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Weekly Economic Briefing of the President

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EYES ONLY

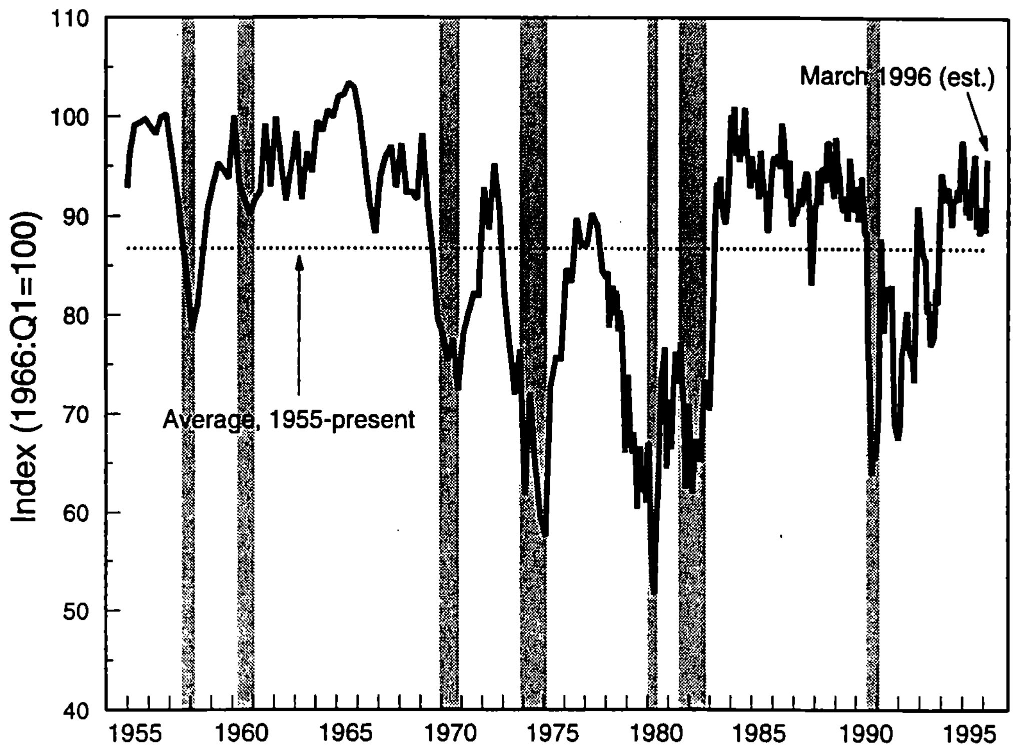
WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

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

March 29, 1996

CHART OF THE WEEK

Consumer Sentiment



Note: Shaded areas indicate recessions.

Consumer confidence in the economy is above average by historical standards according to the latest reading of the University of Michigan Index of Consumer Sentiments. Although media reports indicate increased anxiety among Americans concerning jobs and the economy, the index is at levels similar to those recorded during periods of strong economic expansion in the 1960s and the 1980s.

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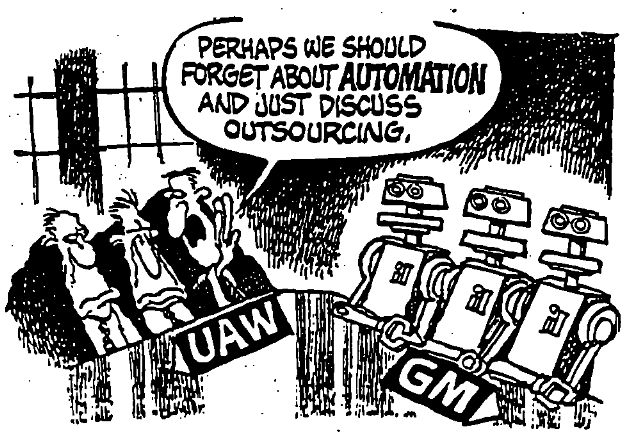


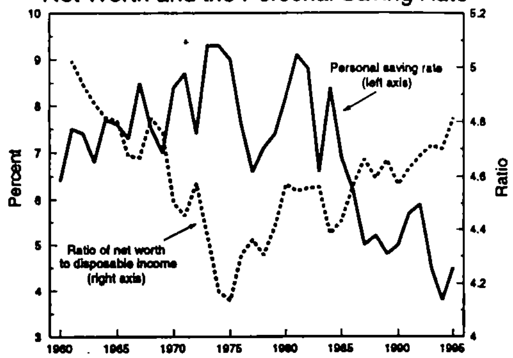
EYES ONLY

SPECIAL ANALYSIS

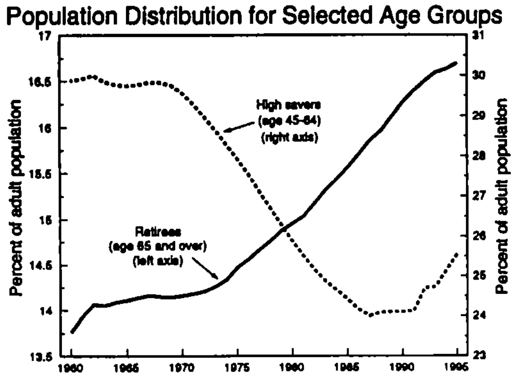
Why Has the Personal Saving Rate Fallen?

Personal saving as a share of income—the personal saving rate—has fallen sharply since 1992, continuing a decline that began over a decade ago. After averaging about 8 percent from 1960 to 1985, the saving rate has averaged only a bit over 4 percent for the past 3 years (see solid line in top chart). The low saving rate has generated concern that Americans are not planning for their futures.

Net Worth and the Personal Saving Rate



Population Distribution for Selected Age Groups



Analysis. The reasons for the decline in the personal saving rate are not fully understood, but two factors are probably important.

Rising Net Worth. The decline in the saving rate over the past decade occurred as stock prices and real estate values increased sharply. These gains generated a rise in household net worth (see dashed line in top chart). Thus, households aiming to accumulate a certain amount of wealth may be saving less because the value of assets they already own is increasing. This phenomenon is evident in the case of pension plans, many of which reached full funding, triggering a fall in contributions and therefore saving.

Demographic Trends. The share of the population represented by retirees, who tend to save less, has risen steadily since 1970, while the share represented by people in their prime saving years has fallen (see bottom chart). These demographic trends probably contributed to the decline in the saving rate, but could not have caused it, since they began much earlier. Moreover, these trends are now partly reversing as baby boomers move into the high-saving age bracket.

Caveats. Not all households have enjoyed gains in net worth and many likely are saving too little. But as more and more baby boomers reach the age when saving tends to rise, the personal saving rate may turn around slightly. Even with such a turnaround, however, our national saving rate (the sum of personal, business and government saving as a share of GDP) is likely to remain low compared to rates in most other industrial countries. Thus, efforts to balance the budget should remain a top priority.

EYES ONLY

SPECIAL ANALYSIS

Do Layoffs Raise Stock Prices?

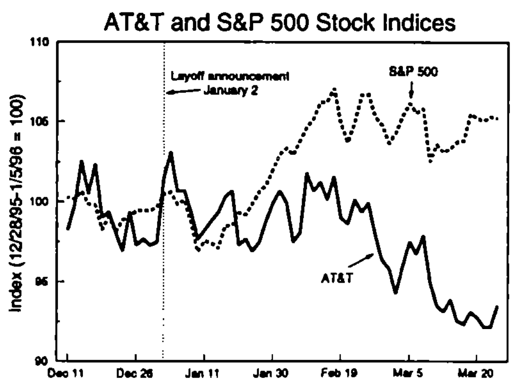
Some observers believe that when major corporations announce layoffs, their stock prices increase. The perception that shareholders and managers gain at the expense of laid-off workers strikes many people as patently unfair.

