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Weekly Economic Briefing - Oct. 22, 1999.

THE PRESIDENT HAS SEEN
10-27-99

WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

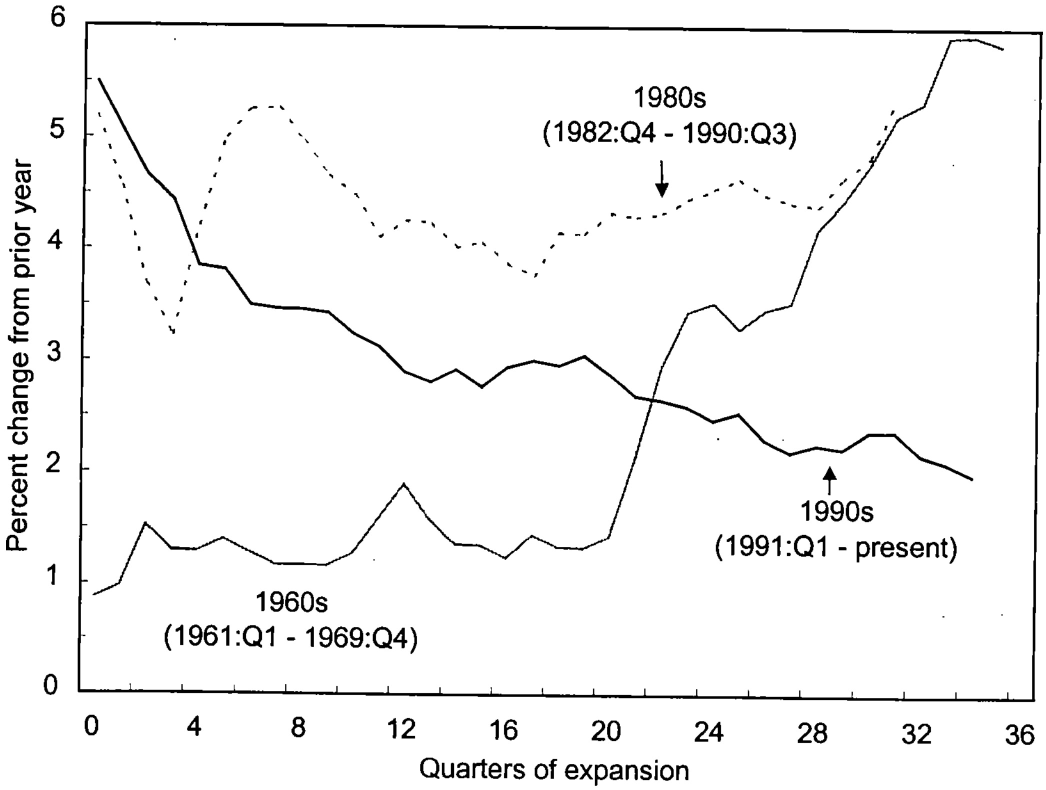
Prepared by the Council of Economic Advisers
with the assistance of the Office of the Vice President

October 22, 1999

copied
Baily
Podesta

CHART OF THE WEEK

Core Inflation in Three Long Expansions



The increase in the consumer price index for September announced this week was in line with market expectations and seems to have calmed financial market concerns that inflation might be heating up. In fact, this expansion has continued to show remarkably tame inflation (as measured by the consumer price index excluding the volatile food and energy components). By this point in the long 1960s expansion, for example, inflation was rising sharply.

