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THE PRESIDENT HAS SEEN

9-3-96

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WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

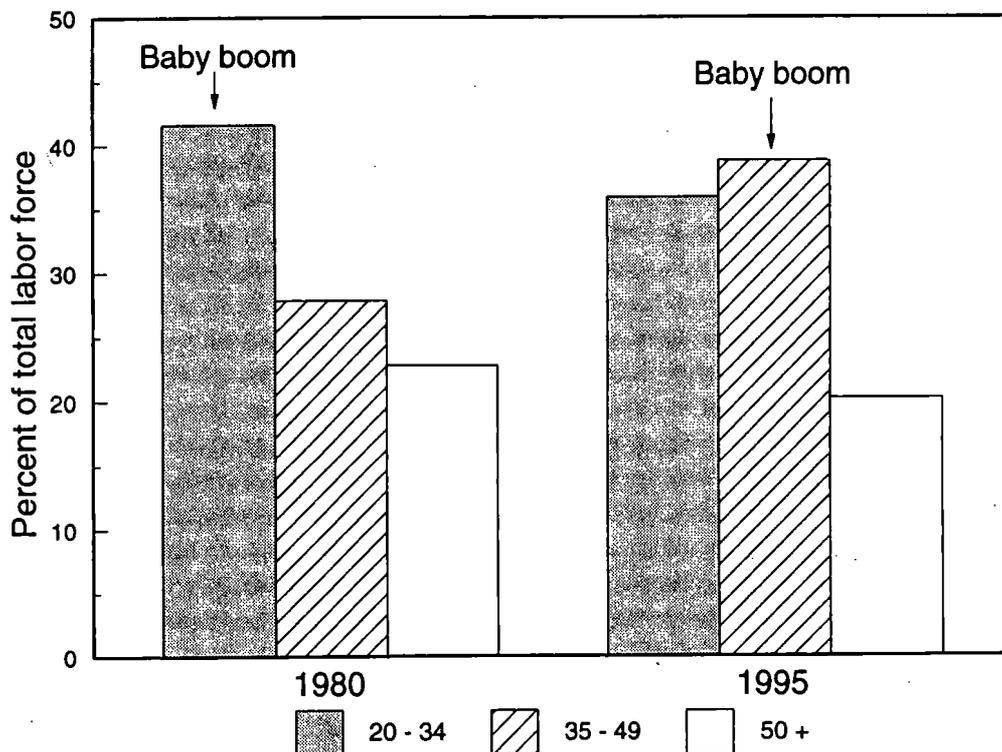
Prepared by the Council of Economic Advisers
with the assistance of the Office of the Vice President

August 23, 1996 cc: Stiglitz
Chiron

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CHART OF THE WEEK

The Baby Boom and the Age-Composition of the Workforce



Changes in the age-composition of the workforce reflect the aging of the baby-boom generation. The proportion of the labor force made up of 20-34-year olds has fallen since 1980 as baby boomers grew older. Boomers are now increasing the proportion of the workforce represented by 35-49-year olds. An article in this Weekly Economic Briefing describes the importance of this changing composition in understanding trends in the female-to-male earnings ratio.

CONTENTS

CURRENT DEVELOPMENT

Poor Weather Lowers Crop Forecasts 1

SPECIAL ANALYSES

Trade Patterns and the U.S.-China Trade Deficit 2

The Mix Matters: A Comparison of Fiscal and Monetary
Policy in the 1980s and 1990s 3

ARTICLE

The Baby Boom and Women's Wages 5

DEPARTMENTS

Business, Consumer, and Regional Roundup 7

International Roundup 8

Releases 9

U.S. Economic Statistics 10

Financial and International Statistics 11

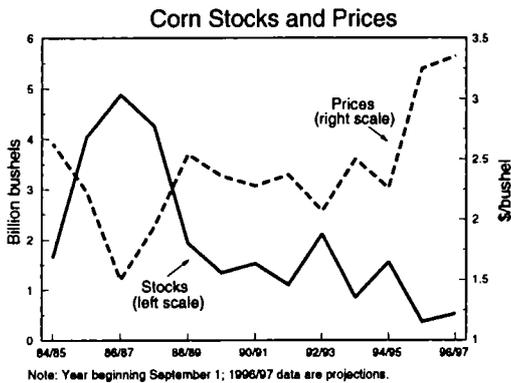


"I know exactly how you feel. I'm a Boomer, too."