Why might stock prices rise? Economists believe that stock prices respond to available information about a firm's future prospects. A firm announcing layoffs as part of a major restructuring may be signaling that it has addressed its problems. In this case, the layoff announcement is merely a small part of the information being communicated and an increase in the stock price would reflect positive news that the firm was taking serious steps to turn itself around.

Why might stock prices fall? A firm announcing layoffs in response to abnormally low sales or poor future prospects is signaling bad news to investors. But, here too, the layoff announcement may be only a small part of the story. A drop in the stock price in response to the announcement could reflect investors' increasing pessimism about the firm's future profitability.

What does the evidence show? Several studies have examined how layoff announcements affected stock prices during the 1980s. Contrary to conventional wisdom, these studies find little or no systematic effect. A layoff notice does not appear to convey unequivocally good or bad news to the market, although stock price volatility does seem to increase around the time of an announcement.

In contrast to these studies, some analysts cite the rise in AT&T's stock price following a layoff announcement earlier this year as evidence that layoffs actually do raise stock prices. The proper question to ask, however, is not whether the stock price changed but whether it changed by more than it would have if no layoff had been announced. The accompanying chart shows both the S&P 500 and AT&T's stock price, which over the past several years has tended to track movements in the overall market. As the chart illustrates, the price of AT&T shares increased around the time of the layoff announcement, but not substantially more than the market as a whole. In the months subsequent to the announcement, AT&T's stock price has dropped steadily, contradicting the notion that the layoff would have a lasting positive effect on its stock price.



EYES ONLY

SPECIAL ANALYSIS

How Much Does Unemployment Insurance Vary Across States?

In assessing how well unemployment insurance (UI) is meeting the needs of workers, it is important to recognize that UI programs vary substantially across the states. Any consideration of changes to the UI system at the Federal level needs to take account of the differential impact of such changes on various states.

Federal requirements. Although the Federal Government has no direct jurisdiction over state UI programs, the structure of the Federal unemployment tax indirectly imposes some minimum standards. In particular, the Federal unemployment tax is reduced by $378 per worker for firms in states that levy taxes on at least the Federal wage base ($7000), have a maximum tax rate of at least 5.4 percent, and adjust the tax depending on an employer's layoff experience. As a result, all 50 states have at least these wage-base and tax standards. Apart from these minimum standards, states have tremendous leeway to set their own tax schedule, eligibility requirements, and benefit levels.

Employer Taxes. The average state unemployment tax was 0.9 percent of total payroll in 1993. South Dakota had the lowest average tax, at 0.2 percent, while Rhode Island had the highest average tax, at 2.1 percent. These differences in average tax rates reflect differences in the taxable wage base (which varied from $7000 to $25,500 in 1995), as well as differences in UI tax rates.

Coverage. The fraction of unemployed workers claiming UI benefits varies substantially across the states—from 18 percent in Virginia to 65 percent in Rhode Island, with an average coverage rate of 34 percent. One way states limit coverage is by requiring workers to have a high level of earnings in the period preceding unemployment.

Benefit Amounts. The average weekly UI benefit in 1994 was $177, but ranged from $118 in Louisiana to $266 in Hawaii. Although higher income states tend to pay higher dollar benefits, such states tend to pay somewhat lower UI benefits relative to average earnings in the state.

Conclusion. Differences across states in the specific features of their UI programs (benefit levels and eligibility requirements) and in actual economic conditions lead to considerable variation in the extent and generosity of UI benefits. States with high unionization rates tend to have the most generous programs, both in terms of coverage as well as benefit levels. States with high unemployment rates tend to have higher UI tax rates, but less generous benefits relative to wages.

EYES ONLY

ARTICLE

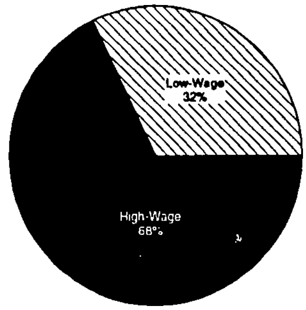
Economy Creating High-Wage Jobs

Much attention recently has been focused on the quality of the 8 million jobs created over the past 3 years. Some have claimed that these jobs primarily are part-time, reflect an increase in people holding second jobs, and pay low wages. But such claims are not justified by the evidence: part-time employment has not increased substantially (see Weekly Economic Briefing, March 22, 1996) and the proportion of the employed working multiple jobs increased only slightly over the past 2 years, from 5.8 percent to 6.3 percent. Moreover, evidence is now accumulating that recent job gains have been in high-wage occupations within high-wage industries.

Are the new jobs really high-wage jobs? Three-fifths of net employment growth since January 1993 has occurred in higher paying "managerial and professional" occupations, representing an increase in the total share of employment in these occupations. On the other hand, despite these gains in high-wage occupations, concerns had been raised that more than half of the new jobs created during 1993 and 1994 were in low-wage industries. Recent evidence, however, shows clear improvement, with slightly more than half of the new jobs created since January 1995 being classified in high-wage industries.

Studying occupations within industries. In order to learn more about the characteristics of the jobs created in recent years, we have measured job growth in full-time employment for specific occupations within industries. For instance, we count a manager at Microsoft in a different category from a manager at a McDonald's restaurant. This more careful look at the data shows that 68 percent of employment growth since February 1994 has occurred in "high-wage" job categories—those paying more than the median wage (see chart). (Data collection methods were changed in January 1994, so data for earlier years are not comparable.) The new jobs have not simply been "McJobs" in low-paying occupations in the service industry. Rather, some of the fastest growing categories were middle-managers in manufacturing, elementary and secondary school teachers, and workers in the construction trades.

Percent of Net Employment Growth in High- and Low-Wage Jobs, 1994-1996



Wage gains overall still lagging. Notwithstanding these improvements, overall wage growth remains sluggish. Median wages grew no faster than inflation between February 1994 and February 1996. When it comes to raising overall wages, gains in wages for existing jobs simply are much more important than gains in wages for newly created jobs: net employment growth between February 1994 and February 1996 represented less than 5 percent of total employment. Only over time will the effect of better quality new jobs begin to be felt on overall wages.

EYES ONLY

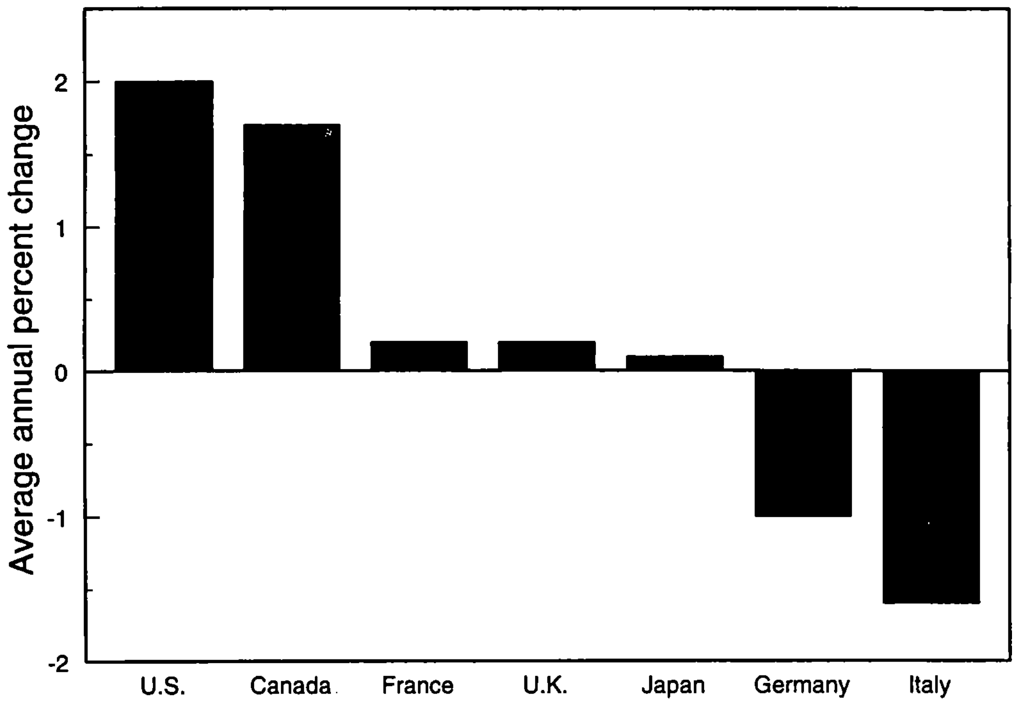
WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