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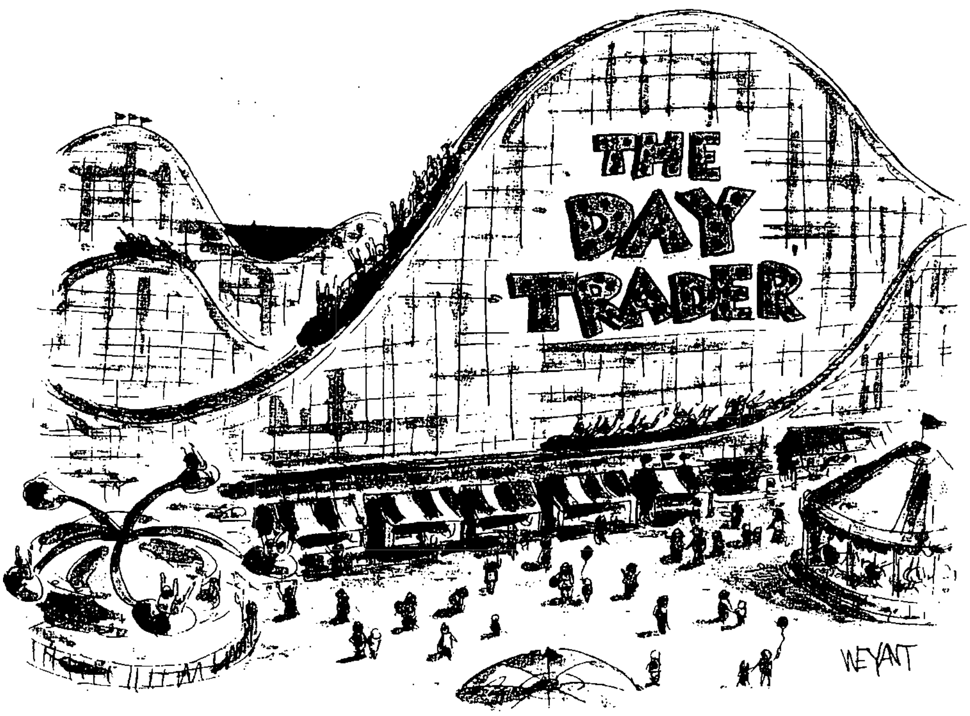
CONTENTS



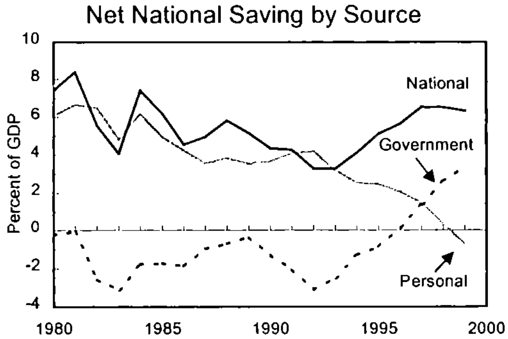
TREND

Have Americans Stopped Saving?

The fraction of disposable income that Americans save has been declining for the past two decades, and the personal saving rate is now negative. In the minds of some, this trend seems to indicate a crisis in personal saving, but a recent analysis of the saving data provides a somewhat more optimistic assessment.

Personal saving is just part of the story. Personal saving as measured in the National Income and Product Accounts (NIPA) has indeed declined precipitously since the early 1990s—falling by about 5 percentage points of GDP (see chart). But personal saving is just one part of national saving (which also includes the net saving of corporations and government). In contrast to personal saving, national saving has been on the rise, fueled in large part by improvements in the Federal budget balance.

Net National Saving by Source



Note: 1999 data based on first half

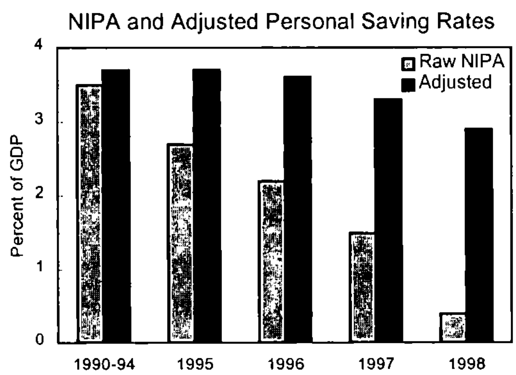
Measuring personal saving. In general, saving may be thought of as the part of current income that is laid aside for future use. The recent study suggests that some adjustments to the NIPA measure of personal saving might bring it more in line with this economic concept of saving. Among the most important are:

- Include changes in the stock of consumer durable goods. Expenditures on owner-occupied housing are included in personal saving, but purchases of other durables are not, even though they too represent assets that yield a stream of future benefits. Reclassifying the net accumulation of durable goods would add about 2 percentage points to both the household and national saving rates over the 1990s.

