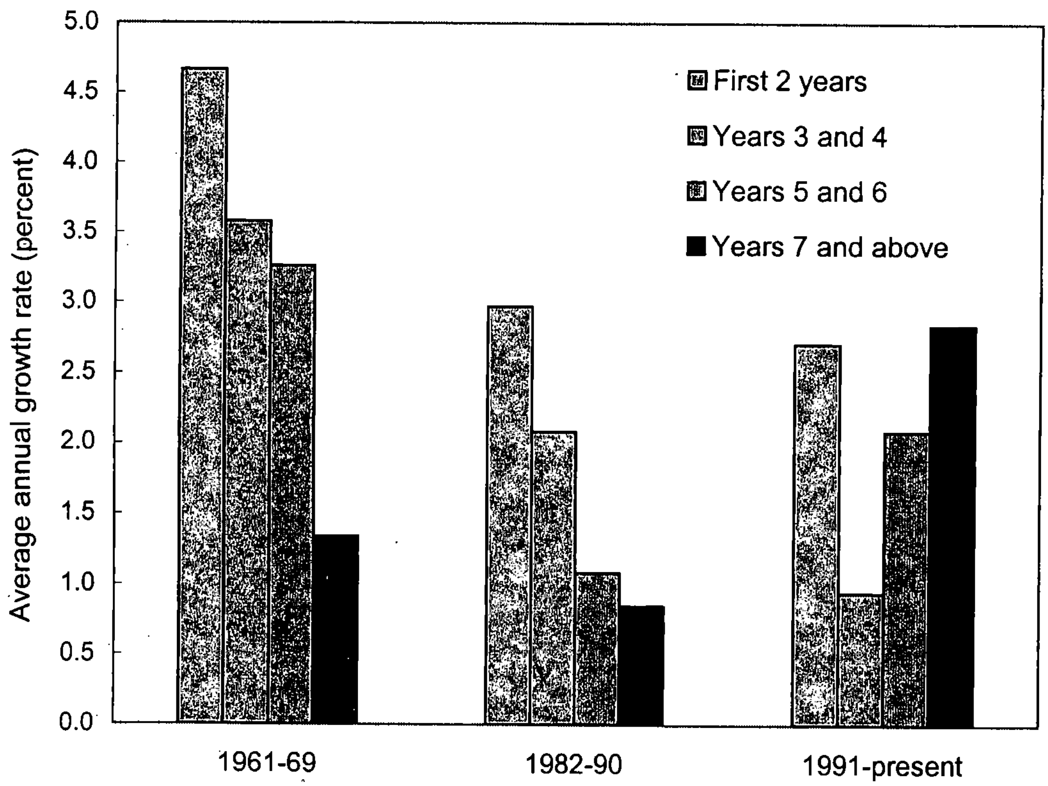
CHART OF THE WEEK

Growth in Nonfarm Output per Hour During Expansions



Productivity growth tends to be strong in the early stages of an expansion as idle resources are put back to work. But the rate of growth of productivity tends to fall as the expansion matures. While this was true of the other two long postwar expansions, it has not been true in the current expansion, with nonfarm productivity growth strongest in the later years. A Special Analysis in this Briefing examines possible reasons for this acceleration.

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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

January [illegible]