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

April 5, 1996

CHART OF THE WEEK

Employment Growth in the G-7, 1993-95



Note: Data are based on household surveys.

The United States experienced the fastest rate of job growth among G-7 countries over the period 1993-95. Only Canada had similar job growth, while other G-7 countries experienced negligible job gains or outright decline. The stronger performance of the United States in part reflects the strength of our recovery from recession in the early 1990s compared to economic conditions abroad. In Europe, however, stagnant employment also reflects structural features of labor markets that have slowed job growth to a standstill since the 1970s and kept unemployment rates above U.S. levels. A Current Development in this issue of the Weekly Briefing reports on the recent G-7 Jobs Conference in France.

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CURRENT DEVELOPMENT

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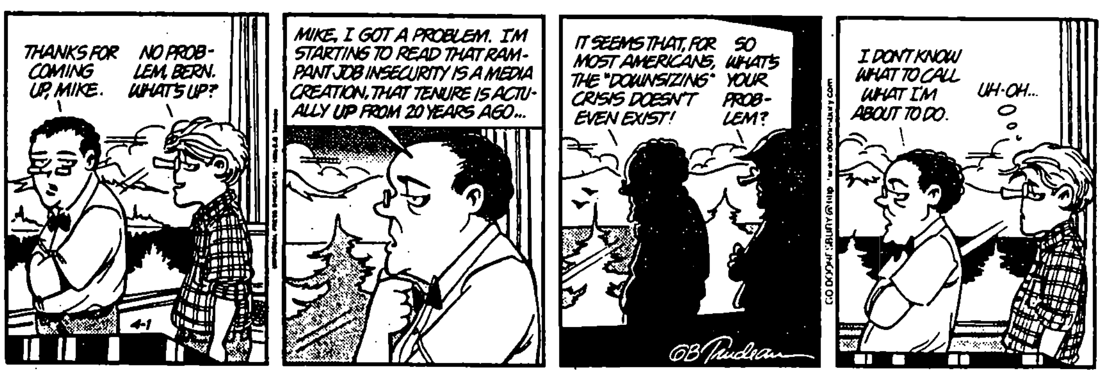
DEPARTMENTS

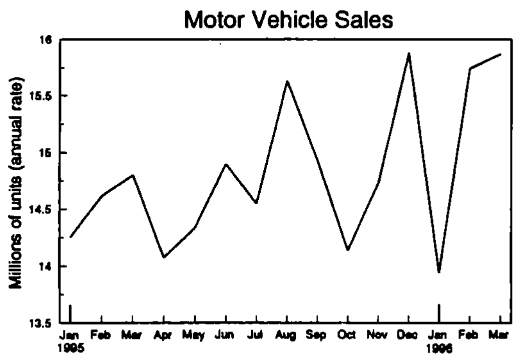


CURRENT DEVELOPMENT

Recent Data Confirm View that Economy is Gaining Momentum

Reports over the past two weeks indicate that the economy has gained momentum and likely will grow close to its potential rate as the year unfolds. The resurgent strength of the economy was reflected in the decision of the Federal Reserve to keep interest rates unchanged at last week's Open Market Committee Meeting.

Analysis. An exceptional gain in employment during February coupled with the solid rise during March give an average monthly increase so far this year of roughly 206,000 jobs, well above last year's monthly pace of 144,000. In addition, claims for unemployment insurance are returning to lower levels now that the temporary blip from the GM strike is past. The strong employment picture was responsible for a huge gain in the index of leading indicators and is firm evidence the economy has emerged from its slow patch of late last year.



Note: Excludes heavy trucks

Consumer spending rebounding. One uncertainty about the outlook had been whether consumer spending, which was weak in the last quarter of 1995, would continue to be a drag on the economy this year. Evidence now suggests that the retrenchment by consumers earlier this year was temporary and primarily due to the government shutdown and severe January weather. Recent moderate gains in retail sales, especially a firming in auto sales (see chart), and a rebound in consumer confidence indicate strengthing consumer spending.

Home building continues to be a bright spot, with housing starts climbing despite what has generally been regarded as a severe winter. Because consumer purchases of home furnishings are related to building activity, the robust housing sector likely will help power additional consumer spending in coming months.

SPECIAL ANALYSIS

Does Unemployment Insurance Lengthen Unemployment?

Although unemployment insurance (UI) reduces the cost to workers of being unemployed, it also reduces their incentive to find a new job quickly. As part of our continuing assessment of the current UI system, we have examined the extent to which UI lengthens the duration of unemployment and studied results from some state experiments designed to address this problem.

The effects of UI benefit levels. By cushioning the economic hardship associated with unemployment, UI allows unemployed workers some time to search for the best available job, instead of being forced to accept the first one that comes along. Although the resulting job search helps improve the match between workers and jobs, the provision of benefits inevitably reduces the incentive to accept work. Evidence suggests that a 10 percentage-point increase in the ratio of benefits to previous wages (say from 60 to 70 percent) would lengthen the average unemployment of those receiving benefits by up to 1.5 weeks.

The effects of UI duration. For insured workers, the likelihood of a return to work (at either their old employers or new ones) increases substantially in the few weeks before benefits are exhausted (typically 26 weeks), whereas there is no similar increase for those not receiving UI. Evidence suggests that a 1-week increase in the duration of benefits increases the average duration of unemployment by roughly 1 day. (In times of recession the average length of unemployment increases, making an extension of benefits appropriate.)

State experiments. Four states (Illinois, New Jersey, Pennsylvania, and Washington) have run experimental programs in which unemployed workers who found jobs within a certain amount of time (ranging from 3 to 13 weeks) received reemployment bonuses. The results from these experiments suggest that reemployment bonuses reduce the duration of unemployment. Moreover, there was no evidence that those receiving bonuses accepted jobs that were lower-paying as a result of their shortened search. From a budgetary perspective, the experiments often did not cost taxpayers additional money, as bonuses on average roughly equaled the reduction in UI payments plus increased tax receipts. (Results varied by state, with Illinois and New Jersey generally saving more than they spent, while Pennsylvania and Washington spent somewhat more than they saved.)

A permanent program, however, could prove more expensive than the experiments suggest. Because reemployment bonuses make short-term unemployment spells less costly for workers, they may be more willing to take jobs in layoff-prone industries, and more of those eligible for UI may be willing to undergo the hassle of applying. Even with these additional costs, such proposals may be desirable if the social and noneconomic benefits of rapid reattachment to the workforce were judged to be sufficiently large.