- Include contributions to social security and public pension and insurance funds. Contributions to and earnings from private pensions are included in personal saving and this adjustment would afford the same treatment to social security and public pensions. This adjustment would add about 1.7 percentage points to the personal saving rate, but it would subtract an equivalent amount from government saving (where such payments are currently credited).

- Adjust for the effect of inflation on assets. Households on balance earn more interest on savings accounts and other assets than they pay on loans. The study argues that the part of these net interest payments that simply compensates for inflation should not be included in saving. Since this adjustment has gotten smaller recently as inflation has declined, adjusted saving would not show as much of a decline as the official measure. The opposite adjustment would be required in sectors that are net payers of interest, hence national saving would be unchanged by the adjustment.

An adjusted measure of personal saving. By including the accumulation of durable goods and contributions to public pensions and by adjusting for inflation (along with some other technical adjustments), the authors compute an adjusted personal saving rate that fell only 0.8 percentage points in the 1990s, to just below 3 percent of GDP. This is a far more modest decline than that of the official NIPA measure (see chart).



What about the stock market? Capital gains are not included in the NIPA personal saving measure or in the adjusted measure reported above. Including them would result in a personal saving rate that has averaged nearly 35 percent since 1995 and has been trending *upward* since the mid-1990s. However, the question of whether capital gains should be treated as saving is tricky. For an individual household, capital gains represent increased future consumption opportunities, but for the economy as a whole it is only the gains associated with increases in the productivity of the underlying assets (as opposed, say, to a change in tastes that reduces the risk premium) that represent increased future consumption opportunities.

Conclusion. Some analysts have questioned whether the sharp decline in the NIPA personal saving rate provides an accurate picture of household saving behavior. One set of reasonable adjustments, for example, leads to a much smaller decline in the personal saving rate than is shown in the official measure. Except for the inclusion of the accumulation of durable goods, however, these adjustments mainly represent a reallocation of saving from business and government to personal saving and do not change measured national saving.

SPECIAL ANALYSIS

Recent Trends in Philanthropy

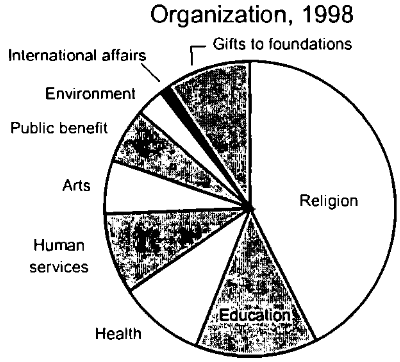
Charitable giving in 1998 reached an estimated $174.5 billion, or just over 2 percent of GDP (see upper chart). Giving has not been so large as a share of GDP since the early 1970s, and recent estimates of future giving suggest that contributions will continue to rise over the next 20 years as baby boomers age.

Sources of data. Data on giving come from a variety of sources. The data in the upper chart come from *Giving USA*, which combines data on giving by individuals, foundations, and corporations to make annual estimates of total giving. Individual giving (apart from bequests) is estimated from IRS data on charitable contributions by those who itemize and national survey data on giving by non-itemizers.

