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WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

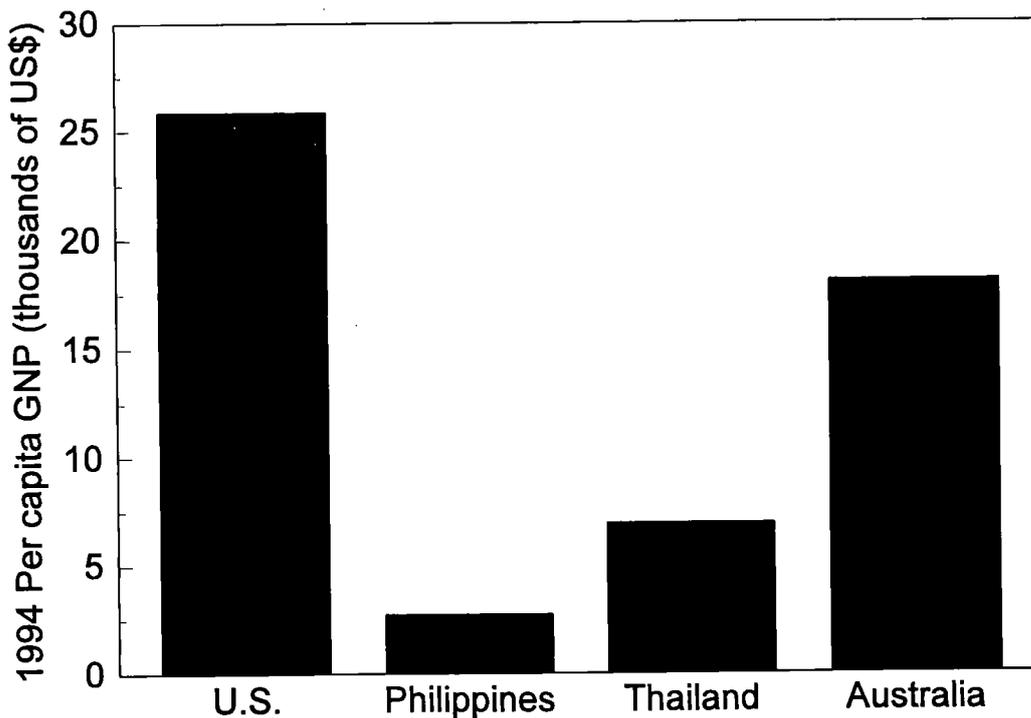
Prepared by the Council of Economic Advisers
with the assistance of the Office of the Vice President