CHART OF THE WEEK

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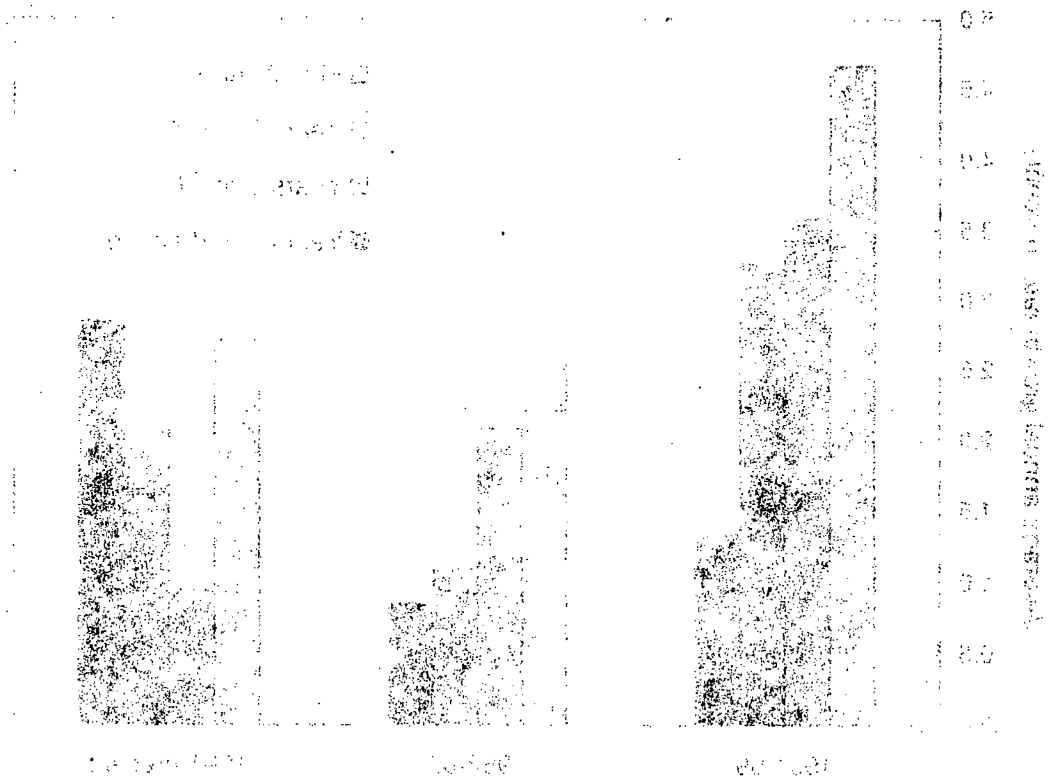

Productivity [illegible] in the early stages of an expansion [illegible] ... [illegible] the rate of growth of productivity tends to [illegible] as the expansion matures [illegible] ... [illegible] the current expansion [illegible] ... [illegible] Briefing [illegible]

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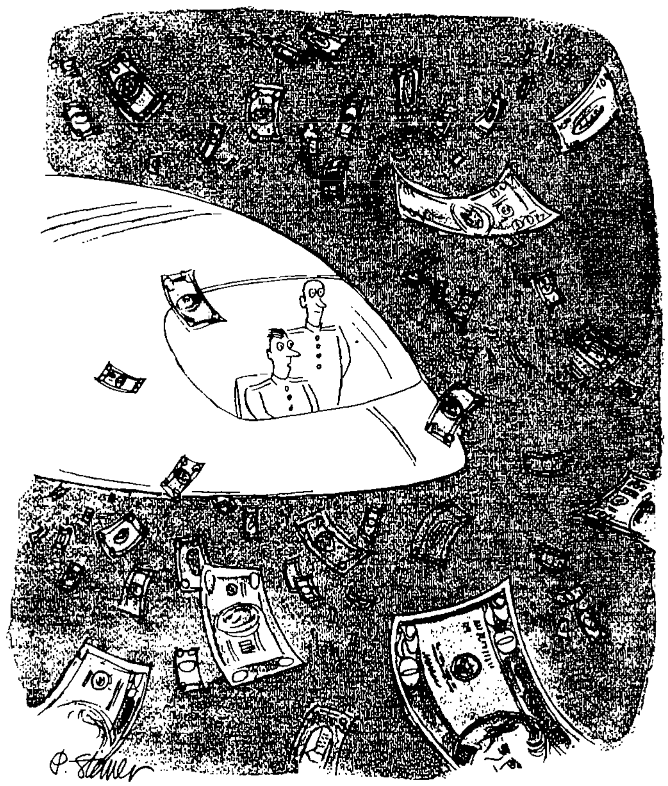

"Captain, it looks like we've entered cyberspace."