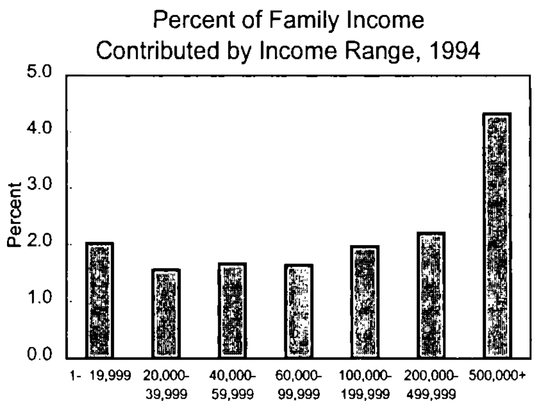
Who gives? Individuals accounted for an estimated 85 percent of all contributions in 1998 (77 percent of all giving was from living individuals and another 8 percent was from bequests). Other giving came from foundations (10 percent) and corporations (5 percent). About 70 percent of households contributed to charity last year, giving an average of $1,075. Contributions by individuals have increased 31 percent since 1995, while foundation giving has risen by about 50 percent.

Who gets? Religion is by far the single largest recipient category, with 44 percent of total contributions in 1998 (see lower chart). Several types of organizations have received substantial increases in donations since 1990. These include education (up 59 percent), environmental organizations (up 69 percent), public-benefit organizations such as civil rights groups and community development organizations (up 78 percent), and foundations (whose receipt of gifts is up 254 percent).

Contributions Received by Type of Organization, 1998



Characteristics of individual donors. Except for the richest, families at all levels of income are about equally generous. The average contribution in groups with annual income below $500,000 (representing 99.7 percent of families) was roughly 1.5 to 2 percent of income in 1994 (see chart on next page). The average



contribution of the richest 0.3 percent of donors, by contrast, was 4.3 percent of income.

Giving by net worth shows a different pattern. Those with the least net worth give the most in percentage terms, and this percentage declines as net worth increases. This is consistent with the highly skewed distribution of net worth and the relatively small net worth in much of the distribution. Households with high income or wealth do, however, provide a disproportionate share of individual contributions. For example, the 20 percent of families with incomes of $60,000 or more in 1994 gave 67 percent of all individual contributions that year. The 4.3 percent of families with incomes above $125,000 gave 46 percent of the total. Finally, elderly households (those with a head aged 65 or over) in every income group make larger contributions than their non-elderly counterparts.

A golden age of philanthropy? A new study estimates that levels of charitable bequests—one component of individual giving—will increase dramatically over the next 20 years, due in part to the aging of baby boomers. The study's lower-bound estimate of total charitable bequests over the period is $1.7 trillion (in 1998 dollars). Such estimates are inherently speculative, but if this estimate proves accurate, bequests over the next two decades will be an order of magnitude greater than the $176 billion in bequests over the past 20 years and would imply dramatic increases in total philanthropic giving.

Conclusion. The strong economy and stock market have helped create a resurgence in philanthropy since 1995. Projections show that increases in giving are likely to continue, and may accelerate as baby boomers age.

ARTICLE

Reviving Russia: What Is to Be Done?

Russia's economy is in dire straits, according to a new report, with falling production and declining productivity. Old industries have not been restructured, and market distortions make even new firms unproductive. The growth potential is great, however, since existing assets could be operated much more efficiently in many industries, and Russia has both an educated labor force and vast natural resources, including large and economically attractive energy reserves.

Russian GDP: falling from an already low level. The study's best estimate is that even in 1991, before major reforms, Russia had only 27 percent of the U.S. level of GDP per capita (all comparisons are to U.S. levels in 1995). A subsequent decline of 40 percent through 1997 brought GDP per capita down to 16 percent of the U.S. level (compared, for example, with Brazil's 23 percent). Even though significant unemployment has developed, most jobs have been "nominally" preserved despite the fall in output. Between 1991 and 1997, hours worked per capita fell from 90 to 83 percent of the U.S. level.

