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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

April 7, 2000

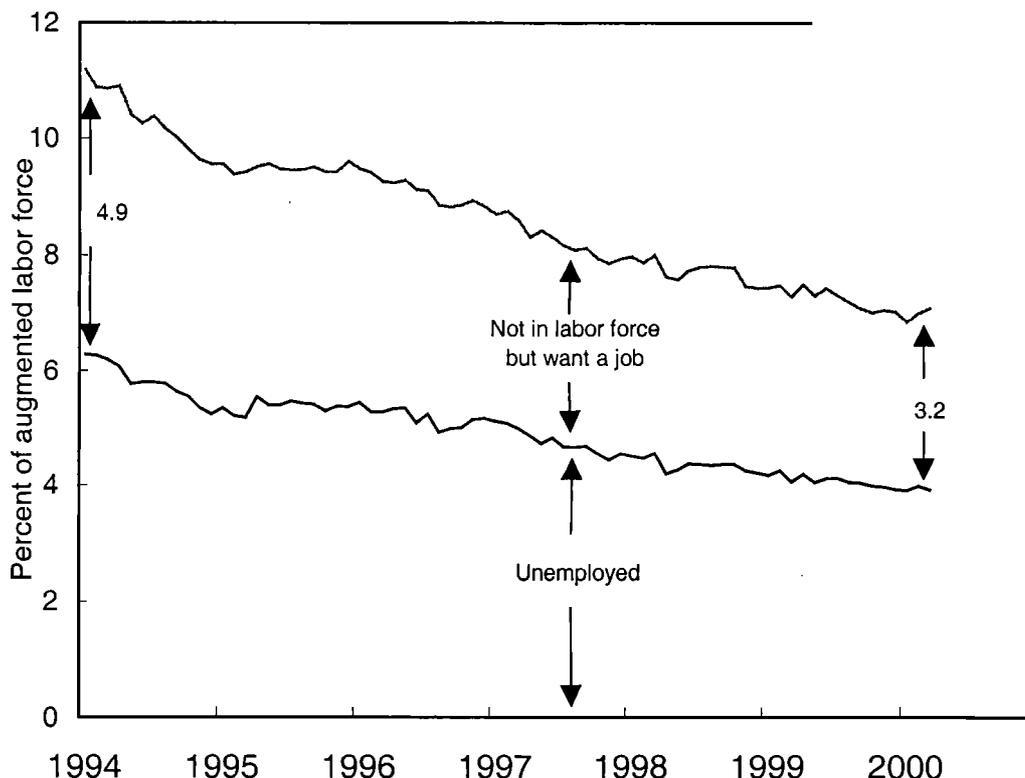
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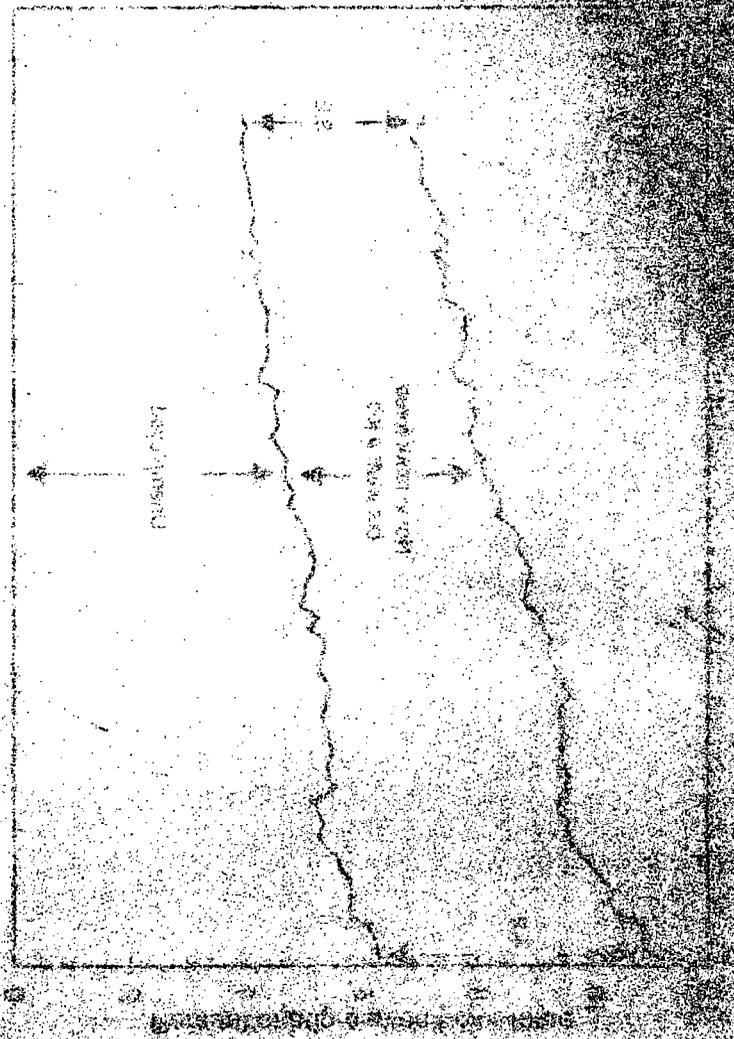
CHART OF THE WEEK

