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THE PRESIDENT HAS SEEN
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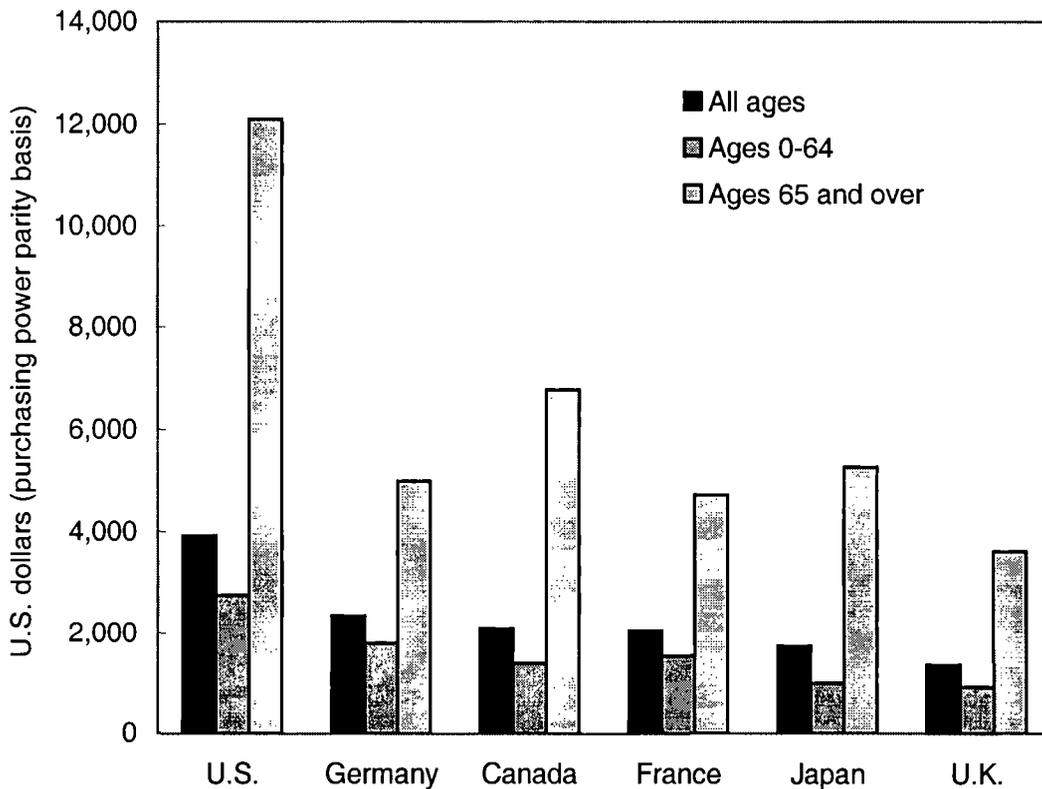
WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

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

June 16, 2000

CHART OF THE WEEK

Per Capita Health Spending in Selected Countries, 1997



Calculations based on OECD data show that the United States spends considerably more per capita than other developed countries on health, both for the elderly and for the non-elderly. The United States spends 4.4 times as much on an elderly person as on a non-elderly person, which is not as high as Japan's 5.3 times or Canada's 4.8 times.

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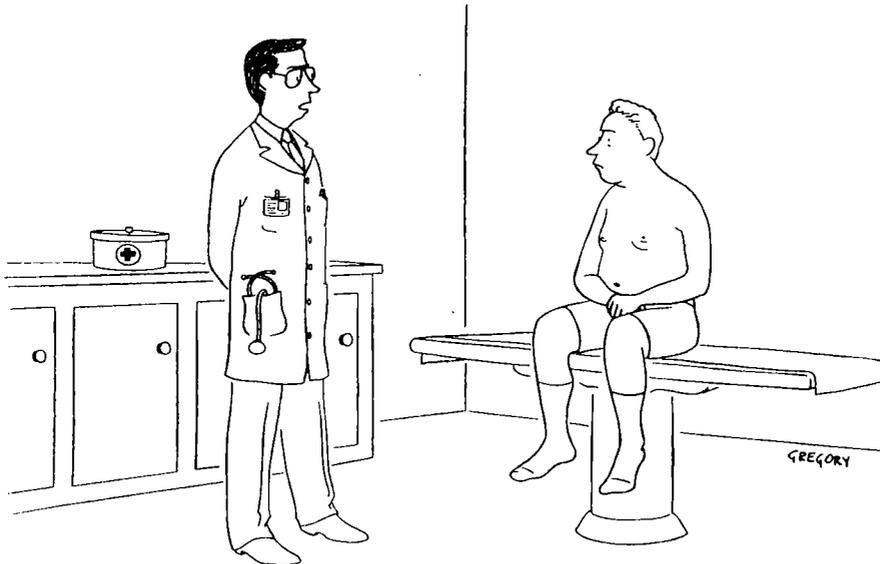
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"Your infection may be antibiotic-resistant, but let's see how it responds to intensive litigation."