November 15, 1996

Copied to Stiglitz

CHART OF THE WEEK

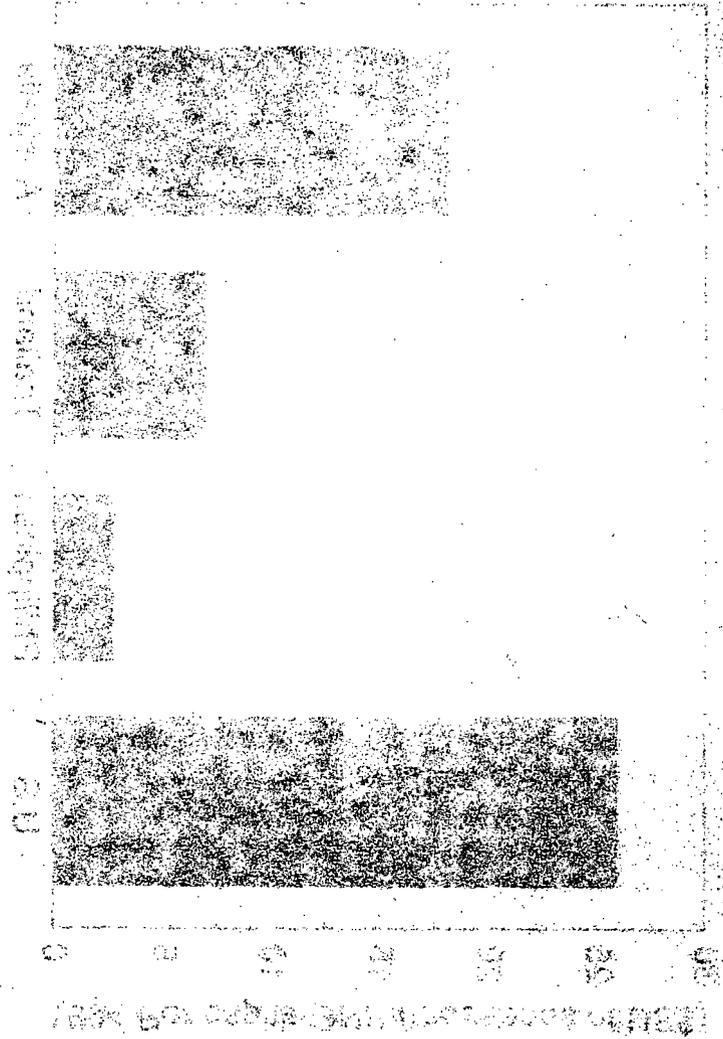
Per Capita GNP in Selected Countries



Measured by per capita gross national product (adjusted to reflect purchasing power), the material standard of living in Australia is 70 percent of what it is in the United States. Thailand stands at 27 percent and the Philippines at 11 percent.

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PERCENTAGE OF CIGARETTE CONSUMPTION IN VARIOUS COUNTRIES

REPORT OF THE JURY

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REPORT OF THE JURY ON THE PROCEEDINGS OF THE TRIAL OF THE DEFENDANT

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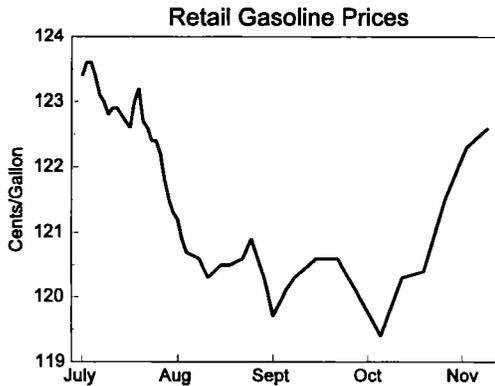


"The prince married the princess, the kingdom got most-favored-nation status, and they lived happily ever after."

CURRENT DEVELOPMENT

The Up-and-Down World of Energy Prices

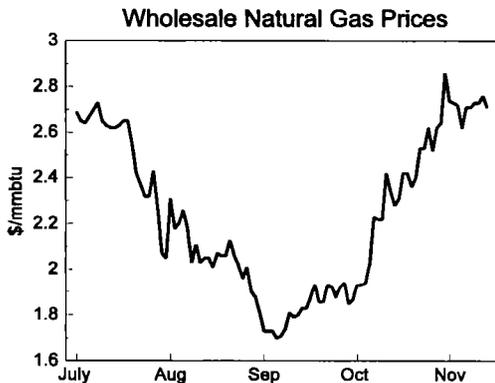
Over the past few months, the prices of several energy products have fluctuated widely (see charts). To some extent, volatile energy prices appear to reflect temporary shocks. But a shift toward “just-in-time” inventory practices may have resulted in lower inventories and greater price swings.



Gasoline. The Department of Energy’s investigation into last spring’s spike in gasoline prices to \$1.29 per gallon found that much of it could be explained by higher world crude oil prices. Other explanations included uncertainty about Iraq’s re-entry into world oil markets, which reinforced other forces leading to lower inventory levels.



Distillates. Wholesale prices of distillates (mainly home heating oil and diesel fuel) shot up in September and October, in part reflecting earlier increases in crude oil prices. Their recent decline has reflected greater-than-expected refinery production, lower levels of exports, and relatively light demand thus far in this heating season. At current low inventory levels (approximately 15 percent below year-earlier levels in mid-September), shocks like unexpectedly cold winter weather or a refinery shutdown could have a marked impact on prices.