The Pool of Potential Workers



As Federal Reserve Chairman Greenspan noted again this week in his remarks at the White House conference, overall demand for goods and services has outpaced potential supply over the past 4 years. An increasing share of this extra demand has been met by rising net imports and the rest has been met by drawing down the pool of potential workers, which includes not just the officially unemployed but also those who are not in the labor force (because they did not actively seek work) but say they want a job.

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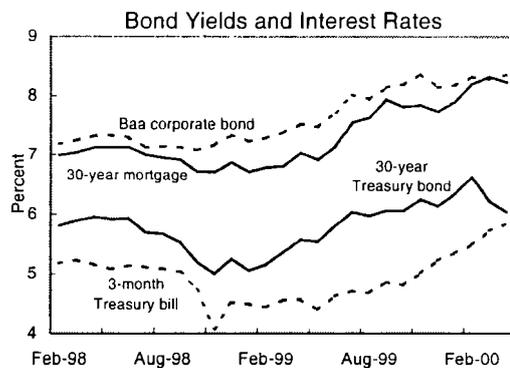
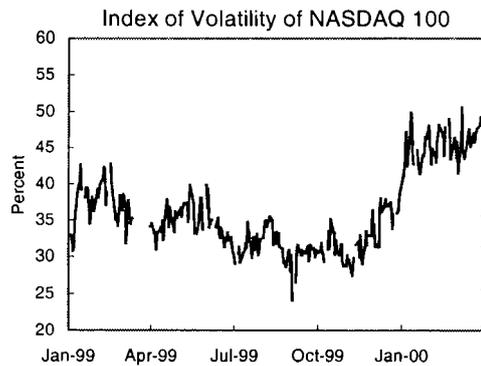
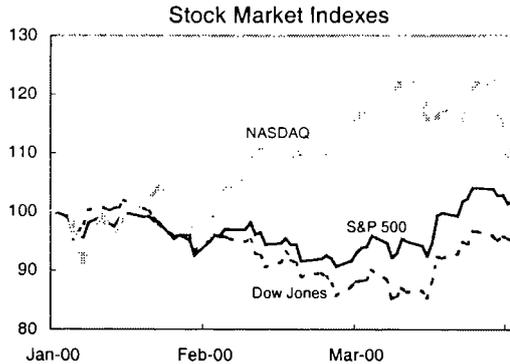
"THIS MUST BE THAT STRANGE CREATURE
THEY MENTIONED IN HISTORY CLASS"



FINANCIAL MARKET UPDATE

First Quarter 2000

Although technology stocks again outperformed the overall market during the first quarter of 2000, a sharp decline at the end of March foreshadowed turmoil this week. Tightening by the Federal Reserve led to generally higher interest rates and borrowing costs, but long-term Treasuries behaved idiosyncratically.



March madness. The NASDAQ Composite Index recorded a solid 12.4 percent gain in the first quarter—though it finished 9 percent below its mid-March peak (see upper chart). The Dow Jones and the S&P 500 showed an opposite pattern, first sinking and then recovering. These gyrations may have prompted a reassessment of the risk associated with investing in the technology sector, with one measure of NASDAQ volatility showing a distinct increase after a year of stability (see middle chart).