CURRENT DEVELOPMENT

Poor Weather Lowers Crop Forecasts

Corn and soybean production will be lower than expected this summer due to cool weather in the Great Lakes region from Ohio to Minnesota, according to the latest U.S. Department of Agriculture (USDA) projections. Prices for both corn and soybeans rose sharply after USDA's forecast was announced.



Analysis. This summer, farmers have planted the largest number of acres of corn and soybeans in the last decade. While yields are forecast to be lower than previously expected, this year's harvests should be among the largest on record.

Despite the expected large harvests, prices for feedgrains like corn and soybeans were at or near record levels even before the USDA's announcement (see top chart). Domestic grain stocks have been declining in recent years, partly as a result of U.S. farm policies that suppressed farm output and stimulated demand both here and abroad. Poor harvests in 1993 and 1995 also contributed to declining grain stocks. Even average yields per acre this summer would have helped replenish stocks.

The Food and Agricultural Policy Research Institute predicts that food prices will increase by 4.3 percent in 1997 as increased feedgrain prices reduce U.S. dairy and meat production. This increase would be the largest annual change since 1990, but well below previous peaks in 1973-74 and 1979 (see bottom chart). Moreover, consumers spend a relatively small fraction of their total income on food, and food price increases are already running at about 3.9 percent. Hence the likely change in food prices would add less than 0.1 percentage point to CPI inflation.



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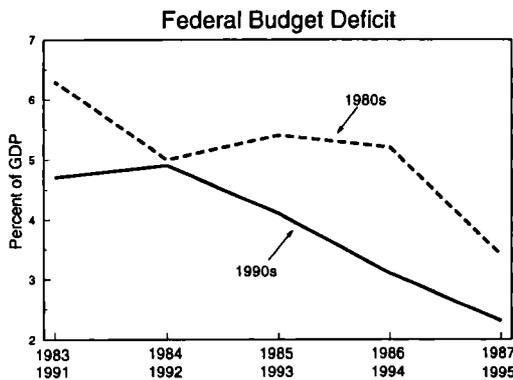
SPECIAL ANALYSIS

The Mix Matters: A Comparison of Fiscal and Monetary Policy in the 1980s and 1990s

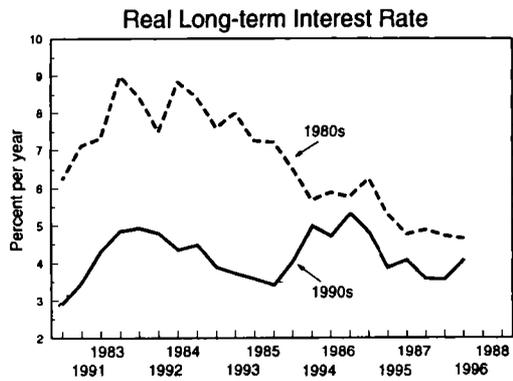
Advocates of large tax cuts point to the expansion of the 1980s as proof that tax cuts make the economy grow. But this argument obscures the difference between a business cycle expansion and sustainable long-run growth.

The importance of the policy mix. When there is slack in the economy, any mix of monetary and fiscal policies that produces net stimulus can generate a short-term expansion. But the actual mix of policies matters a great deal when it comes to laying the foundation for sustained long-term economic growth and a rising standard of living. The following charts compare several indicators, starting with a business cycle trough (the fourth quarter of 1982 and the first quarter of 1991) and covering a comparable amount of time of the subsequent expansion.