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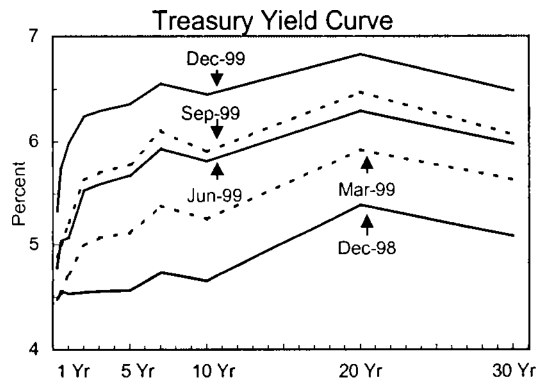
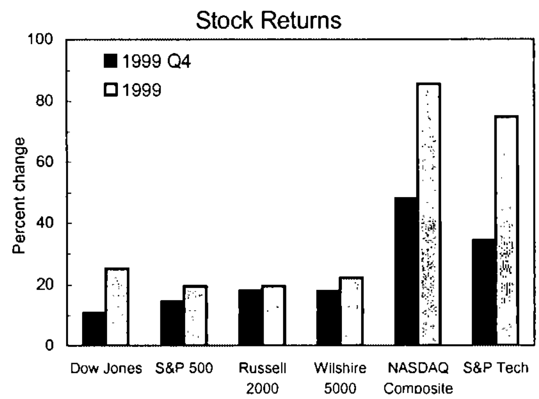
FINANCIAL MARKET UPDATE

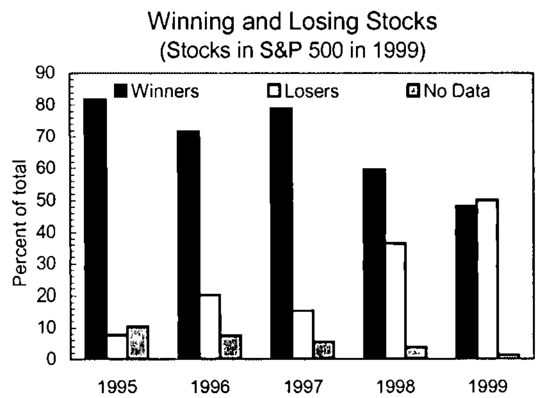
Fourth Quarter 1999

Stock prices soared in the last quarter of 1999, led by technology companies. All major indexes closed out 1999 at record highs. The Federal Reserve raised its target lending rate in November but made no further move in December. Market concerns about future rate hikes have kept yields on long-term Treasuries near 2-year highs.

Interest Rates. Treasury rates increased over the past 3 months at all maturities (see top chart). In November, when the Federal Reserve raised its federal funds target rate 25 basis points to 5½ percent, it cited the shrinking pool of available workers and the potential inability of production to keep pace with demand. Signaling a commitment to help smooth the year-2000 transition, the Fed made no further move in December despite continued concerns about increasing inflationary pressures. However, federal funds futures rates rose at the end of December, indicating that the market expects the Fed to raise rates again in February.







Stock prices. The Standard and Poor's 500 index grew a robust 15 percent in the fourth quarter, but technology-based indexes performed even better, illustrating the strength of the technology sector relative to the market as a whole (see middle chart). In particular, the NASDAQ significantly out-performed other major indexes, gaining 48 percent in the fourth quarter alone and 86 percent for 1999.

Concentrated gains. Although the broad indexes showed strong growth, gains were more concentrated than in previous years. For example, in 1999 the S&P 500 grew about 20 percent, yet fewer than half of all stocks in the index realized any gains (see bottom chart). In contrast, over 70 percent of these stocks saw price increases in 1996, even though the index as a whole grew at about the same rate as in 1999.

Happy New Year? Stock prices have been volatile this week. After falling sharply in the first few days, the Dow recouped some its losses and the S&P 500 stabilized. Technology stocks were particularly hard hit, however, with the NASDAQ falling over 8 percent through Thursday.

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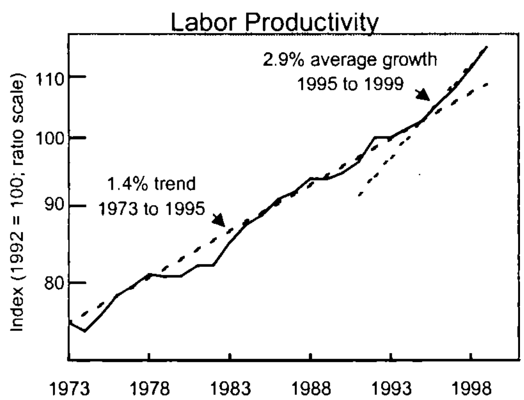
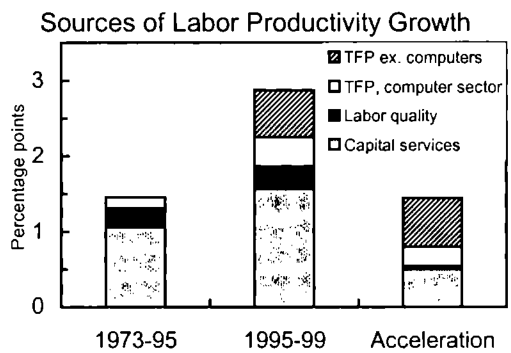
SPECIAL ANALYSIS