SPECIAL ANALYSIS

The Costs of Reducing MTBE

Last week the Administration sent the Congress a report that examined the economic consequences of reducing or eliminating the use of MTBE in gasoline. The report finds that reducing MTBE and maintaining the air quality benefits of the reformulated gasoline program could raise gasoline prices by about 2 cents per gallon.

You can breath the air... The 1990 Clean Air Act Amendments mandated cleaner burning gasoline for the most polluted urban areas through the reformulated gasoline (RFG) program. This program included an oxygenate mandate that at least 2 percent of each gallon must be oxygenates such as ethanol and MTBE. RFG makes up about a third of all gasoline sold in the country and 87 percent of RFG contains MTBE. Refiners have preferred MTBE because of its ease of transport and blending and the lower costs relative to ethanol for making RFG. Since 1995, RFG has achieved significant reductions in vehicle emissions of toxic and smog-forming pollutants.

...but don't go near the water. While MTBE has delivered air quality benefits, leaks from pipelines and underground storage tanks have contaminated drinking water supplies. Contamination at or above the EPA advisory range may make water smell and taste so bad that it becomes unusable for consumption. The risk of MTBE contamination has prompted California and New York to ban its use in gasoline effective in 2002 and 2004, respectively.

A new approach. The Administration has proposed to reduce or ban MTBE while maintaining the air quality benefits of the RFG program. To provide flexibility to refiners in continuing to meet the emissions standards, the Administration has also recommended repealing the oxygenate mandate. In addition, the Administration supports a flexible renewable fuel standard (requiring that a minimum percentage of all gasoline must contain renewable fuel, such as ethanol). A modeling assessment of a variety of policy scenarios consistent with these principles and based on a smoothly functioning national gasoline market found the following:

- Reducing MTBE use to its pre-1990 level by 2003, maintaining the air quality benefits of the RFG program, and repealing the oxygenate mandate is projected to increase the national average price of gasoline by about 2 cents per gallon.
- Banning MTBE in 2003, maintaining the air quality benefits of the RFG program, and repealing the oxygenate mandate is projected to increase the national average price of gasoline by about 3 cents per gallon.

- The costs of a renewable fuel standard vary with the level of that standard. A standard of about 1.7 percent in 2005 (60 percent above estimated 2000 use) would have negligible additional costs, since a policy of reducing MTBE to its pre-1990 level, maintaining air quality benefits of the RFG program, and repealing the oxygenate mandate is projected to increase ethanol consumption to this level anyway. However, a more aggressive renewable fuel standard would be more costly: a 2 percent standard in 2005 would add another 2 cents per gallon to the price of gasoline.
- In 2005, receipts to the Highway Trust Fund would fall by about \$600 million to \$900 million because of the tax-favored status of ethanol relative to gasoline.

Replacing the oxygenate standard. Banning MTBE without repealing the oxygenate mandate would be very expensive, because it would effectively require ethanol to be used in summer RFG, which would involve substantial costs in transporting and blending ethanol with gasoline. However, a renewable fuel standard that allowed refiners to buy and sell tradable ethanol credits would provide the flexibility needed to allow ethanol to be used in the least-expensive regions at the least-expensive time of the year, subject to meeting emissions requirements for conventional gas and RFG. Thus, midwest winter gasoline could contain ethanol well in excess of the renewable fuel standard and east coast summer gasoline could contain no ethanol under this approach. A renewable fuel standard that delivers the same amount of ethanol to market as the oxygenate mandate would cost refiners and consumers less.

Conclusion. Despite its value in reducing air pollution, MTBE has been found to contaminate drinking water. Reducing MTBE and repealing the oxygenate mandate could raise gasoline prices by 2 cents per gallon, while a renewable fuel standard could have a negligible impact or it could nearly double the gasoline price increase, depending on the level of the standard.