Fiscal policy in the 1980s, characterized by the large tax cut of 1981 and large



Federal budget deficits, was expansionary (see Weekly Economic Briefing, August 9, 1996). Fiscal policy in the 1990s, by contrast, has been more restrictive, marked by serious efforts to bring down the deficit. These efforts began with the Omnibus Budget Reconciliation Act of 1990 and proceeded through OBRA93 to current proposals to eliminate the Federal budget deficit.



In the 1980s, when fiscal policy was expansionary, monetary policy, acting through higher interest rates, provided the restraint needed to keep the economy from overheating. In the 1990s, when fiscal policy was more restrained, monetary policy accommodated private sector growth. In both cases, the economy was able to expand following a recession, but real (inflation-adjusted) interest rates have been lower in the 1990s than they were in the 1980s.

The high real interest rates of the 1980s may have discouraged investment, especially the equipment investment many economists believe is critical to productivity growth.

9-3-96

SPECIAL ANALYSIS

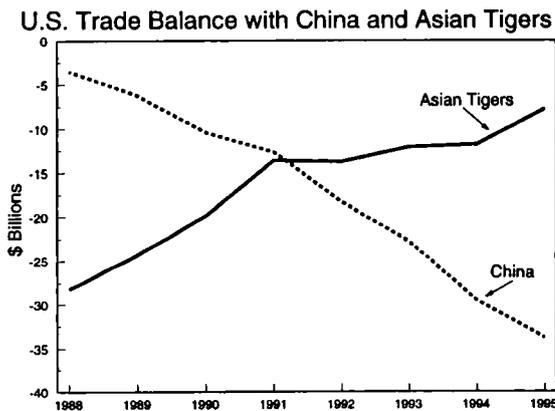
Trade Patterns and the U.S.-China Trade Deficit

In June, for the first time on record, the U.S. monthly trade deficit with China surpassed that with Japan. Although much popular attention has focused on our trade balances with China and Japan, economists believe that too much emphasis is placed on bilateral imbalances. Even if U.S. trade were balanced overall, there would still be bilateral deficits with many individual countries. Moreover, bilateral imbalances are often difficult to properly measure. Allocating our overall trade flows among trading partners is a somewhat arbitrary process and is particularly problematic in measuring our trade with China.

Although the U.S. trade deficit with China has increased, we now run a growing surplus with Hong Kong (\$4 billion in 1995). This reflects the fact that many U.S. goods destined for China first flow through Hong Kong. Because U.S. customs officials are often not aware of the final destination of the goods, these are recorded as exports to Hong Kong in the U.S. data. Adding these "re-exports" would increase the level of U.S. exports to China by roughly 40 percent in recent years. Re-exports accounted for 35 percent of the dollar value of U.S. exports to Hong Kong in 1995.

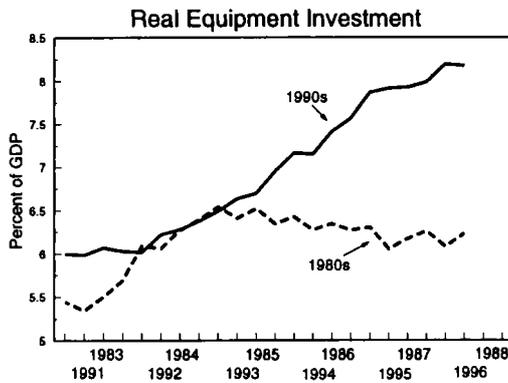
Moreover, our trade balances with other countries in Asia have also risen. In the period since 1988, our annual trade balance with China has fallen \$30 billion, while our balance with the "Asian Tigers" (Hong Kong, Taiwan, Singapore, and Korea)

has risen by roughly \$20 billion (see chart). As these countries have developed, production of textiles, footwear, and other light manufactures has shifted to China. As production has shifted, so too have trade patterns.