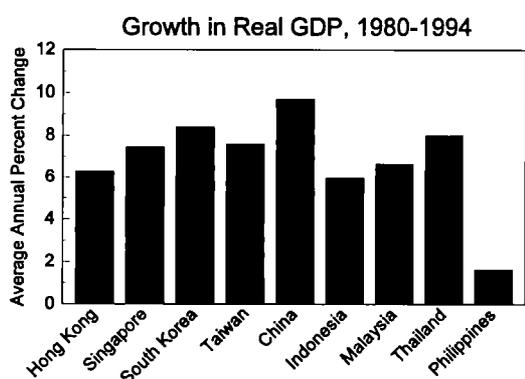
Natural Gas. The roller-coaster behavior of natural gas wholesale spot prices is different from that observed in prior years and appears to reflect more than just seasonal factors.

SPECIAL ANALYSIS

The Philippines: The Next Asian Tiger?

After lagging behind its neighbors in the 1980s and early 1990s, the Philippines has begun to see faster growth in the last 2 years. But its saving rate may be too low to achieve sustainable growth rates like those of other industrializing Asian economies.

Background. The Philippines averaged less than 2 percent annual growth in GDP between 1980 and 1994 (see chart). Malaysia and Thailand, by contrast, have undergone a prolonged growth spurt, and before long these countries may join the four Tigers—Hong Kong, Singapore, South Korea, and Taiwan—in the ranks of industrialized economies. China and Indonesia are further behind in per capita income but have also grown rapidly.



Philippine exports (in dollars) grew 8 percent per year, compared with rates ranging from 11 percent in Malaysia to 15 percent in Hong Kong and Thailand. Only oil-exporting Indonesia's 6 percent export growth was slower than that of the Philippines.

Preparing for growth. The Philippines undertook a host of structural reforms in the early 1990s. Major state companies have been privatized; monopolies have been broken up; and foreign investment and foreign exchange restrictions have been eliminated. Political stability has improved, and the government budget deficit has been reduced. With all these changes in place, the Philippines has at last begun to experience rapid, export-driven growth. Export growth has nearly doubled since 1993. GNP growth jumped from 2.8 percent in 1993 to 5.5 percent in 1995; and the IMF projects growth to continue to increase through next year. Foreign capital inflows have also increased, especially direct foreign investment.

Ready to roar? The Philippines does not yet fully resemble an Asian Tiger. Growth in East and Southeast Asia has been financed by very high domestic saving and investment rates. Although very respectable, Philippine saving rates are not up to regional standards. Gross domestic saving in the Philippines averaged 19 percent of GDP over the 1980s and early 1990s, closer to that of the United States than to the 30-percent-and-above rates of the Philippines' fast-growing neighbors. Despite the stronger economy, the saving rate shows no sign of increasing. Fortunately, the investment rate has been somewhat higher, because the Philippines benefits from capital inflows and large remittances from the many Filipinos working abroad.

Conclusion. A relatively moderate saving rate will not prevent the Philippines from improving on its past growth record. But it may keep it from becoming a Tiger.

SPECIAL ANALYSIS

Welfare Reform and the Unemployment Rate

Recently enacted welfare reform legislation, which should stimulate efforts by welfare recipients to find work, may also raise the unemployment rate.

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to work for Section fr. this*

Analysis. The monthly unemployment rate is calculated from data collected in the Current Population Survey (CPS), in which respondents are classified as employed, unemployed, or not in the labor force. Those without jobs who say they are available for work and have actively sought work in the past 4 weeks are classified as unemployed. Those who have not sought work are classified as not in the labor force and do not enter the unemployment rate calculation.

Currently, about 135 million people are in the labor force, 7 million of whom are unemployed. Of the roughly 4.5 million adult welfare recipients, perhaps 2 or 3 million will be compelled to look harder for jobs because of welfare reform's work requirements and time limits. The box illustrates two theoretical possibilities, assuming 2 million welfare recipients increase their efforts to find jobs and half are successful. In Case 1, where the former welfare recipients are assumed to be new entrants into the labor force, the unemployment rate increases. In Case 2, where they are assumed to be previously unsuccessful job seekers who search harder and are more successful finding jobs, the unemployment rate goes down.

| Theoretical Unemployment Rate Outcomes | | | |
|--|----------------------|----------------------|----------------------|
| | <u>Initial level</u> | <u>Case 1 Change</u> | <u>Case 2 Change</u> |
| Labor Force | 135 million | +2 million | 0 |
| Employed | 128 million | +1 million | +1 million |
| Unemployed | 7 million | +1 million | -1 million |
| Unemployment Rate | 5.2 percent | +0.6 percent | -0.8 percent |

Notes: Case 1 assumes welfare recipients are not in the labor force initially; Case 2, that they are in labor force initially. In each, 2 million potential workers move off welfare and half find jobs.