SPECIAL ANALYSIS

U.S. Approach Receives Positive Response at G-7 Jobs Conference

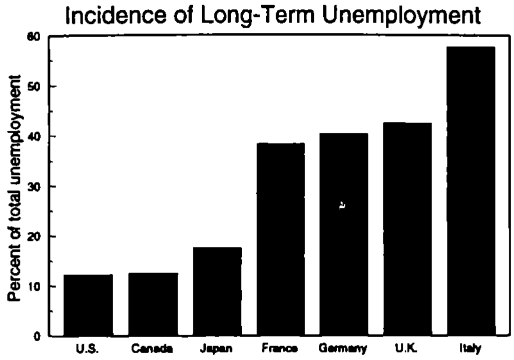
The Lille Jobs Conference—the follow-on to the Detroit Jobs Conference—was held earlier this week. The Conference's primary purpose was to emphasize the continued commitment of the governments of the G-7 countries to job creation and to share views about the most effective approaches. Continuing the tradition established at Detroit, ministers recognized the interdependence of labor market policies with macroeconomic policies, education and training policies, and policies that promote competition, facilitate the creation of new enterprises, and encourage economic development.

U.S. job growth highlighted. Much was made of the U.S. success in creating 8.4 million jobs while simultaneously cutting the fiscal deficit, especially in comparison to other G-7 countries, whose economies together have generated fewer than 1 million jobs between 1993 and 1995.

"The right way." French President Jacques Chirac started the event by calling for a "third way" that avoids both the stagnant employment growth of many European economies and the weak wage growth and "precarité" associated with the U.S. approach. However, analyses showing that new U.S. jobs pay high wages (see Weekly Economic Briefing, March 29, 1996), are mostly full-time (see Weekly Economic Briefing, March 22, 1996), and do not represent a significant increase in multiple job holding, averted the criticism that recently created U.S. jobs are not good jobs. Ultimately, the quote that carried the day was that of Secretary Ron Brown when he said, "The question is not whether we take the first way, the second way or the third way, but the right way."

U.S. intellectual approach embraced. Partly because of strong U.S. economic performance, the U.S. intellectual approach dominated the discourse, with frequent use of vocabulary that we have introduced, such as "lifelong learning" and "human capital investment." Policymakers in countries such as France embraced our approach—with its emphasis on the opportunities associated with the technologies and globalization of the 21st century—as a persuasive alternative to the protectionist and anti-technology attitudes that remain more pervasive in their political discourse.

The changing meaning of economic security. The U.S. team emphasized that in today's economy, we simply cannot hope to provide security in the same way that we have in the past: security no longer means employment at a single company, or perhaps even in a single occupation. Rather, we need to increase the security of an individual's "employability" over the course of his or her working lifetime and to facilitate transitions (for instance, by ensuring portability of pensions and health insurance.) Shorter average job tenures will also affect the nature of training, lowering the incentives for employers to invest in the education of their workers, and for workers to invest in firm-specific knowledge. This may necessitate a larger role for government in providing general education and training.



Note: Long-term unemployed are those unemployed 1 year or more.

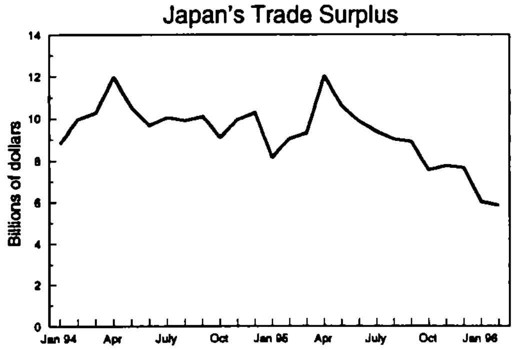
Much work remains. All countries expressed concern about the special problems posed by unskilled workers and the long-term unemployed. Long-term unemployment remains a much larger problem in most European countries (see chart). While expressing their dissatisfaction with current welfare systems, and especially the strong adverse incentive effects that arise when the full complement of income-support measures (housing, food, cash benefits) are considered, the conference participants recognized that there are no easy solutions.

ARTICLE

Japan's Falling Trade Surplus

In January 1996, Japan recorded its lowest monthly trade surplus in 6 years, continuing the downward trend of the past year (see top chart). Japan's bilateral trade surplus with the United States has moved in tandem, declining nearly 10 percent during 1995. Much of the fall in Japan's overall trade surplus can be attributed to strong import growth in Japan. In the past year alone, Japanese merchandise imports grew 12 percent, with particularly high growth in computers, electrical equipment, and motor vehicles. A joint CEA-Treasury study to be issued next week will report an increase of more than 85 percent in Japanese imports of U.S. goods covered by Administration trade agreements since 1993.

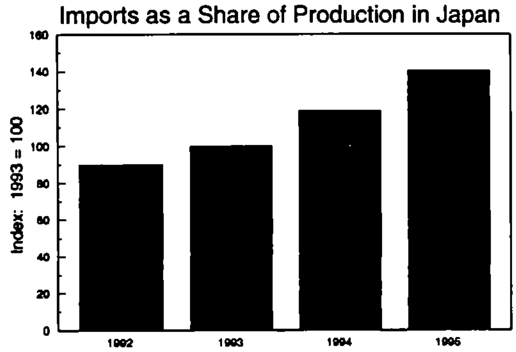
Japan's Trade Surplus



Note: Data are 3-month moving averages.

Analysis. The Japanese government has adopted several fiscal stimulus packages over the past few years in an attempt to pull the economy out of recession. As a result, the government budget has moved from a surplus of 1.5 percent of GDP in 1992 to an estimated deficit of 4 percent of GDP in 1995. Because the broad measure of trade known as the current account surplus reflects the overall balance between saving and investment in the economy, the widening budget deficit (which represents a drop in government saving) has led to a decline in the current account and trade surpluses. The rise in the value of the yen over the last 4 years has supported the reduction of these surpluses.

Imports as a Share of Production in Japan



Manufactured imports as a share of industrial production.

However, econometric models that predict Japan's trade on the basis of changes in economic growth, exchange rates, and the price of oil fail to explain fully the drop in the trade surplus, particularly over the last 6 months. Thus, many analysts have concluded that recent import growth may have been driven by structural changes in the Japanese economy.

Evidence of a steady trend upward in manufactured imports as a share of Japan's industrial production supports the hypothesis of structural change (see bottom chart). Japanese companies are moving low-tech production overseas, particularly to lower cost Asian neighbors. Increased imports by companies that shut down low-tech production at home in favor of investments in facilities overseas will tend to sustain imports into Japan even if the yen declines in value.

At the same time, Japanese auto companies continue to invest in the American market and export a large number of cars made in the United States back to Japan. At least 60 percent of Japan's imports of U.S.-made autos in 1995 were supplied by Japanese transplants. Since Japanese companies can now shift production between domestic and overseas facilities, imports such as these—and hence our bilateral imbalance—will remain sensitive to exchange rate movements.

A breakdown in distribution barriers—such as an increase in the number of larger scale retail outlets—may also be spurring Japan's imports. Insofar as these outlets provide wider choices and cheaper prices, they give Japanese consumers an incentive to try imported products. Cheaper prices in turn help to expand the market. Indeed, this seems to be exactly what is occurring with products as diverse as beer, computers, and toys.