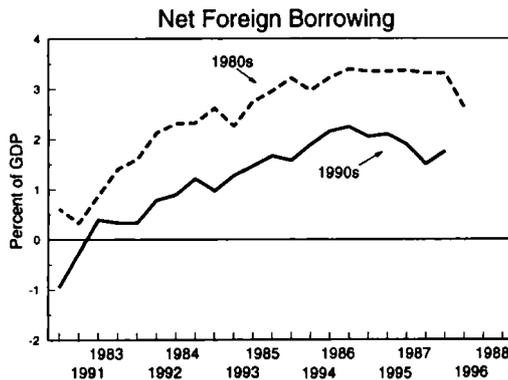


Of course, how we allocate trade among countries does not affect the overall trade deficit. Data released this week indicate that the U.S. trade deficit in the first 6 months of this year declined 14 percent from

the same period last year. Further progress on reducing the Federal budget deficit and an increased pace of economic growth abroad should shrink the U.S. trade deficit further. These improvements in the overall trade deficit imply that decreases in the trade balance with China are being more than offset by increases in trade balances with other countries.



Similarly, the lower real interest rates of the 1990s may have allowed investment to grow more strongly.



Investment would have been even lower in the 1980s if we had not been able to borrow abroad to offset some of the national saving depleted by large Federal budget deficits. This borrowing put the United States on a path that turned it from the world's largest creditor to its largest debtor. And many of the benefits of investment financed by foreign borrowing accrue to foreigners, not U.S. citizens. Foreign borrowing has been substantially less in the 1990s.

Finally, higher interest rates increased demand for dollar-denominated assets. This factor may have been partly responsible for increasing the foreign exchange value of the dollar in the mid-1980s. A strong dollar raises the foreign

price of U.S. goods, making it harder for U.S. producers to sell abroad, and lowers the U.S. price of foreign goods, allowing foreign producers to make substantial inroads into U.S. markets. In the late 1980s, the real exchange rate of the dollar fell sharply, perhaps reflecting lower real interest rates in the United States. The dollar has not shown similar gyrations in the 1990s, reducing the shocks experienced by firms engaged in international commerce.

Conclusion. The economic expansion of the 1980s (following the deep 1981-82 recession) was no supply-side tax miracle. In fact, the combination of an expansionary fiscal policy and a restrained monetary policy produced a number of deleterious supply-side effects (such as restrained equipment investment and a sharply increasing trade deficit). The current recovery, by contrast, has produced stronger investment performance and less foreign borrowing, and thereby laid a better foundation for future prosperity.

ARTICLE

The Baby Boom and Women's Wages

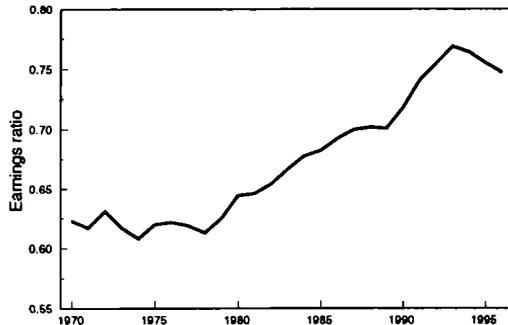
A Biblical View of the Male-Female Wage Ratio

And the Lord spoke unto Moses, saying 'Speak unto the children of Israel, and say unto them: When a man shall clearly utter a vow of persons unto the Lord, according to thy valuation, then thy valuation shall be for the male from twenty years old even unto sixty years old, even thy valuation shall be fifty shekels of silver, after the shekel of the sanctuary. And if it be a female, then thy valuation shall be thirty shekels.'

—Leviticus, chapter 27, verses 1-4

Although the ratio of female-to-male wages remained consistent with biblical decree for much of the postwar period, women's relative earnings improved substantially through the 1980s and early 1990s (see upper chart). By 1993, women's relative earnings peaked at more than three-quarters of what men earned. Recently, improvement has slowed, and even reversed in the past few years. One potential explanation of the downturn is demographic change.