Accounting for the Surge in Productivity Growth

Labor productivity trended upward at an average annual rate of 1.4 percent from 1973 to 1995, but it has since accelerated to a 2.9 percent annual clip over the past 4 years (see upper chart). CEA analysis finds that half of this acceleration is accounted for by an increase in capital—especially computer capital—and by productivity growth in the computer-producing sector.





More capital per worker. Labor productivity increases when workers have more capital to work with. Partly because business investment as a share of GDP has been above its long-term average since 1995, capital services per hour have grown faster since 1995 as well. Analysis of preliminary data indicates that this capital deepening accounted for 1.5 percentage points of annual labor productivity growth during the 1995-99 period, up from 1.1 percentage points during the 1973-95 period (see lower chart). Thus, the increase in capital services per hour accounts for about a third of the 1.5 percentage point increase in annual productivity growth. Most of this gain from capital deepening is accounted for by investment in computers and software.

Computer quality. Besides their role in capital deepening, computers enter GDP directly as a flow of new investment. Hence, productivity growth in the production of computers contributes directly to overall productivity growth. Productivity growth has been particularly rapid in the computer-producing sector, as reflected in the rapid decline in computer prices. Price declines for computers, which had been running at a 15 percent average annual rate before 1995, fell at a 27 percent annual rate thereafter, indicating an acceleration in computer quality after 1995. Improved computer quality added an estimated 0.25 percentage point to the post-1995 productivity acceleration.

Work force quality. The American work force has become better educated, and, since about 1980, the average worker has had more work experience. However, nothing dramatically new happened to the index of labor composition after 1995, and the estimated contribution of work force quality to productivity growth of 0.3 percentage point per year since 1995 is only slightly above the pre-1995 pace.

Total factor productivity. According to these estimates, the combined effects of capital deepening, changing labor composition, and rising computer quality account for about half of the post-1995 acceleration in productivity. The residual, called total factor productivity (TFP), reflects all the other factors that affect productivity growth. These may include cyclical influences and new efficiencies from the use of the Internet, especially for business-to-business transactions.

Outlook. Can the factors that account for the more rapid pace of labor productivity growth since 1995 be sustained? Of course we cannot know for sure, but current trends are positive and Administration policies are supportive.

- Capital deepening. The growth rate of capital services per hour increased in 4 of the past 5 years, reaching 5.4 percent in 1999—a rate that implies a 1.8-percentage-point per year contribution of capital deepening to labor productivity growth. For 2000, the pace of capital deepening is likely to increase further, because the level of investment is already very high. Projections over the longer run are more speculative, but the level of nominal investment is expected to remain high relative to nominal output. Pursuing a budget policy of debt reduction also promotes investment.

- Computers. The pace of computer price declines has been particularly rapid over the past 4 years and may not be sustainable. However, the contribution of computers to productivity growth would still be important even if the rate of price declines slowed to the longer term rate of about 20 percent per year.

- Work force quality. The trend toward a more educated work force seems likely to continue with the Administration's policy of promoting human capital investment, and the average age of the work force will continue to rise through at least 2008, when the leading edge of the baby-boom generation retires. But these factors are not expected to accelerate, and the contribution of labor composition to productivity is not likely to change much from its historical average of 0.3 percentage point per year.

- Total factor productivity. This is the most difficult factor to forecast since it is a residual reflecting a wide variety of factors.