Conclusion. Japan's strong import growth has been particularly striking given the weakness of the Japanese economy. Some of the increase in imports is due to the past strengthening of the yen, and since trade flows often adjust to exchange rate changes with a delay, one can expect a marginal decline in Japan's surplus this year in response to the continuing effects of these past exchange rate movements. In the medium term, a decline to below 2 percent of GDP can be expected as Japan's economy recovers and investment picks up. With continued deregulation and structural change in Japan, and progress toward a balanced budget in the United States, we may expect further corrections in the external imbalances of the world's two largest economies.

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

Electricity Futures Market Opens. The New York Mercantile Exchange ushered in a new era on March 29 with the introduction of trading in futures contracts for electricity in the western United States. Traditionally, electricity was supplied by large, vertically integrated, fully-regulated utilities with defined market territories. Deregulation, however, has fostered competition and new transmission technologies have helped create broader geographical markets for electricity (see Weekly Economic Briefing, June 12, 1995). A futures contract requires the seller and the buyer to exchange a specified unit of electricity for the agreed-upon price at a future date. Such contracts can help reduce uncertainty by capping the price an industrial user will pay and setting a floor on the price an independent power producer will receive. These contracts also may encourage additional competition by making public information about the price traders are willing to pay for electricity. The market had a successful first day, with more than 1,200 contracts changing hands.

Teen Pregnancy Rate Rose Rapidly in Late 1980s, but has Dropped Recently. An article in this week's Journal of the American Medical Association confirms earlier reports that teen pregnancy and birth rates in the United States rose rapidly in the late 1980s. Although the teen pregnancy rate remained stable and the birth rate declined between 1980 and 1985, the teen pregnancy rate rose 9 percent while the birth rate rose 18 percent in the last half of the decade. The researchers warn that despite similar rates of sexual experience among teenagers, rates of teen pregnancies and births in the United States are the highest among developed countries, with an estimated 95 percent of teen pregnancies unintended. In a document released earlier, the Centers for Disease Control and Prevention estimated that the teen birth rate declined 4 percent between 1991 and 1993.

Income Tax Refunds Running at Faster Pace. Tax refunds this year are running almost 25 percent above last year's level, leading some analysts to attribute the recent strength of retail sales in part to the surge in tax refunds. Although refunds in February 1995 were slowed by increased efforts to detect refund fraud (thus making any comparison difficult), by March of that year refunds were back on track. Still, the dollar amount of refunds during March 1996 was almost 20 percent more than in March of last year. Both the total number and the dollar amount of tax refunds are higher than last year—the average refund so far in 1996 is $1,252, compared to $1,076 for the same period last year. The IRS also reports that about 21 percent of all filers are requesting direct deposit of their refunds into their bank accounts, although most of these are electronic filers. This is the first year that most taxfilers will be able to take advantage of direct deposit for their refunds, an option that is intended to reduce the cost of processing returns.

INTERNATIONAL ROUNDUP

EU Launches New Measures in Effort to Contain Mad Cow Disease. On Wednesday the European Union put forth a number of measures to eradicate the spread of "mad cow disease", which may be linked with a deadly brain illness. All beef exports from the United Kingdom to other countries have been temporarily banned. Cattle aged 30 months or older that are intended for slaughter—an estimated 700,000 animals per year—must be totally destroyed. The EU will take special action to support Europe's beef industry, which has been jolted by falling prices, as consumers switch to pork and poultry. Up to 50,000 tons of beef will be affected by the EU's minimum price guarantee. In 1996, the total cost of the containment effort to the EU budget will amount to roughly $400 million. In the United States, where no British beef has been imported since at least 1985, the FDA reportedly is planning to close a loophole that could allow cosmetics and dietary supplements to use ingredients from cattle stricken with mad cow disease.

Hungary to Become 27th Member of the OECD. Pending ratification of an accession agreement by its parliament, Hungary will shortly become the newest member of the Organization for Economic Cooperation and Development. It follows the Czech Republic as the second former planned economy to join this association of industrialized economies. Hungary, which introduced market-oriented reforms as early as 1968, returned to positive economic growth in 1994. Last year its output was projected to expand by 3 percent in real terms. It has been the most successful economy in the region in terms of attracting foreign direct investment, which totalled nearly $11 billion over the 1990-95 period. However, the Hungarian economy still suffers from high internal and external deficits: the 1995 budget deficit was projected to be 6.5 percent of GDP, and Hungary's $22.8 billion in foreign debt is the highest in per capita terms in central Europe. The United States has played a supporting role in Hungary's transition from a planned to a market economy. As of September 1995, U.S. assistance to Hungary amounted to $217 million. Although U.S. firms are the leading foreign investors in Hungary, U.S. exports totalled just $340 million in 1995, or 2 percent of Hungary's imports.

EYES ONLY

RELEASES THIS WEEK

Employment and Unemployment

****Embargoed until 8:30 a.m., Friday, April 5, 1996****

In March, the unemployment rate increased to 5.6 percent from 5.5 percent in February. Nonfarm payroll employment increased by 140,000.

Gross Domestic Product

According to revised estimates, real gross domestic product grew at an annual rate of 0.5 percent in the fourth quarter of 1995.

Leading Indicators

The index of leading economic indicators increased 1.3 percent in February following a decrease of 0.5 percent in January.

MAJOR RELEASES NEXT WEEK

Productivity (Wednesday)
Producer Prices (Thursday)
Retail Sales (Thursday)
Consumer Prices (Friday)

EYES ONLY

U.S. ECONOMIC STATISTICS

	1970–1993	1995	1995:2	1995:3	1995:4
Percent growth (annual rate)					
Real GDP (chain-type)	2.7	**1.3**	0.5	3.6	**0.5**
GDP chain-type price index	5.3	2.6	2.5	2.2	2.2
Nonfarm business (NFB) sector:					
Productivity (chain-type)	1.5	0.8	3.0	1.7	–0.5
Real compensation per hour:					
Using CPI	0.6	1.4	2.0	2.2	0.6
Using NFB deflator	1.3	2.2	3.2	2.4	2.4
Shares of Nominal GDP (percent)					
Business fixed investment	10.9	10.2	10.2	10.2	**10.2**
Residential investment	4.5	4.0	3.9	4.0	4.0
Exports	8.2	11.1	11.1	11.1	11.3
Imports	9.2	12.5	12.8	12.5	**12.4**
Personal saving	5.1	3.3	2.9	3.2	3.6
Federal surplus	–2.7	**–2.2**	–2.2	–2.2	**–2.1**

	1970–1993	1995	Jan. 1996	Feb. 1996	March 1996
Unemployment Rate	6.7**	5.6**	5.8	5.5	**5.6**
Payroll employment (thousands)					
increase per month			**–146**	**624**	**140**
increase since Jan. 1993					**8498**
Inflation (percent per period)					
CPI	5.8	2.5	0.4	0.2	N.A.
PPI-Finished goods	5.0	2.2	0.3	–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, April 5, 1996.**

EYES ONLY

FINANCIAL STATISTICS

	1994	1995	Feb. 1996	March 1996	April 4, 1996
Dow-Jones Industrial Average	3794	4494	5519	5612	5683
Interest Rates					
3-month T-bill	4.25	5.49	4.83	4.96	4.98
10-year T-bond	7.09	6.57	5.81	6.27	6.33
Mortgage rate, 30-year fixed	8.35	7.95	7.08	7.62	7.78
Prime rate	7.15	8.83	8.25	8.25	8.25

INTERNATIONAL STATISTICS

Exchange Rates	**Current level April 4, 1996**	**Percent Change from** Week ago	Year ago
Deutschemark-Dollar	1.481	+0.3	+7.0
Yen-Dollar	107.1	+0.7	+24.0
Multilateral $ (Mar. 1973=100)	86.57	0.0	+5.0