Female/Male Weekly Earnings Ratio of Full-Time Workers



Note: 1996 data is for second quarter.

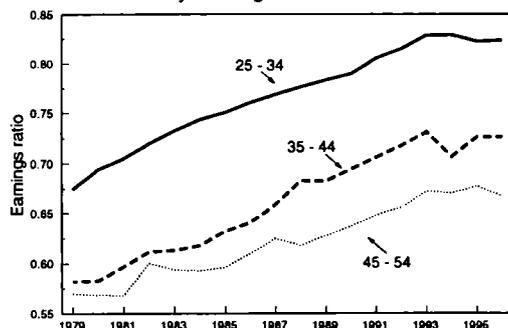
Recently, improvement has slowed, and even reversed in the past few years. One potential explanation of the downturn is demographic change.

Demographic Trends. Separating the workforce into different age groups (see lower chart) shows the ratio of female-to-male earnings is lower for older workers than it is for younger workers. This

pattern reflects greater amounts of time spent out of the labor market for childbearing and lower educational attainment for older cohorts of women.

Within age groups, the recent decline in women's relative earnings in the aggregate

Female/Male Weekly Earnings Ratio of Full-Time Workers



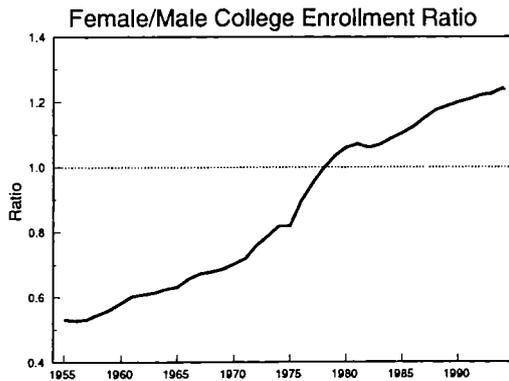
Note: 1996 data is for second quarter.

is not evident. This apparent contradiction may be explained by the aging of the baby boomers that has skewed the distribution of employment towards older workers (see Chart of the Week). As a result, the age groups in which women's relative earnings are low are acquiring increasing weight in determining the aggregate female-to-male earnings ratio. Trends within age groups tend to be more reliable indicators

4-3-96

of relative wage changes. These data show that women's relative-earnings advances appear to have slowed, but have not reversed.

Explaining wage differentials. These trends within age groups may be understood by dividing the wage differential between men and women into two components.



Differences in wages may arise from readily identifiable characteristics (like education and experience) and hard-to-detect factors (like commitment to work or labor market discrimination). Over time, women's average educational attainment and labor market experience has been rising faster than men's. Although only about half as many women as men were enrolled in college in 1955, for example, more women than men were enrolled by the 1980s (see

chart). The reduced gap in labor force experience can be partially explained by women taking shorter periods out of the labor market to raise children. Improvements in these readily identifiable characteristics began to pay off in the 1980s in the form of higher relative earnings for women.

Research indicates, however, that women make significantly less than men even with identical levels of education and experience. Slower growth in women's relative wages may reflect the fact that most of the gains from reducing differences attributable to these factors have already been made. Further advancement is likely to be more difficult because it may require changes in social norms regarding the role of women and the behavior of firms.

**PHOTOCOPY
WJC HANDWRITING**

9-3-96

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

More Mortgage Lending to Minorities. The latest Home Mortgage Disclosure Act data suggest that affordable home loan programs, initiated in recent years to benefit low-income, moderate-income and minority households and neighborhoods, may be having an impact. In 1995, mortgage loans to blacks rose by nearly 10 percent and loans to Hispanics grew by over 4 percent, even though overall mortgage lending decreased. Denials of minority loans also increased, reflecting a large increase in applications. Although this jump in approvals is encouraging, the data do not provide enough information to determine whether ethnicity and race matter in mortgage lending. To do that requires additional information about the economic and demographic characteristics of the mortgage applicants.