Average Labor Productivity by Sector, Russia 1997

Industry case studies. The study examined 10 industries in detail, finding that productivity was low across the board—nowhere more than 40 percent of U.S. levels and much lower than that in some cases (see chart). Specific results include the following:

- Steel. Large numbers of obsolete steel plants remain in operation as a legacy of the old Soviet industry. They are kept in operation with subsidized energy supplies and employ many "stranded" workers. Some relatively productive steel plants are aggressive exporters, but even these seem to maintain unneeded workers and have organizational problems and poor quality control.

- Retailing. Traditional Soviet retailers, *gastronoms*, were highly inefficient and are being driven out of business. They are being replaced by kiosks and outdoor wholesale markets that are also inefficient but are able to compete through tax and tariff evasion and the sale of counterfeit goods. More productive modern retailing formats (such as supermarkets) cannot compete, as they have to obey the law and pay taxes.

- Oil. Although some individuals may have become rich through oil, the development of the industry today is inhibited by government intervention and unstable tax polices. Oil exports are limited to ensure a subsidized supply to the military, agriculture, and traditional manufacturing. The industry suffers from poor drilling and maintenance practices and needs access to foreign capital.

- Software. Although this industry is relatively productive, growth is limited by widespread piracy and the lack of demand for its products in other sectors.

Across the 10 industries, persistent low productivity can be traced to three main factors: the retention of excess workers in old assets; the continued prevalence of inefficient organization in old companies; and the failure to make potentially profitable new investments.

What created these conditions? Three main causes of Russia's current difficulties can be distilled from the study:

- Structural shocks. Following reform, prices were liberalized and government spending was cut. Many existing industries were unable to meet the market test and collapsed. In particular, residential construction and heavy manufacturing were hard hit.

- An unstable political and economic environment. Large budget deficits led to high inflation followed by the 1998 financial crisis. In this environment, the cost of attracting both foreign and domestic investment became excessive.

- Barriers to restructuring and new investment. Government intervention and corruption slowed or stopped the restructuring of old firms and discouraged new productive activities. The energy sector has been forced to subsidize failing enterprises, and elaborate barter transactions distort the market, effectively giving government tax subsidies to unproductive companies. The lack of property rights, enforceable laws, and an appeal mechanism make it difficult for productive companies to prosper.

Russia's potential. The study argues that Russia should break out of its current economic mess by removing market distortions, especially in high-growth sectors. Once new jobs are created, workers can be moved out of old industries, and these too can be turned around. Nearly three-quarters of the old assets in Russia are economically viable and could achieve productivity levels that are up to 65 percent of U.S. levels. The example of Poland shows how a transition economy can grow. And even within Russia, the Novgorod region has grown since 1995 as the regional government sought out foreign investment, removed red tape, and made land available for new investors.

THE PRESIDENT HAS SEEN
10-27-99

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

Cost Deters Low-Income Workers from Taking Health Insurance. Twenty percent of uninsured Americans have access to employer-sponsored health insurance but choose not to enroll, with the majority citing cost as the main reason, according to a recent study. The study reports that low-income workers with access to employer-sponsored coverage are far more likely to be uninsured than middle- and upper-income workers; 19 percent of people below the poverty line with access to employer-sponsored insurance are uninsured, compared with 5 percent of the overall population. One reason cost is a barrier to enrollment for low-income workers is that the employee share of premiums represents a higher percentage of their income than it does for higher income workers. In addition, the study finds that employee contributions tend to be higher in absolute dollars in firms that employ primarily low-wage workers.

Using Recreation Expenditures to Measure Living Standards. A new study examines trends in the share of household budgets spent on recreation—what it calls the quintessential luxury good—to suggest that the U.S. standard of living has risen by more than is implied by standard income and expenditure measures. Between 1972 and 1991, trends in recreational expenditure shares suggest that the standard of living rose by 3.6 percent per year, or twice the rate of growth in per capita expenditures. Over a broader sweep of time, the share of recreation in household expenditures has increased sharply, especially for lower income families. In 1888, less than 2 percent of the household budget was allocated for recreation; by 1991 recreation's share had risen to 6 percent as the proportion of income devoted to necessities fell. The study also suggests that consumption of recreation has become less concentrated by income class and that reasons for this may include cost-reducing and quality-improving technological change as well as government provision of goods such as parks.