Interest rates. The Fed raised its target lending rate 25 basis points in both February and March. At 6 percent, the federal funds target is at its highest level since June 1995. With the Fed continuing to express concern about inflationary pressures, markets expect another 25-basis-point increase in May and a 6.75 percent federal funds rate by year's end. Both mortgage rates and corporate bond yields climbed in the first quarter (see lower chart), raising borrowing costs of businesses and households. Yields on long-term government securities went

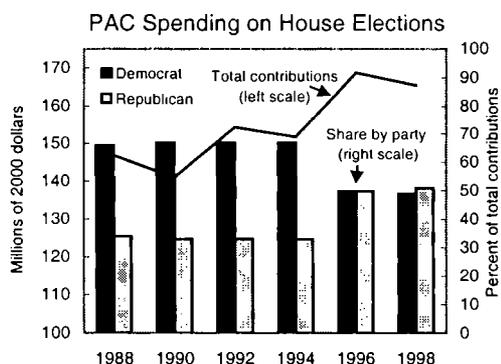
down—perhaps reflecting supply constraints associated with the fiscal surplus.

Volatility continues. The role reversal that began to emerge in late March has continued this week with the "old-economy" indexes inching upward and the NASDAQ down about 7 percent. Although the NASDAQ is still up 5 percent for the year, the short-term outlook for technology stocks seems to have become more uncertain.

SPECIAL ANALYSIS

The Political Economy of Campaign Financing

Federal Election Commission data show that direct political action committee (PAC) contributions to House candidates over the last four federal election cycles represented almost one-third of all funds raised by these candidates. As total election spending has increased, the total dollar amount of PAC contributions has risen. For House candidates, total PAC contributions increased by 13 percent in real terms between the 1988 and 1998 election cycles (see chart). Incumbent candidates received the largest share of these contributions, and when the House switched from Democratic to Republican control following the 1994 election, PAC contributions changed as well.



A statistical analysis of PAC contributions. A recent study examined some of the factors that may motivate repeated PAC contributions to candidates across different election cycles. Looking at incumbent members of the House, the study found that after controlling for other factors, the number of PACs that repeatedly gave to candidates over different election cycles declined as the

candidates' margin of victory in the last election increased. This effect could be due to either less fund raising by the candidate (because her seat is relatively safe) or fewer contributions by PACs (because they believe they have less influence with candidates in such districts). The study also found that repeated giving by PACs increased significantly as seniority on congressional committees increased, over and above any increase attributable to greater tenure in the House or the effect of being chairman of a committee. As the probability that a Congressman will retire increases, however, the study found that repeat giving by PACs declines sharply.

Reputation effects and PAC contributions. The authors of the study interpret the increase in repeat giving that is associated with greater committee seniority as the outcome of a reputation-building process. Organized interest groups initially may be uncertain about what policies legislators will support when they first arrive on Capitol Hill. As legislators define their positions more clearly over time by working on issues in committees, PACs that favor those issues are more likely to support candidates who represent their interests with repeated contributions. As the probability of retirement increases, however, the repeated interactions required to sustain this outcome become attenuated. PACs may see fewer long-run benefits from contributing to a lawmaker nearing retirement, and lawmakers may decide to support policy positions that some of their contributing constituents may oppose.

Conclusion. This analysis suggests that politicians' reputations affect PAC giving. Implications for campaign finance reform are less clear, though one provocative proposal seeks to separate financial support for positions from possibility that large donors might unduly influence the political process (see box).