Rural America Rebounds. After suffering severe ailments in the 1980s, rural counties are benefitting from revived employment and population growth in the 1990s. A recent study has found that the population outflow of the 1980s has already been offset by inflows of 1.6 million people in the 1990s. Rural employment growth in the 1990s has outpaced job growth in urban areas, although many of the new jobs pay relatively low wages. With new communications technologies, companies are finding it easier to locate in rural areas that offer lower taxes, utility bills and labor costs. Workers find that living costs are lower and quality of life higher with less congestion and pollution. Because of these perceived advantages for both workers and firms, forecasters predict that rural communities will continue to grow.

Banking On the Internet. Internet banking is poised for tremendous growth likely to reduce banking costs for consumers, according to an industry study. Predicting continued increases in computer ownership, Internet usage, and acceptance of electronic banking, the study finds that Internet banking customers will represent almost 16 percent of households by the year 2000, up from less than 1 percent in 1996. Over the Internet, typical transactions cost about 1 cent, compared to more than a dollar for a traditional branch bank transaction. And, since it is much easier for consumers to switch banks on the Internet, banks will be forced to pass their transaction cost savings on to consumers in the form of lower fees. Despite increased competition, banks see Internet banking as a substantial profit opportunity because those customers likely to use the Internet represent a disproportionately high percentage of retail banking profits. They are younger, more affluent, and use more services than other customers. As a result, the number of banks offering Internet banking is expected to increase from 30 by the end of 1996 to more than 500 by the end of the decade.

9-3-96

INTERNATIONAL ROUNDUP

Mexico Records Positive Growth in Second Quarter. During the second quarter of 1996, the Mexican economy registered a real rate of growth of 7.2 percent vis-a-vis the same period last year. This is the first quarter of real growth (year over year) since late 1994, and the fastest growing quarter since late 1990. Industrial production expanded at a remarkable 11.9 percent last quarter, while agriculture grew by 4 percent. Due to strong growth in imports, Mexico's second quarter trade surplus of \$2.2 billion is down 16 percent from last year's level. For the first 6 months of 1996, Mexico's trade surplus with the United States, which totaled \$8.3 billion, was 8 percent higher than last year.

France Announces Sweeping Budget Cuts for 1997. On August 7, the French government announced plans to slash public spending by 2 percent in real terms to achieve a spending freeze in 1997. In order to meet the Maastricht fiscal criterion for monetary union, France must reduce its budget deficit from over 4 percent of GDP this year to 3 percent by 1997. Concerns have been voiced that a new round of social unrest could be triggered in the fall as details on the budget cuts are made public. (France was hit by numerous strikes in the last year.) Although France rebounded from a contraction of output in 1993 with growth of nearly 3 percent in 1994, economic performance has been more sluggish since then, with output forecast to rise by only 1 percent this year. France also suffers from high unemployment, which is 12 percent this year and unlikely to fall before 1998.

Brazilian Banking Sector to Get Government Help in Restructuring. Brazil's Finance Minister recently outlined a Federal plan to finance the restructuring or privatization of the beleaguered state banks. Brazil's state banks have been seriously weakened by the practices of state governors, who borrowed heavily from their banks without offering adequate guarantees. Another exacerbating factor has been the dramatic decline in inflation in the last 2 years, which has eroded the profits made by banks on non-interest bearing deposits. Under the new government refinancing plan, states that choose to privatize their state banks or transform them into non-financial institutions can receive up to 100 percent of the funds needed to finance the restructuring. States that choose not to relinquish ownership of their state banks would be reimbursed for only half the cost of restructuring, and would have to offer full collateral on the loans.

Athletic Prowess and Economic Status Show Few Links at Olympic Games. At the Centennial Olympic Games in Atlanta, the United States was the most successful nation in terms of medals won—44 gold, 32 silver, and 25 bronze. But if one takes into account the population and wealth of the United States, other nations—many of them quite poor—appear to have outperformed the United States. A country's national income seems to bear no relationship to its medal "score" (calculated by awarding three points for a gold, two points for a silver, and one point for a bronze).