Rising Immigrant Poverty: a Second Look. A recent study has gotten some attention with its conclusion that immigrant poverty is a growing problem in the United States. The study reports that in 1997, 21.6 percent of people living in poverty resided in an immigrant household (including children born here), up from 9.7 percent in 1979. The study argues that increases in the poverty rate for each new wave of immigrants partly explain the rise in immigrant-related poverty. There are several reasons to be cautious when interpreting this study. First, the number of people living in immigrant households more than doubled from 17.3 million in 1979 to 35.3 million in 1997, suggesting that most of the rise in the immigrant share of the poor may simply reflect overall growth in the immigrant population. Second, while the poverty rate for *recent* immigrants increased 5 percentage points from 1979 to 1989, it increased only 1 percentage point between 1989 and 1997. Meanwhile, the educational attainment of working-age people in immigrant households has not deteriorated since 1989. Instead, the share of people in immigrant households with less than a high school education has fallen from 40 percent in 1989 to 34 percent in 1997. Finally, since 1996, the poverty rate for immigrants has declined.

10-27-99

INTERNATIONAL ROUNDUP

Hunger in a World of Plenty. The latest estimates from the Food and Agriculture Organization of the United Nations show that the number of people going hungry in developing countries has declined by 40 million since the early 1990s. But 790 million people in developing countries, plus another 34 million in the industrialized and transitional economies, still do not have enough to eat. About two-thirds of the undernourished live in Asia and the Pacific, with India alone home to 204 million. In Somalia, over 70 percent of the population is undernourished, the highest concentration in the world. Surveys show that two out of five children in the developing world are stunted (low height for age), and one in three is underweight. Nearly half of these children live in South Asia, where half the children under 5 years old are underweight. Each year the number of undernourished people falls by 8 million—a rate too slow to reach the World Food Summit's goal of halving the number of hungry people in the world to 400 million by the year 2015. Indeed, the number of undernourished is growing in many parts of the world: between 1991 and 1996, the number going hungry rose in 59 out of 96 countries. The problem is especially severe in parts of sub-Saharan Africa, where little progress has been made against hunger thus far, and land degradation is expected to cause the situation to deteriorate in the future.

Effect of Privatization in the UK. In 1979 state-owned industries accounted for almost one-tenth of British GDP. Since then the British government has pursued a major program of privatization. A recent study has compared the performance of the newly privatized firms, state-owned firms, and publicly traded firms not subject to government control. It found that, while state-owned firms tended to deliver a much lower rate of return on net operating assets than the publicly traded firms, the newly privatized firms delivered returns near the average level of the publicly traded firms. The study also found significant changes in managerial accountability for financial performance. In those firms that had been privatized for at least 4 years, top managers were more likely to be fired for poor financial results than managers in state-owned firms.

Entrepreneurs and Growth. A recent study by the Global Entrepreneurship Monitor concludes that as much as one-third of the differences in national economic growth may be due to differences in entrepreneurial activity. The study identifies certain features of individual countries that are positively associated with business start-up activity: a young age structure within the working age population, involvement of women in entrepreneurial activities, high expected population growth, involvement in post-secondary or tertiary education, and a relatively high level of income inequality. A survey of experts on entrepreneurship in 9 major industrialized countries suggests that the U.S. entrepreneurial environment is typically perceived to be more favorable than other countries', especially in terms of social and cultural attitudes, availability of finance, and well-established commercial and professional support services.

RELEASES THIS WEEK

U.S. International Trade in Goods and Services

The goods and services trade deficit was $24.1 billion in August; it was $24.9 billion in July.

Housing Starts

Housing starts fell 3 percent in September to 1.618 million units at an annual rate. For the first 9 months of 1999, housing starts are 5 percent above the same period a year ago.