Donor Anonymity: an Alternative Approach to Campaign Finance Reform

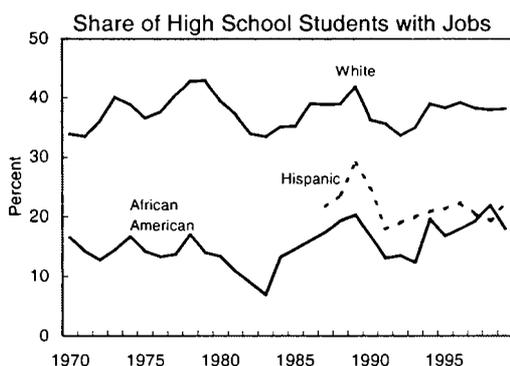
Concern about the ability of large donors to influence the political process unduly has prompted campaign finance reform proposals that involve limitations on the overall amount that any one donor can contribute to a campaign, as well as requirements that contributions be publicly disclosed. Another approach suggested in a 1998 law review article, however, is to require that all contributions above a certain (low) threshold be made to a blind trust so that the candidate knows how much is available to spend, but not who has given the money. Attendees at a political fundraising dinner, for example, could be asked to pay for the cost of their meal, but would mail checks containing contributions to the trust. With donor anonymity, contributors motivated by a desire to support a particular person because of his views would still be able to do so, but contributors motivated by a belief that their contribution would "buy" future access would be deterred. Such individuals would be indistinguishable from others who simply claimed to make large donations, because the candidate has no knowledge of who has actually contributed to the campaign.

ARTICLE

Working While in School: Are There Net Benefits?

A substantial fraction of today's youth combine school with a job. Working may provide important lessons for young people about responsibility, punctuality, dealing with people, and money management, while increasing self-esteem and independence. In turn, these traits may lead to increased rates of employment and higher wages in the years following high school. However, work may also conflict with schooling by taking away time from other valuable activities, such as studying and sleeping.

Background. Approximately 3.3 million young people (aged 16-24) are both enrolled in high school and employed in the labor market. This figure represents about a third of the 9.9 million high school students in that age group. Of those



employed, only about 6 percent report working full-time. While employment rates have been fairly constant over time, there are fairly substantial differences between racial and ethnic groups (see chart). Part of these differences may be explained by the differences in unemployment across the groups. The unemployment rate for white youths who are enrolled in high school is currently 13.4 percent.

The rate for African Americans and Hispanics is about 24 percent. When high school students are interviewed directly, about 80 percent report that they have held a job at some point during their junior or senior years of high school. Half of all working 15- to 17-year olds have jobs in the retail sector (restaurants, fast-food outlets, grocery stores, and other retail stores).

Costs and benefits. Researchers have examined the effect of work on a number of outcomes. The direct effect of high school employment is difficult to identify because the decision to work is correlated with many other observed and unobserved factors. For example, factors such as motivation, work effort, and parental support may be associated with both the decision to work as a teenager and subsequent educational and employment outcomes. Nonetheless, a few conclusions from the literature seem to be emerging.

- Subsequent educational attainment. There is little consensus among researchers about the effect of working while in school on subsequent educational attainment, as measured by school performance (grades), grade completion, and persistence in school. However, a number of studies have found that if harmful effects exist, they result from working many hours per week. One recent study that controls for unobserved factors found that

extensive employment during the school year had a negative impact on academic performance, especially that of racial minorities.

- Vocational development and occupational attainment. Researchers have found that students who work in school also tend to have greater future job market success, as measured by better employment prospects or higher wages. However, a recent study that carefully controls for the complicated selection issues found that the future economic returns to working in school (both high school and college) are probably more modest than those found in previous research.
- Health and safety. It has been estimated that each year about 100,000 young people seek treatment in hospital emergency departments for work-related injuries. The rate of injury per hour worked appears almost twice as high for children and adolescents as for adults—about 4.9 injured per 100 full-time equivalent workers among adolescents, compared with 2.8 for all workers. The most common nonfatal injuries observed among working young people are lacerations, sprains and strains, contusions, burns, and fractures.

Moderation is key. While the general evidence is mixed, one clear lesson is that young people who work while in school should do so in moderation. (Evidence suggests that summer employment does not carry the same potential for detrimental impact as does work during the school year.) Health and safety issues are also an important concern.

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

New DOE Forecast Sees Gasoline Price Moderation. This week the Department of Energy released a new energy forecast with gasoline prices through 2000 estimated to be 6 cents per gallon lower than in last month's forecast. Regular unleaded gasoline prices are expected to fall from a peak this month of just over \$1.50 per gallon. For the summer driving season, they are expected to average \$1.46 per gallon (nearly 30 cents per gallon higher than last summer). Prices are projected to average \$1.33 per gallon in the last 3 months of the year. The fall in prices reflects the recent OPEC production agreement. However, low inventories and lower imports may slow the fall in gasoline prices. Gasoline stocks are at the low end of the normal supply range and imports are down in part because some foreign refiners may not be able to meet new environmental standards for gasoline. While imports and stocks usually buffer gasoline prices from refinery outages, a disruption in refinery output this spring or summer could have a larger effect on gasoline prices than in the past.