International Comparisons	**Real GDP growth (last 4 quarters)**	**Unemployment rate**	**CPI inflation (last 12 months)**
United States	1.3 (Q4)	**5.6** (Mar)	2.7 (Feb)
Canada	0.6 (Q4)	9.6 (Jan)	1.3 (Feb)
Japan	2.2 (Q4)	3.4 (Jan)	−0.2 (Feb)
France	0.7 (Q4)	12.3 (Oct)	2.0 (Feb)
Germany	1.5 (Q3)	6.8 (Dec)	1.5 (Feb)
Italy	2.4 (Q4)	11.9 (Oct)	5.1 (Feb)
United Kingdom	1.9 (Q4)	8.4 (Jan)	2.7 (Feb)

U.S. unemployment data **embargoed until 8:30 a.m., Friday, April 5, 1996.**

EYES ONLY

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

May 15, 1995

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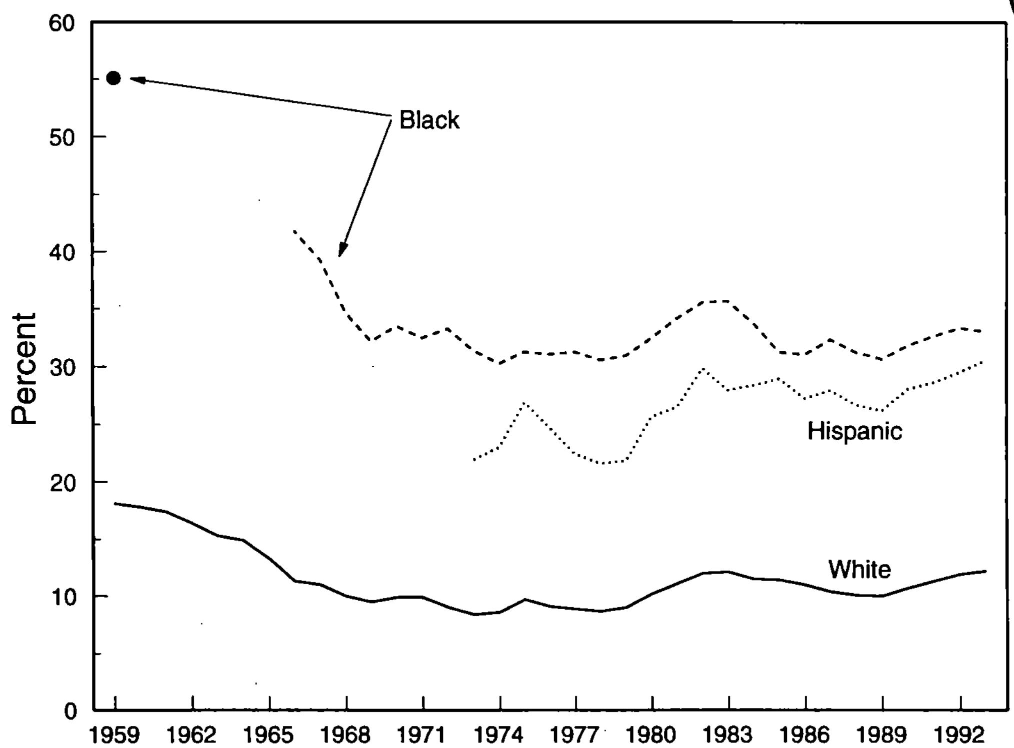
CHART OF THE WEEK

Poverty Rates By Race



During the 1960s, the poverty rate declined dramatically for both blacks and whites. (Data for Hispanics during the 1960s are not available.) Since the early 1970s, however, the poverty rate has either remained about unchanged (for blacks), edged up slightly (for whites) or increased substantially (for Hispanics). In 1993, the rates for blacks and Hispanics were more than twice the rate for whites. The Article in this issue of the Weekly Economic Briefing examines issues related to the measurement of poverty, and analyzes the key recommendations of a major recent report.

EYES ONLY

CONTENTS

"Congressman, our people would look upon it favorably if you were to oppose any additional sin taxes."

SPECIAL ANALYSIS

Nunn-Domenici: "Inside the Beltway" Tax Reform

Senators Nunn and Domenici have proposed transforming the current individual and corporate income taxes into a type of consumption tax levied at both the personal and business levels.

- The goal: The proposal aims to promote saving and investment while continuing to raise about the same amount of aggregate revenue and maintaining the current distribution of the tax burden across broad income classes.
- The assessment: The proposed tax system might not stimulate much additional saving and investment. Moreover, the new system would be even more complicated than the current one, and many taxpayers inevitably would be made worse off by the new system (even though its designers are attempting to maintain the current distribution of tax burdens).

Structure of the plan. The tax liability of individuals would be based on the amount of income they consume. "Consumed income" would be defined to include not only many of the items that are familiar from the current system (e.g., wages, salaries, interest, dividends, alimony received, a portion of social security benefits, and pension benefits), but also the value of employer-provided benefits such as health insurance. An unlimited deduction would be allowed for net additions to savings. Deductions would also be available for mortgage interest, alimony and child support paid, charitable contributions, and post-secondary tuition expenses (up to $2,000 per person per year). In addition, a family allowance and personal exemptions provide taxpayers with an amount of tax-free consumption. However, current-law deductions for state and local taxes, medical expenses, and certain other items would be eliminated.

Consumed income would be taxed at graduated rates ranging in 1996 from 19 percent to 40 percent. For a family of four that consumed all its wage earnings and had no deductions other than the family allowance and personal exemptions, the 40 percent rate would apply to income above $41,600. Two tax credits would be allowed: an earned income tax credit and a new tax credit for the social security tax paid by an employee.

The tax liability of businesses would be based on receipts less purchases (including investment in plant and equipment). Payments for wages and salaries, fringe benefits, interest, and dividends would not be deductible. Businesses would pay a flat rate of 11 percent. The impact of the nondeductibility of wages would be softened by the availability of a nonrefundable credit for business payments of social security taxes.

Savings incentives. In effect, the Nunn-Domenici plan would allow individuals to make unlimited IRA contributions with no restrictions on withdrawals, and thus would allow assets to accumulate at the pre-tax rate of return. Some families would boost their saving in response to this increase in the incentive to save. However, the overall response probably would not be very large because personal saving does not appear to be very sensitive to changes in the rate of return.

Complexity. The Nunn-Domenici plan is not a recipe for tax simplification. Almost all individual filers would find the new form more complicated to fill out than the current tax form. In addition to nearly all the information on income and deductions required under the current system, filers would have to report net acquisitions of assets and debt. Business tax compliance would likely be somewhat easier than under current law. Capital expensing would help in this regard, as would the elimination of most other deductions and the need to distinguish between equity and debt. However, there would still be plenty of room for disagreement between the IRS and taxpayers.

Winners and losers. Treasury has yet to release a full-blown distributional analysis of this proposal, but even if the designers of the plan succeeded in altering the overall distribution of the tax burden relatively little, there would certainly be winners and losers relative to current law. Winners would include those who save a lot, and lower-income wage earners with few fringe benefits (whose payroll taxes can far exceed Federal income tax liabilities). Losers would include those who save little or who dissave, those who receive a relatively large proportion of their compensation in the form of currently tax-favored fringe benefits, and middle-class retirees who would find themselves pushed into higher tax brackets. A box on the next page examines the distributional implications of the proposed plan in greater detail.

Transition rules. The transition rules for this plan are complicated in their own right. In part, this complication reflects the fact that the plan tries to avoid taxing consumption financed by the liquidation of previously accumulated assets (on the theory that the income used to purchase such assets had already been taxed once).