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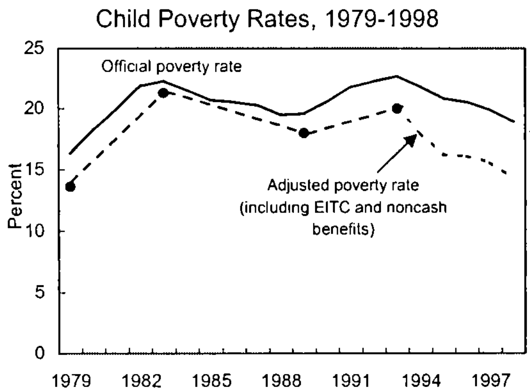
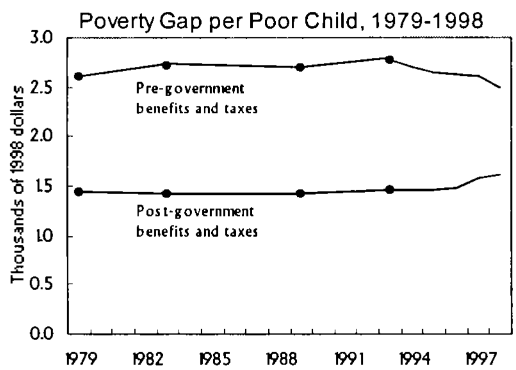
SPECIAL ANALYSIS

Recent Changes in the Safety Net and Child Poverty

Since 1993, the number of poor children has fallen by 2.3 million. However, a new study from the Center on Budget and Policy Priorities finds that the average poor child in 1998 was worse off than the average poor child in 1994. The study attributes this result to sharp declines in the number of poor children receiving cash assistance and food stamps. This conclusion must be interpreted cautiously, however, in light of the changing composition of the families who remain poor.

Trends in the child poverty rates. The official child poverty rate, which is based on a measure of income that includes earnings and cash assistance but excludes other benefits such as the EITC and food stamps, has declined sharply, from 22.7 percent in 1993 to 18.9 percent in 1998 (see upper chart). This is the lowest rate since 1980. The study finds that the decline is even sharper using a broader income measure that includes the EITC and noncash benefits such as food stamps.





The child poverty gap. To examine trends in the depths of poverty, the study focuses on a different statistic, the "child poverty gap," which measures the *amount* by which poor children's family income falls short of the poverty threshold. The study finds that, in 1998, the per child gap before taking into account government benefits and taxes was $2,489—the lowest it has been since 1979 (see lower chart). The net effect of taxes and transfers is to shrink the gap. However, the study finds that the post-tax-and-transfer gap per child has risen in recent years and, at $1,604 in 1998, was the largest on record and $149 higher than it was in 1994.

Together, these results imply that many low-income families with children boosted their earnings, taking advantage of the strong economy and welfare reform—but that these earnings gains have not been large enough to offset reductions in net transfers from government.

Analysis. This plausible but pessimistic interpretation is the one emphasized in the study. It notes that in both 1993 and 1995, 57 percent of poor children (before counting benefits based on income) received AFDC, while by 1998, only 41 percent of poor children received TANF. Child participation in the food stamp program also shows a downward trend: between 1995 and 1998, the number of children receiving food stamps declined by almost 27 percent while the number of poor children fell 10 percent.

While the data clearly show that the average child poverty gap has widened (based on the comprehensive, post-tax-and-transfer-income measure), the interpretation of this finding is difficult because the composition of the poor population has changed. The data do not track individuals over time, and the strong economy and policy initiatives such as EITC and minimum wage have been successful in helping many families escape poverty since 1993. To the extent that those who have escaped poverty had incomes closer to the poverty threshold to begin with than those left behind, the per child gap could have increased with no individual families becoming worse off. However, the narrowing of the pre-tax-and-transfer gap suggests that remaining poor families may in fact have both increased their earnings and experienced some decline in benefits.

Conclusion. Further research is required to learn more about how much of the change in the child poverty gap reported in the study reflects compositional effects and how much reflects changes in receipt of government benefits. Even so, the study highlights the plight of families where parents face the greatest barriers to employment, such as limited work experience, a disability, or difficulty in finding child care. This points to the importance in fighting poverty of continued efforts to ensure that low-income families receive the benefits for which they are eligible, and for finding innovative ways to reduce child poverty.