Unfortunately, the monthly CPS does not provide information about the labor force status of welfare recipients. Evidence from other surveys suggests, however, that only about 15 percent of current welfare recipients without jobs are looking for work—more in line with Case 1 than with Case 2.

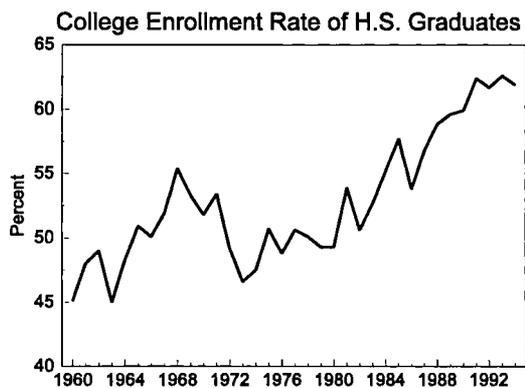
These calculations are quite sensitive to job-finding rates of welfare recipients. The unemployment rate would be largely unaffected, for example, if welfare recipients were as likely to find jobs as other labor force entrants. Economic performance over the past four years has shown that the economy is capable of creating new jobs. But lack of basic skills, inability to obtain affordable child care, or other constraints may make the transition to work difficult for welfare recipients.

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ARTICLE

Trends in College Enrollment

The share of recent high school graduates entering college rose over the 1980s and early 1990s, but has been flat over the past few years (see chart). Tuition costs have out paced the college wage premium and may be an important reason for the change.



An Economic Model of the Enrollment Decision.

Economists model the decision to go to college as an investment that is made if the benefits of attending college exceed the costs. The main economic benefit of college is a lifetime of higher earnings relative to a high school graduate. The costs include not only tuition and other direct college expenses but also the earnings forgone by going to college instead of working.

Changing benefits and costs. This economic model performs well in predicting the qualitative direction of college enrollment trends based on changes in the costs and benefits of attending college. Rising enrollment through the 1980s and early 1990s is consistent with increases in the college wage premium (see *Weekly Economic Briefing*, November 1, 1996) that out paced increases in tuition. During the past few years, however, increases in tuition were not matched by increases in the college wage premium. This reduced the net economic benefit of going to college, which is consistent with a flattening trend in enrollment.

Complicating factors. Although the net benefit may have dropped in recent years, back-of-the-envelope calculations suggest that an investment in a college education still yields a substantial economic return. If the college wage premium received by the average student remains at its present level, an 18-year-old who decides to go to college can expect to receive roughly \$200,000 to \$400,000 of additional earnings for an initial investment of less than \$100,000.

Several factors may explain the apparent discrepancy between these numbers and the qualitative success of the economic model (of course, noneconomic factors may affect educational decisions as well).

- Average versus marginal students. Returns to college are estimated based on the net economic benefits for the typical graduate. Some students receive considerably smaller returns. For the student at the margin, the return is zero. For students at or near the margin, small changes in the costs and benefits of a college investment can make the difference in their enrollment decision.