Conclusion. The Nunn-Domenici proposal is appealing to those analysts concerned about the low level of saving and investment currently undertaken in the United States. However, it might not be very successful in correcting those problems, and it certainly takes a big step away from tax simplification.

EYES ONLY

Nunn-Domenici vs. the Current Income Tax: Two Case Studies

A married couple with the following characteristics would just about break even under the Nunn-Domenici plan: two children, $65,000 in salary, $5,000 in capital income, $4,000 in fringe benefits, $10,000 in mortgage interest payments, $5,000 in state and local taxes, and $7,000 in saving. This family would pay about $7,200 under both current law and the proposed system. However, for each $1,000 less they save (or more they get in fringe benefits), their tax bill under the proposed plan rises $400.

Now consider a high roller: A married couple with no children, salary of $1,000,000, capital income of $10,000,000, fringe benefits of $40,000, mortgage interest of $50,000, charitable contributions of $1,000,000, state and local tax payments of $200,000, and saving of $9,000,000. This family would see their taxes slashed 90 percent, from almost $4 million to less than $400,000.

EYES ONLY

ARTICLE

A New Method of Estimating the Poverty Rate?

The current method of estimating the poverty rate has a number of serious problems. For example, a drastic reduction in the earned income tax credit (EITC) or in food stamps, such as some Republicans in Congress are proposing, would have no direct effect on the official poverty rate as currently calculated. A recent report from the National Research Council (NRC) proposes a new method that would solve the most serious of the problems afflicting the current measure.

Current practice. The poverty threshold was defined in the early 1960s as three times the minimum amount required at that time to purchase a balanced diet. (The figure of three was chosen because the average family was judged to allocate roughly one-third of its budget toward food). Since 1969, the threshold amount has been adjusted upward in nominal terms according to the increase in overall consumer prices. Thus, current methodology establishes a fixed goalpost, in the sense that the threshold is intended to represent the same standard of living today as it did in 1963. A family is defined to be poor if its before-tax cash income falls short of the threshold relevant for its family size.

Proposed changes. The NRC panel recommended three key changes in the methodology underlying the poverty rate:

Redefining family income: The panel proposed expanding the definition of family income to include the value of transfers such as food stamps, public housing, and the EITC, and to exclude taxes and other expenses over which the household may have little or no discretion, such as child support payments, health insurance and out-of-pocket health-care costs, and work-related expenses such as child care.

Allowing regional variation in the threshold: The panel proposed adjusting the poverty threshold for regional differences in housing costs.

Reengineering the annual adjustment of the threshold: The panel recommended moving the threshold up each year in line with the increase in the outlays of the median family for food, clothing, and housing. Thus, the panel recommended transforming the poverty line from a fixed to a moving goalpost: Outlays of the median family on food, clothing, and housing will increase over time not only because prices increase, but also because general living standards rise.

Analysis. The proposed revision to the definition of family income would provide a more accurate picture of the resources available to a family for the satisfaction of its basic needs. It would allow the effects of government transfer programs such as the EITC to be reflected in the poverty statistics. And it would tend to raise the measured poverty rate for families with workers (because work-related expenses would be deducted from family income), and lower it for welfare recipients (because non-cash benefits would be included in family income). It would also increase measured poverty rates in the North and West (where housing costs are relatively high), and lower them in the South and Midwest (where housing costs are low). There is widespread agreement that a shift toward a more comprehensive measure of resources, such as the one recommended by the panel, would be an important improvement.

On the other hand, there is considerable controversy over the issue of whether poverty should be measured with a fixed or moving goalpost. The greatest strength of a "fixed goalpost" type of poverty line is that it provides a natural benchmark for assessing the performance of the economy in improving the economic circumstances of society's least well-off members. The greatest weakness of such a standard is that it will be surpassed eventually by all (or nearly all) of the population, and it therefore could be used in the very long run to claim that the problem of poverty had been "solved."

The proposed "moving goalpost" would (loosely) tie the standard of living associated with the poverty line to the standard of living of the median family in society. Historically, households near the median of the income distribution have tended to increase spending on food, clothing, and shelter about 7 percent for every 10 percent increase in their overall income. Therefore, even under the proposed methodology, the gap between the standard of living of the median household and the standard of living associated with the poverty threshold would widen over very long timespans, though not as rapidly as it would if the threshold were to be left fixed.

Surveys indicate that public perceptions of a subsistence living standard typically are higher in more affluent nations and tend to rise over time within countries as general standards of living increase. Therefore, the proposed adjustment would move official methodology toward public sensibilities in this area. Nonetheless, this proposed change is controversial, and was one of the main reasons why one panel member dissented from the panel's final report.

Implementation. The Office of Management and Budget is the final arbiter of the methodology that is used to produce the official statistics on poverty. The Department of Health and Human Services has authority over the definition of poverty that is used to determine eligibility for many Federal benefits. Both agencies will be studying the NRC report in coming months.

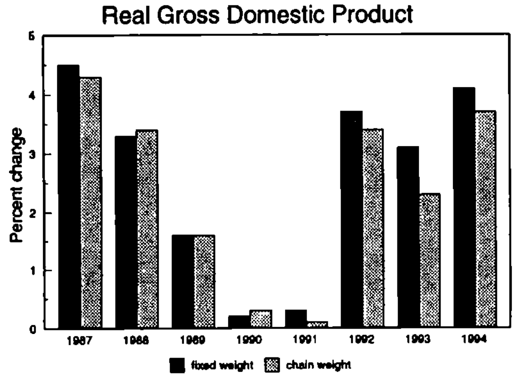
EYES ONLY

CURRENT DEVELOPMENT

Commerce Announces Plan for GDP Revision

On May 4, the Commerce Department formally announced its intention to emphasize a "chain-weight" measure as the primary gauge of real GDP growth, rather than the current "fixed-weight" series.

Real Gross Domestic Product



When this switch is implemented at the end of this year, GDP growth rates for the last few years will probably be revised downward significantly. Currently available data suggest that estimated growth in 1993 will be marked down 0.8 percentage point, while growth in 1994 will be reduced 0.4 percentage point (see chart).

Even if Commerce had not opted to change its focus to the chain-weight index, the GDP growth estimates for 1993 and 1994 would have been revised downward for technical reasons related to the characteristics of fixed-weight indexes.

Analysis. One important advantage of a chain-weight measure is that it provides a more accurate gauge of long-run trends. Chain-weight data were featured in the 1995 Economic Report of the President, which examined long-term trends in the growth of productivity. Another important advantage of a chain-weight measure is that, unlike its fixed-weight cousin, it will not be subject to downward revision once every five years.

There is widespread support among economists for the switch to a chain-weight index.

MACROECONOMIC UPDATE

On the Glide Path

Output and the labor market. The pace of economic growth has slowed considerably in the current quarter. Available indicators suggest that real GDP may increase between 1-1/2 percent and 2-1/2 percent at an annual rate this quarter—a shade below the rate many analysts see as sustainable over the long haul. A major factor in the recent slowing has been a sharp scaling back of auto and truck production schedules in response to weak sales and an uncomfortably high level of inventories. Home sales have also been weak, dampening builders' eagerness to start construction of new homes. And the most recent employment report pointed to a slackening in the demand for labor: The unemployment rate moved up 0.3 percentage point in April (see chart), and nonfarm payroll employment edged down slightly.

Note: Data after 1993 reflect the revised Current Population Survey.