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BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

Children without Health Insurance Are Enrolled in Other Programs. Almost three-quarters of all low-income children without health insurance live in families that participate in other government programs, such as the National School Lunch, WIC, Food Stamp and Unemployment Compensation Programs. This finding by the Urban Institute suggests a new possibility for identifying uninsured children and encouraging their families to enroll them for Medicaid or CHIP coverage. Several localities are building outreach efforts around the National School Lunch Program, which serves the families of an estimated 60 percent of all low-income uninsured children. Programs already in existence include sending informational flyers to parents and positioning trained volunteers at schools to answer questions and help complete applications. Concerns such as the need to protect the privacy of lunch program applicants and the fact that Medicaid and CHIP programs require more information than the National School Lunch Program, still need to be addressed.

Bruce — we should be able to do something with this — BC

Enrollment of Foreign Students in U.S. Colleges Nears Half a Million. The number of foreign students attending colleges and universities in the United States increased 2 percent in the last school year to a record total of nearly 491,000, according to a recent study. China supplied the most students (10.4 percent), followed by Japan and Korea. Although foreign students compose only 3 percent of America's total higher education population, they contribute more than $13 billion dollars to the U.S. economy in money spent on tuition, living expenses, and related costs. With over three-quarters of that funded by overseas sources, higher education now ranks as the country's fifth largest service sector export, according to the study.

Maria E — we should be able to attract far more foreign students & encourage them to ... [illegible]

Survey Finds Grandparents Play Active Role in Families. Most grandparents regularly interact with their grandchildren, according to a survey of over 800 grandparents aged 50 and over. The survey, sponsored by the American Association of Retired Persons, found that more than 8 in 10 grandparents had talked with a grandchild on the telephone or had seen a grandchild in person in the previous month. It also found that 11 percent of grandparents are caregivers: 3 percent are raising a child and 8 percent provide day care on a regular basis. Roughly a third of the African American grandparents surveyed are caregivers—compared with roughly a fifth of the white grandparents. Grandparents spent a median of $489 per year for gifts, clothes, outings, tuition, and other purchases for their grandchildren. Among activities engaged in with grandchildren in the past month, the most frequently reported were eating together at home (72 percent) or eating out (65 percent). Other activities with responses in roughly the 40 to 55 percent range included watching a television comedy, having grandchildren stay overnight, shopping for clothes, engaging in exercise or sports, watching educational television, and going to religious services. Asked to rate their relationship with a grandchild on a scale of 0 to 10 (excellent), the mean answer was 8.7.

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1-10-00

INTERNATIONAL ROUNDUP

International Mergers Increase as Regulation Becomes More Complex. Last year was a record year for mergers and acquisitions, with more than $1.7 trillion in announced deals recorded in the United States, $1.2 trillion in Europe, and $162 billion in Asia. However, at the same time that mergers, particularly cross-border mergers, are rapidly increasing, merger control laws are becoming more numerous and complex. A survey of 99 international jurisdictions found that 28 countries and the European Union have substantially revised and strengthened existing competition laws in the past 3 years, and that 41 countries have instituted new merger control regulations in the past decade. The proliferation of regimes means that obtaining clearance for mergers and acquisitions worldwide is becoming increasingly complex, as companies must comply with merger notification requirements in different jurisdictions, each with its own rules, time frames, thresholds, and policy aims.

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EU and Mexico Reach Trade Agreement. At the end of November 1999, Mexico and the European Union agreed on the terms of a free trade area (FTA) between the two regions, although both partners must still approve the agreement. The agreement will include an FTA covering industrial and agricultural goods, a preferential agreement in services, an agreement covering investments, rules on competition and intellectual property, and an effective dispute settlement system. The agreement may help bolster the share of Mexico's imports coming from the EU. (This share had declined from an average of 14 percent in 1990-92 to 9 percent in 1998.) At the same time, the agreement may allow Mexico to decrease its dependence on U.S. markets, currently the destination for roughly 80 percent of Mexican merchandise exports. Anecdotal evidence suggests that the proposed free trade agreement is already stimulating foreign direct investment in Mexico. For instance, the Nissan-Renault automobile alliance recently announced a joint venture of $400 million in Mexico over the next 7 years.