Economic Factors Can Affect Teen Pregnancy Risk. Teenagers appear to weigh the costs of pregnancy and disease when making decisions about sexual activity and contraception, according to a recent study. For non-economists, teen sexual activity is often considered spontaneous and irrational, and pregnancies are viewed as "mistakes." The study found, however, that "pregnancy risk" (defined as the proportion of teen boys and girls who are sexually active and not using contraceptives) is sensitive to economic factors. According to the study, the increase in teenage employment between 1991 and 1996 decreased pregnancy risk by an estimated 5 percent. (Actual pregnancies fell by 16 percent.) The estimated effect of welfare generosity was that each 10 percent reduction in the maximum state welfare benefit level would lead to a reduced pregnancy risk of 1.2 percent for girls and 0.7 percent for boys. The study also estimated that increased AIDS incidence in a region would increase abstinence. Many effects have contributed to the recent decline in teenage birthrates, but these results indicate that a rational weighing of costs appears to have played a role.

Transportation and the Concentration of the Poor in Cities. A common explanation for why the poor are concentrated in cities in the United States is that wealthier individuals prefer to live in the suburbs where there is more land. A recent study questions this explanation, however, based on low empirical estimates of the sensitivity of the demand for land to income. The authors argue instead that public transportation is a key factor attracting the poor to cities. They report that a detailed examination of different metropolitan areas suggests a three-ring model of urban location: an interior walking ring where rich people live, a middle public transportation ring where poor people live, and an exterior car ring where rich people live. They find as well that the existence of subway systems enlarges the public transportation zone, and that income is low in this enlarged zone. Redistributive factors matter as well: the urban poor are 9.7 percentage points more likely to live in a subsidized public housing unit and 23 percent more likely to receive significant government income transfers than the suburban poor.

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INTERNATIONAL ROUNDUP

World Health Day 2000 Focuses on Blood Safety. April 7 marks World Health Day 2000, dedicated to the theme of Blood Safety. Availability of blood and avoiding the transmission of infection by blood and blood products are major health safety issues confronting the global community, according to the World Health Organization (WHO). Currently the 83 percent of the world's population living in developing countries has access to only about 40 percent of the blood donated annually in the world. Each year 150,000 pregnancy-related deaths could be avoided with appropriate transfusion therapy. The blood donated in developing countries is not tested for transfusion-transmissible infection in 43 percent of cases, and up to 5 percent of HIV infections worldwide are transmitted through transfusion of contaminated blood and blood products. Through global partnerships, the WHO hopes to encourage member states to implement national blood legislation to ensure the provision of safe blood, and to promote donations from voluntary, unpaid blood donors from low-risk populations.

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Bridging the Global Digital Divide. United Nations Secretary-General Annan presented his Millennium Report this week, identifying the pressing challenges faced by the global community and proposing a number of programs to be considered at the Millennium Summit in September. In addition to setting an agenda to reduce poverty and inequality, improve education, combat HIV/AIDS, and protect the environment, he proposed concrete initiatives to "build digital bridges" to help developing countries "leapfrog" the earlier stages of development via information technology. The initiatives include the establishment of 10,000 online sites in hospitals and clinics in developing countries to provide access to up-to-date medical information, and a volunteer corps to train groups in developing countries in the use of the Internet. The report also announced a new disaster response initiative, to be led by the communication company Ericsson, which will provide mobile and satellite telephones as well as microwave links for relief workers in areas affected by natural disasters and emergencies.

Better Governance Could Combat Poverty. Effective governance is often the missing link between anti-poverty efforts and poverty reduction in poor countries, according to a new report by the UN Development Program. The report advocates shifting decisionmaking power closer to poor communities by devolving authority and resources to local governments. However, this decentralization needs to be complemented by strengthening and increasing the accountability of local governments and fostering civic participation by the poor. The report stresses that resources for the poor should be directed toward helping them build their own organizational capacity rather than toward the social safety net. In Ghana, for example, 5 percent of the national budget is now allocated to local districts, which must use 20 percent of their allotment for local poverty-reduction activities. On the international front, the report criticizes the protection of agriculture in industrialized countries, which prevents poor countries from gaining access to export markets at the same time they are being asked to open their domestic markets to imports.