The current pattern of production cutbacks in order to bring inventories in line with sales is typical of times when the pace of economic growth is slowing. No evidence exists that the size of the current inventory overhang is sufficient to tip the economy into recession. Moreover, substantial declines in long-term interest rates—roughly 40 basis points on both the 10-year bond rate and the mortgage interest rate during the last two weeks alone—should ultimately boost the demand for autos, housing and other consumer purchases, thereby limiting the necessary inventory correction. Indeed, more than 80 percent of the forecasters surveyed in the most recent Blue Chip roundup thought there would not be a recession before the next presidential election.

Wages and prices. Although increases in employee compensation remain surprisingly moderate, inflation—as measured by the Consumer Price Index and the Producer Price Index (as well as the core CPI and PPI)—has proceeded at a somewhat higher pace in the first four months of 1995 compared to 1994. As the economy slows, though, inflation rates should stabilize, as producers find that they have less latitude to widen their profit margins.

Conclusion. Despite recent signals of near-term weakness, the economy still appears to be on course for a soft landing. The latest Blue Chip report shows a consensus forecast for GDP growth over the four quarters of 1996 of 2.3 percent—close to estimates of the economy's potential growth rate.

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

The Beige Book: Slow and Steady Is the Pace. According to the latest survey of current economic conditions by the Federal Reserve, the economy continued to expand in most regions last month, but at a less vigorous pace. Manufacturing activity reportedly was up in most districts, but retail sales were described as sluggish, and auto sales were down. Forward momentum appeared to be greatest in the Midwest. Industrial and commodity prices are continuing to rise in most Districts, but for the most part these increases are still not being passed through to the retail level. Furthermore, wage pressures remain moderate, despite tight labor markets in a number of sectors and regions.

Giuliani Confronts Widening Deficit. Mayor Rudolph Giuliani of New York City unveiled his second budget on April 28. Absent any corrective action, the city is currently projected to run a deficit of $3.1 billion—or nearly $450 per resident—during the fiscal year beginning July 1. To narrow the gap, Giuliani has budgeted union concessions of $600 million, as well as cuts of $700 million from city spending on Medicaid and welfare programs, $224 million from the Board of Education, and $1.2 billion in other spending reductions and increases in state and Federal aid. (Total spending on Medicaid and welfare might decline by an additional $700 million or more, due to the loss of state and Federal matching monies.) Despite it all, the Mayor is simultaneously proposing nearly $200 million in tax cuts for businesses. Council Speaker Peter Vallone indicated less than total enthusiasm: "If just to cut taxes we destroy the quality of life for our middle class, if the trade-off is in the form of filthy streets and failing schools, then the cost is too high."

In Education, As in Other Things, Quality Matters. Educational attainment—the quantity of education that a worker obtains—has long been recognized as an important determinant of wages. A recent study from the National Bureau of Economic Research shows that the quality of that education matters too. The study defines a composite index of school quality based on teacher salaries, teacher/student ratios, counselor/student ratios, and book/student ratios. The study then shows that high school graduates who attended schools at the 75th percentile of the quality distribution earned 5 percent more, on average, than graduates of schools at the 25th percentile.

Welcome to the New Members of the Club. For the first time ever, Fortune included both industrial and service companies in its fabled list of the biggest American businesses. Nonindustrial giants wasted no time in making their presence felt: Wal-Mart, AT&T, and Sears ranked 4th, 5th, and 9th on the list, respectively. But some things never change: General Motors, No. 1 in the inaugural 1954 Fortune 500, was once again at the top of the heap in 1994. Business for the newly constituted list of 500 companies was good last year—very, very good: In the aggregate, these companies posted a 54 percent increase in profits.

EYES ONLY

RELEASES LAST WEEK

Consumer Price Index

****Embargoed until 8:30 a.m., Friday, May 12, 1995****

The consumer price index increased 0.4 percent in April. Excluding food and energy, consumer prices also rose 0.4 percent.

Retail Sales

Advance estimates show that retail sales decreased 0.4 percent in April following an increase of 0.8 percent in March. Excluding sales in the automotive group, retail sales rose 0.1 percent.

Producer Price Index

The producer price index for finished goods increased 0.5 percent in April. Excluding food and energy, producer prices rose 0.3 percent.

Productivity

Nonfarm business productivity increased 0.7 percent at an annual rate in the first quarter. Manufacturing productivity increased 3.6 percent.

MAJOR RELEASES THIS WEEK

Housing Starts (Tuesday)
Industrial Production and Capacity Utilization (Tuesday)
U.S. International Trade in Goods and Services (Thursday)

EYES ONLY

U.S. ECONOMIC STATISTICS

	1970–1993	1994	1994:3	1994:4	1995:1
Percent growth (annual rate)					
Real GDP	2.5	4.1	4.0	5.1	2.8
GDP deflator	5.5	2.3	1.9	1.3	2.2
Productivity					
Nonfarm business	1.2	**2.0**	3.2	**4.0**	**0.7**
Manufacturing (1978-93)	2.1	**4.7**	3.5	**3.4**	**3.6**
Real compensation per hour	0.6	0.7	−0.4	1.2	**1.0**
Shares of Real GDP (percent)					
Business fixed investment	11.0	12.6	12.7	13.0	13.5
Residential investment	4.7	4.3	4.3	4.3	4.2
Exports	8.0	12.3	12.4	12.8	12.7
Imports	9.2	14.4	14.6	14.8	14.9
Shares of Nominal GDP (percent)					
Personal saving	4.9	3.0	3.0	3.4	3.9
Federal surplus	−2.8	−2.4	−2.3	−2.3	N.A.
			Feb. 1995	**Mar. 1995**	**Apr. 1995**
Unemployment Rate	6.7*	6.1*	5.4	5.5	5.8
Payroll employment (thousands)					
increase per month			355	177	−9
increase since Jan. 1993					6315
Inflation (percent per period)					
CPI	5.8	2.7	0.3	0.2	**0.4**
PPI-Finished goods	5.0	1.7	0.3	0.0	**0.5**

*Figures beginning 1994 are not comparable with earlier data.

New or revised data in **boldface**.
CPI data **embargoed until 8:30 a.m., Friday, May 12, 1995.**

EYES ONLY

FINANCIAL STATISTICS

	1993	1994	March 1995	April 1995	May 11, 1995
Dow-Jones Industrial Average	3522	3794	4063	4231	4411
Interest Rates					
3-month T-bill	3.00	4.25	5.73	5.65	5.66
10-year T-bond	5.87	7.09	7.20	7.06	6.68
Mortgage rate, 30-year fixed	7.33	8.36	8.45	8.32	7.87
Prime rate	6.00	7.15	9.00	9.00	9.00

INTERNATIONAL STATISTICS

Exchange Rates	**Current level May 11, 1995**	**Percent Change from Week ago**	**Year ago**
Deutschemark-Dollar	1.432	4.2	−14.0
Yen-Dollar	85.85	2.3	−17.5
Multilateral (Mar. 1973=100)	83.64	2.8	−10.2

International Comparisons	**Real GDP growth (last 4 quarters)**	**Unemployment rate**	**CPI inflation (last 12 months)**
United States	4.0 (Q1)	5.8 (Apr)	**3.1** (Apr)
Canada	5.6 (Q4)	9.7 (Mar)	2.2 (Mar)
Japan	0.9 (Q4)	3.0 (Feb)	0.2 (Feb)
France	3.7 (Q4)	12.1 (Feb)	1.9 (Mar)
Germany	3.3 (Q4)	6.4 (Mar)	2.3 (Mar)
Italy	2.7 (Q4)	12.2 (Jan)	5.0 (Mar)
United Kingdom	3.9 (Q1)	8.6 (Mar)	3.5 (Mar)