Debt-for-Health Swap for Sub-Saharan Africa. Of the estimated 34 million people living with HIV/AIDS in the world today, 23 million live in sub-Saharan Africa. Infection rates approach a quarter of the adult population in several countries in the region and top 10 percent in many others. A shortage of funds hinders efforts to slow the spread of the epidemic and reduce its impact. Recent international debt relief programs, such as the Cologne Debt Initiative, may free up resources to address social problems, and a recent study argues that HIV/AIDS prevention should be placed at the top of the agenda for sub-Saharan Africa. The study reviews various debt-for-development swap programs since 1987 and recommends using the debt relief savings to establish a "counterpart fund" in debtor countries, with a top priority of implementing HIV/AIDS prevention programs. The study states that even with a modest amount of funding, the effect on HIV/AIDS prevention could be significant. For example, Uganda launched a national campaign against HIV/AIDS with less funding than what could be available to most other sub-Saharan countries through debt relief, and it has successfully reduced the HIV/AIDS prevalence rate among Uganda's teenagers from 28 percent in 1992 to 10 percent in 1996.

cc: Sandy
we should
press this hard
w/ other nations
who have to
work w/ Uganda
BC

PHOTOCOPY
WJC HANDWRITING

RELEASES THIS WEEK

Employment and Unemployment

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

In December, the unemployment rate was unchanged from November at 4.1 percent. Nonfarm payroll employment rose by 315,000.

NAPM Report on Business

The Purchasing Managers' Index fell 0.7 percentage point to 55.5 percent in December. (A reading above 50 percent indicates that the manufacturing economy is generally expanding.)

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	1998	1999:1	1999:2	1999:3
Percent growth (annual rate)					
Real GDP (chain-type)	3.0	4.6	3.7	1.9	5.7
GDP chain-type price index	5.2	1.1	2.0	1.3	1.1
Nonfarm business (NFB) sector:					
Productivity (chain-type)	1.7	3.1	2.7	0.6	4.9
Real compensation per hour:					
Using CPI	1.0	3.9	2.8	1.2	2.1
Using NFB deflator	1.5	4.7	2.9	2.9	4.4
Shares of Nominal GDP (percent)					
Business fixed investment	11.4	12.5	12.6	12.6	12.7
Residential investment	4.5	4.2	4.4	4.5	4.4
Exports	8.2	11.0	10.7	10.7	10.8
Imports	9.2	12.7	12.9	13.4	13.8
Personal saving	6.6	2.6	2.2	1.8	1.5
Federal surplus	-2.8	0.5	1.1	1.3	1.4

	1970-1993	1999	October 1999	November 1999	December 1999
Unemployment Rate (percent)	6.7**	**4.2****	**4.1**	**4.1**	**4.1**
Payroll employment (thousands)					
increase per month			**284**	**222**	**315**
increase since Jan. 1993					**20367**
Inflation (percent per period)					
CPI	5.8	N.A.	0.2	0.1	N.A.
PPI-Finished goods	5.0	N.A.	-0.1	0.2	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, January 7, 2000**.

FINANCIAL STATISTICS

	1998	1999	November 1999	December 1999	Jan. 6, 2000
Dow-Jones Industrial Average	8626	10465	10810	11246	11253
Interest Rates (percent per annum)					
3-month T-bill	4.78	4.64	5.07	5.20	5.25
10-year T-bond	5.26	5.65	6.03	6.28	6.57
Mortgage rate, 30-year fixed	6.94	7.43	7.74	7.91	8.15
Prime rate	8.35	8.00	8.37	8.50	8.50

INTERNATIONAL STATISTICS

Exchange Rates	**Current level January 6, 2000**	**Percent Change from**	
		Week ago	**Year ago**
Euro (in U.S. dollars)	1.032	3.0	-11.3
Yen (per U.S. dollar)	105.2	2.8	-6.7
Major currencies index (Mar. 1973=100) (trade-weighted value of the U.S. $)	92.62	-0.5	1.3

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	4.3 (Q3)	**4.1** (Dec)	2.6 (Nov)
Canada	4.2 (Q3)	7.2 (Oct)	2.1 (Nov)
Japan	1.0 (Q3)	4.7 (Oct)	-1.2 (Nov)
France	3.0 (Q3)	11.0 (Sep)	0.9 (Nov)
Germany	1.3 (Q3)	9.0 (Oct)[2]	1.0 (Nov)
Italy	1.2 (Q3)	12.1 (Apr)	2.0 (Nov)
United Kingdom	1.8 (Q3)	5.9 (Aug)	1.4 (Nov)

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

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 unified Germany.