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RELEASES THIS WEEK

Employment and Unemployment

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

In March, the unemployment rate was unchanged from February at 4.1 percent. Nonfarm payroll employment increased by 416,000.

Leading Indicators

The composite index of leading indicators decreased 0.3 percent in February.

NAPM Report on Business

The Purchasing Managers' Index decreased 1.1 percentage points in March to 55.8 percent. (A reading above 50 percent indicates that the manufacturing economy is generally expanding.)

MAJOR RELEASES NEXT WEEK

Producer Prices (Thursday)

Retail Sales (Thursday)

Industrial Production and Capacity Utilization (Friday)

Consumer Prices (Friday)

U.S. ECONOMIC STATISTICS

	1970- 1993	1999	1999:2	1999:3	1999:4
Percent growth (annual rate)					
Real GDP (chain-type)	2.9	4.6	1.9	5.7	7.3
GDP chain-type price index	5.2	1.6	1.3	1.1	2.0
<u>Nonfarm business (NFB) sector:</u>					
Productivity (chain-type)	1.7	3.6	0.6	5.0	6.4
Real compensation per hour:					
Using CPI	1.0	1.7	1.4	2.1	0.8
Using NFB deflator	1.5	3.0	2.9	4.0	2.1
Shares of Nominal GDP (percent)					
Business fixed investment	11.4	12.6	12.6	12.7	12.5
Residential investment	4.5	4.4	4.5	4.4	4.4
Exports	8.2	10.8	10.7	10.8	10.9
Imports	9.2	13.5	13.4	13.8	14.0
Personal saving	6.6	1.7	1.8	1.5	1.3
Federal surplus	-2.8	1.2	1.3	1.4	1.2
<hr/>					
	1970- 1993	1999	January 2000	February 2000	March 2000
Unemployment Rate (percent)	6.7**	4.2**	4.0	4.1	4.1
Payroll employment (thousands)					
increase per month			394	7	416
increase since Jan. 1993					21213
Inflation (percent per period)					
CPI	5.8	2.7	0.2	0.5	N.A.
PPI-Finished goods	5.0	3.0	0.0	1.0	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 7, 2000.**

FINANCIAL STATISTICS

	1998	1999	February 2000	March 2000	April 6, 2000
Dow-Jones Industrial Average	8626	10465	10542	10483	11114
Interest Rates (percent per annum)					
3-month T-bill	4.78	4.64	5.55	5.69	5.72
10-year T-bond	5.26	5.65	6.52	6.26	5.93
Mortgage rate, 30-year fixed	6.94	7.43	8.33	8.24	8.20
Prime rate	8.35	8.00	8.73	8.83	9.00

INTERNATIONAL STATISTICS

Exchange Rates	Current level April 6, 2000	Percent Change from	
		Week ago	Year ago
Euro (in U.S. dollars)	0.958	-0.1	-11.6
Yen (per U.S. dollar)	104.8	-0.7	-13.2
Major currencies index (Mar. 1973=100) (trade-weighted value of the U.S. \$)	95.30	-0.1	-0.1

International Comparisons ^{1/}	Real GDP growth	Unemployment rate	CPI inflation
	(percent change last 4 quarters)	(percent)	(percent change in index last 12 months)
United States	4.6 (Q4)	4.1 (Mar)	3.2 (Feb)
Canada	4.7 (Q4)	6.8 (Jan)	2.7 (Feb)
Japan	0.0 (Q4)	4.7 (Dec)	-0.6 (Feb)
France	3.2 (Q4)	10.4 (Dec)	1.4 (Feb)
Germany	2.3 (Q4)	8.7 (Jan)	1.8 (Feb)
Italy	2.1 (Q4)	11.2 (Jan) ^{2/}	2.4 (Feb)
United Kingdom	3.0 (Q4)	5.9 (Nov)	2.3 (Feb)

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

1/ For unemployment data, rates approximating U.S. concepts as calculated by the U.S. Department of Labor, Bureau of Labor Statistics, except as noted in footnote 2.

2/ Data from OECD standardized unemployment rates.