- Credit constraints. Student borrowing from the main federal loan program is limited to \$2,625 in the first year of college, \$3,500 in the second year, and \$5,500 in the third and fourth years, never amounting to the full cost of the investment. If students are constrained in their ability to pay for college, relatively small changes in tuition may prevent them from making an otherwise profitable investment. Credit constraints and low returns for students at the margin help explain the finding that college enrollment is very responsive to relatively small changes in tuition levels. One recent study shows that a \$1,000 increase in tuition might reduce enrollments by as much as 20 percent.
- Informational problems. Even if credit constraints exist, the low tuition cost of community colleges makes at least two years of college affordable for all students who live at home. If students are unaware of the availability of loans or other financial aid, however, perceived financial constraints may prevent them from enrolling.
- Risk aversion. Students may be nervous that they might not be able to repay any loans taken out to cover educational expenses. The recent introduction of income-contingent repayment options should help alleviate this concern.
- Changing expectations. Students may respond to changes in the college wage premium by projecting that any new trend will continue. For example, if students in the 1980s expected the premium to continue to grow, the projected benefits of obtaining a college degree would be enhanced substantially. The recent slowdown in the college wage premium may have led students to revise their expectations, significantly reducing the projected benefits of going to college.

Policy implications. One way programs to promote college attendance will be assessed is to look at whether enrollment rates change. Demonstrating the success of programs may be particularly difficult when enrollments are leveling off for other reasons.

Economists focus on market forces—costs and benefits—as a primary determinant of enrollment decisions. Unknowns in the eventual success of Administration policy, including the proposed tax initiatives, are (a) the extent to which their impacts will be offset by tuition increases; and (b) the importance of credit constraints and avoiding additional debt burdens to those who are currently at the margin of enrolling.

INTERNATIONAL ROUNDUP

Japan Announces Plans for Major Financial Sector Deregulation. On Monday, the Japanese government unveiled plans for far-reaching reforms of its financial markets by 2001, aimed at reestablishing Tokyo as a top international financial center. Another aim is to improve investment opportunities for the nation's \$10.8 trillion of savings. The reform package seeks to deregulate stockbroking commissions and allow cross-entry by banks, securities firms, and insurance companies into each other's businesses. Also proposed are the abolition of foreign exchange restrictions and the end of fixed commissions on other transactions, including insurance premiums. These changes would be complemented by wider reform of Japan's legal, tax and accounting systems. The government has reportedly declared itself ready to accept the collapse of weaker financial institutions, which may result from deregulation. Analysts appear skeptical that the government will be able to push through the announced reforms against a series of vested interests.

International Development Organizations Focus on Eliminating Hunger. At this week's World Food Summit, leaders pledged to halve the number of undernourished people from its current 800 million by 2015. The World Bank also recently issued a "wake-up call" on food security, stating that a transformation of agriculture and rural development is vital to feeding the Earth's growing population, which is expected to reach 8 billion in the next 30 years. Small-holder farmers represent the largest number of people involved in business throughout the world. They are also among the world's poorest. Therefore, the World Bank is focusing attention on improving conditions in rural areas, through programs that support agricultural research and improve credit access for the very poor.

European Companies Call for Faster Progress Towards the Single Market. In two major recent studies covering thousands of companies in the European Union, respondents registered general satisfaction with the single market. But the studies also showed that business does not think that movement to remove obstacles to trade has been fast enough. Problem areas identified by the studies include slow progress in the setting of common technical standards, which affects the movement of machinery and building materials; failure by member states to recognize other members' certification and test results in certain sectors; a lack of convergence in environmental standards, especially in waste recovery; poor implementation of legislation opening up the public procurement market; and lack of progress on energy market liberalization.

RELEASES THIS WEEK

Consumer Price Index

The consumer price index increased 0.3 percent in October. Excluding food and energy, consumer prices increased 0.2 percent.

Retail Sales

Advance estimates show that retail sales increased 0.2 percent in October following an increase of 0.8 percent in September. Excluding sales in the automotive group, retail sales increased 0.4 percent in October following an increase of 0.5 percent.

Producer Price Index

The producer price index for finished goods increased 0.4 percent in October. Excluding food and energy, producer prices fell 0.3 percent.