Cuba, for example, had one of the highest medal scores per capita, despite having very low average income. Other countries that performed well on this measure were Bulgaria, Jamaica, and Hungary.

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WJC HANDWRITING

RELEASES THIS WEEK

Advance Durable Orders

****Embargoed until 8:30 a.m., Friday, August 23, 1996****

Advance estimates show that new orders for durable goods increased 1.6 percent in July, following a 0.2 percent decrease in June.

U.S. International Trade in Goods and Services

The goods and services trade deficit was \$8.1 billion in June compared with a deficit of \$10.5 billion in May.

MAJOR RELEASES NEXT WEEK

Consumer Confidence—Conference Board (Tuesday)

Gross Domestic Product (Thursday)

U.S. ECONOMIC STATISTICS

	1970– 1993	1995	1995:4	1996:1	1996:2
Percent growth (annual rate)					
Real GDP (chain-type)	2.7	1.3	0.3	2.0	4.2
GDP chain-type price index	5.3	2.5	2.1	2.3	2.1
<u>Nonfarm business (NFB) sector:</u>					
Productivity (chain-type)	1.5	0.3	-1.1	1.8	-0.1
Real compensation per hour:					
Using CPI	0.6	1.4	1.6	0.0	-0.1
Using NFB deflator	1.3	2.1	2.8	2.0	2.0
Shares of Nominal GDP (percent)					
Business fixed investment	10.9	10.2	10.2	10.4	10.2
Residential investment	4.5	4.0	4.0	4.1	4.2
Exports	8.2	11.1	11.4	11.3	11.3
Imports	9.2	12.4	12.3	12.5	12.7
Personal saving	5.1	3.4	3.8	3.6	3.2
Federal surplus	-2.7	-2.2	-2.1	-2.1	N.A.
<hr/>					
	1970– 1993	1995	May 1996	June 1996	July 1996
Unemployment Rate	6.7**	5.6**	5.6	5.3	5.4
Payroll employment (thousands)					
increase per month			407	220	193
increase since Jan. 1993					10224
Inflation (percent per period)					
CPI	5.8	2.5	0.3	0.1	0.3
PPI-Finished goods	5.0	2.3	-0.1	0.2	0.0

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

FINANCIAL STATISTICS

	1994	1995	June 1996	July 1996	August 22, 1996
Dow-Jones Industrial Average	3794	4494	5672	5496	5733
Interest Rates					
3-month T-bill	4.25	5.49	5.09	5.15	5.00
10-year T-bond	7.09	6.57	6.91	6.87	6.62
Mortgage rate, 30-year fixed	8.35	7.95	8.32	8.25	7.93
Prime rate	7.15	8.83	8.25	8.25	8.25

INTERNATIONAL STATISTICS

Exchange Rates	Current level August 22, 1996	Percent Change from Week ago	Year ago
Deutschemark-Dollar	1.491	0.4	0.5
Yen-Dollar	108.2	0.2	11.9
Multilateral \$ (Mar. 1973=100)	86.81	0.1	0.6

International Comparisons	Real GDP growth (last 4 quarters)	Unemployment rate	CPI inflation (last 12 months)
United States	2.6 (Q2)	5.4 (Jul)	3.0 (Jul)
Canada	0.6 (Q1)	10.0 (Jun)	1.4 (Jun)
Japan	5.5 (Q1)	3.6 (Jun)	0.0 (Jun)
France	0.9 (Q1)	12.1 (May)	2.3 (Jun)
Germany	0.4 (Q1)	7.1 (May)	1.3 (Jun)
Italy	1.6 (Q1)	12.5 (Apr)	4.0 (Jun)
United Kingdom	1.9 (Q2)	8.3 (Jun)	2.2 (Jun)