Consumer Price Index

The consumer price index increased 0.4 percent in September. Excluding food and energy, consumer prices rose 0.3 percent.

MAJOR RELEASES NEXT WEEK

Consumer Confidence—Conference Board (Tuesday)
Advance Durable Shipments and Orders (Wednesday)
Gross Domestic Product (Thursday)
Employment Cost Index (Thursday)

U.S. ECONOMIC STATISTICS

	1970-1993	1998	1998:4	1999:1	1999:2
Percent growth (annual rate)					
Real GDP (chain-type)	2.7	4.3	6.0	4.3	1.6
GDP chain-type price index	5.4	0.9	0.8	1.6	1.3
Nonfarm business (NFB) sector:					
Productivity (chain-type)	1.5	2.6	4.1	3.6	0.6
Real compensation per hour:					
Using CPI	0.6	2.5	2.0	2.9	1.5
Using NFB deflator	1.3	3.7	3.4	3.0	3.7
Shares of Nominal GDP (percent)					
Business fixed investment	10.9	11.0	11.0	11.0	11.2
Residential investment	4.5	4.3	4.5	4.6	4.7
Exports	8.2	11.3	11.3	10.9	11.0
Imports	9.2	13.0	13.1	13.2	13.7
Personal saving	5.2	0.3	-0.0	-0.5	-0.9
Federal surplus	-2.7	0.9	0.8	1.4	1.6

	1970-1993	1998	July 1999	August 1999	September 1999
Unemployment Rate (percent)	6.7**	4.5**	4.3	4.2	4.2
Payroll employment (thousands)					
increase per month			373	103	-8
increase since Jan. 1993					19409
Inflation (percent per period)					
CPI	5.8	1.6	0.3	0.3	**0.4**
PPI-Finished goods	5.0	0.0	0.2	0.5	1.1

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

New or revised data in **boldface**.

FINANCIAL STATISTICS

	1997	1998	August 1999	September 1999	Oct. 21, 1999
Dow-Jones Industrial Average	7441	8626	10935	10714	10298
Interest Rates (percent per annum)					
3-month T-bill	5.06	4.78	4.72	4.68	4.99
10-year T-bond	6.35	5.26	5.94	5.92	6.20
Mortgage rate, 30-year fixed	7.60	6.94	7.94	7.82	7.93
Prime rate	8.44	8.35	8.06	8.25	8.25

INTERNATIONAL STATISTICS

Exchange Rates	**Current level October 21, 1999**	**Percent Change from Week ago**	**Percent Change from Year ago**
Euro (in U.S. dollars)	1.081	0.1	N.A.
Yen (per U.S. dollar)	106.0	-0.9	-9.3
Major currencies index (Mar. 1973=100) (trade-weighted value of the U.S. $)	92.09	-0.3	-0.9

International Comparisons [1/]	**Real GDP growth** (percent change last 4 quarters)	**Unemployment rate** (percent)	**CPI inflation** (percent change in index last 12 months)
United States	3.9 (Q2)	4.2 (Sep)	2.6 (Sep)
Canada	3.7 (Q2)	7.8 (Aug)	2.1 (Aug)
Japan	1.1 (Q2)	4.7 (Aug)	0.2 (Aug)
France	2.1 (Q2)	11.3 (Aug)	0.5 (Aug)
Germany	0.6 (Q2)	7.1 (Aug)[2/]	0.6 (Aug)
Italy	0.8 (Q2)	12.1 (Apr)	1.7 (Aug)
United Kingdom	1.4 (Q2)	6.0 (Jun)	1.1 (Aug)

1/ For unemployment data, rates approximating U.S. concepts as calculated by the U.S. Department of Labor, Bureau of Labor Statistics.
2/ Rate for former West Germany. Using OECD standardized unemployment data, the unemployment rate for unified Germany for August was 9.2 percent.