MAJOR RELEASES NEXT WEEK

Housing Starts (Tuesday)

U.S. International Trade in Goods and Services (Wednesday)

U.S. ECONOMIC STATISTICS

| | 1970– 1993 | 1995 | 1996:1 | 1996:2 | 1996:3 |
|--|-----------------------|-------------|----------------------|-----------------------|----------------------|
| Percent growth (annual rate) | | | | | |
| Real GDP (chain-type) | 2.7 | 1.3 | 2.0 | 4.7 | 2.2 |
| GDP chain-type price index | 5.3 | 2.5 | 2.3 | 2.2 | 1.9 |
| <u>Nonfarm business (NFB) sector:</u> | | | | | |
| Productivity (chain-type) | 1.5 | 0.3 | 1.7 | 0.5 | 0.2 |
| Real compensation per hour: | | | | | |
| Using CPI | 0.6 | 1.4 | 0.0 | 0.0 | 1.6 |
| Using NFB deflator | 1.3 | 2.1 | 2.0 | 2.0 | 2.7 |
| | | | | | |
| Shares of Nominal GDP (percent) | | | | | |
| Business fixed investment | 10.9 | 10.2 | 10.4 | 10.3 | 10.5 |
| Residential investment | 4.5 | 4.0 | 4.1 | 4.2 | 4.1 |
| Exports | 8.2 | 11.1 | 11.3 | 11.3 | 11.1 |
| Imports | 9.2 | 12.4 | 12.5 | 12.6 | 12.6 |
| Personal saving | 5.1 | 3.4 | 3.6 | 3.2 | 4.0 |
| Federal surplus | -2.7 | -2.2 | -2.1 | -1.7 | N.A. |
| <hr/> | | | | | |
| | 1970– 1993 | 1995 | Aug. 1996 | Sept. 1996 | Oct. 1996 |
| Unemployment Rate | 6.7** | 5.6** | 5.1 | 5.2 | 5.2 |
| Payroll employment (thousands) | | | | | |
| increase per month | | | 280 | -35 | 210 |
| increase since Jan. 1993 | | | | | 10703 |
| Inflation (percent per period) | | | | | |
| CPI | 5.8 | 2.5 | 0.1 | 0.3 | 0.3 |
| PPI-Finished goods | 5.0 | 2.3 | 0.3 | 0.2 | 0.4 |

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

New or revised data in **boldface**.

FINANCIAL STATISTICS

| | 1994 | 1995 | Sept. 1996 | Oct. 1996 | Nov. 13, 1996 |
|-------------------------------------|------|------|---------------|--------------|------------------|
| Dow-Jones Industrial Average | 3794 | 4494 | 5804 | 5996 | 6274 |
| Interest Rates | | | | | |
| 3-month T-bill | 4.25 | 5.49 | 5.09 | 4.99 | 5.03 |
| 10-year T-bond | 7.09 | 6.57 | 6.83 | 6.53 | 6.20 |
| Mortgage rate, 30-year fixed | 8.35 | 7.95 | 8.23 | 7.92 | 7.67 |
| Prime rate | 7.15 | 8.83 | 8.25 | 8.25 | 8.25 |

INTERNATIONAL STATISTICS

| Exchange Rates | Current level | Percent Change from | |
|---------------------------------|----------------------|----------------------------|-----------------|
| | Nov. 13, 1996 | Week ago | Year ago |
| Deutschemark-Dollar | 1.505 | -0.1 | 6.1 |
| Yen-Dollar | 111.4 | -0.1 | 9.5 |
| Multilateral \$ (Mar. 1973=100) | 86.78 | -0.1 | 3.0 |

| International Comparisons | Real GDP growth (last 4 quarters) | Unemployment rate | CPI inflation (last 12 months) |
|----------------------------------|--|--------------------------|---|
| United States | 2.3 (Q3) | 5.2 (Oct) | 3.0 (Oct) |
| Canada | 1.2 (Q2) | 9.9 (Sept) | 1.5 (Sept) |
| Japan | 3.9 (Q2) | 3.3 (Sept) | 0.0 (Sept) |
| France | 0.5 (Q2) | 12.3 (Aug) | 1.6 (Sept) |
| Germany | 1.1 (Q2) | 7.3 (Sept) | 1.4 (Sept) |
| Italy | 0.7 (Q2) | 11.9 (Jul) | 3.4 (Sept) |
| United Kingdom | 2.3 (Q3) | 8.0 (Sept) | 2.1 (Sept) |