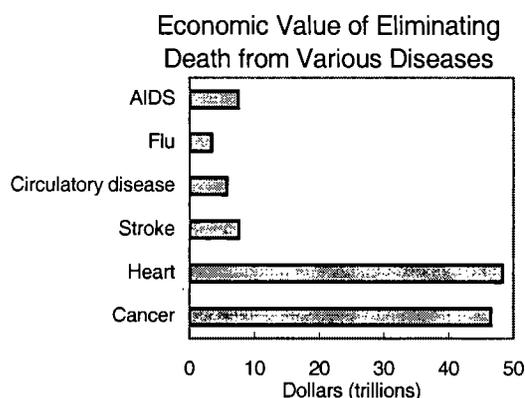
SPECIAL ANALYSIS

The Economic Value of Medical Research

Have the substantial investments in medical research made in the United States over the past few decades provided benefits sufficient to justify their cost? Yes, according to a soon-to-be-published collection of economic studies that find evidence of substantial returns to investments in medical research.

Valuing improvements in life expectancy. A goal of the new studies was to assess the value of medical research in terms of its impact on the length or quality of life and to quantify how research-related reductions in mortality can be valued in monetary terms. A central challenge in such an exercise is to estimate the monetary value of changes in life expectancy. Some of the studies do this by combining estimates of the economic value of life by age (based on economic research on individuals' willingness to take risks) with recent changes in life expectancy.

Dramatic benefits from longer life. One of the studies estimates that the social value of improvements in life expectancy between 1970 and 1990 is between \$2.4 and \$2.8 trillion per year (in 1992 dollars)—a value that is more than half of real GDP in 1980, a midpoint of the period. The reduction in deaths from heart disease generated a substantial share of this gain (\$1.5 trillion annually). This



research also finds that eliminating deaths from various diseases would have a large economic value. Eliminating death from heart disease, for example, (holding death rates from other diseases constant) would be worth \$48 trillion to the U.S. population (see chart). Expressed more realistically, this finding implies that each 1 percent permanent reduction in mortality from this source is worth \$480 billion.

Making the link to medical research. A portion of increases in life expectancy is due to spending on medical research. But some improvements are due to other factors such as changes in life style and diet. One of the papers in the collection attempts to apportion the credit for longevity by focusing on cardiovascular disease, the source of the greatest gains since 1970. The authors provide evidence that one-third of the reduction in cardiovascular disease mortality can be explained by advances in acute medical technology and better pharmaceutical treatments. This suggests that if only one-third of the total economic value of reducing mortality from heart disease (\$1.5 trillion annually between 1970-1990) is attributable to medical research, this research brought an annual return of \$500 billion. This is considerably larger than the most recent estimate of total

expenditures on medical research of \$36 billion in 1995 (\$33 billion, when measured in constant 1992 dollars to be consistent with the measure of annual return).

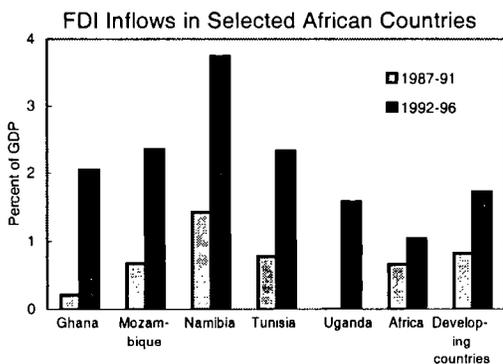
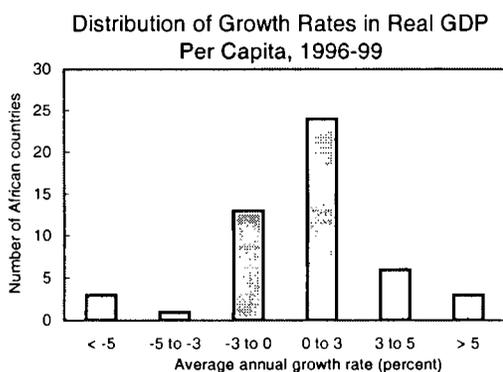
Conclusion. Recent studies provide evidence that past investments in medical research on some diseases have paid off handsomely. While these findings do not imply that future research would yield equally high returns, the large economic valuation assigned to the improvements in life expectancy over the last several decades suggests that research generating even modest advances against major killer diseases is a good economic investment.

ARTICLE

Africa: A Glimmer of Hope

While parts of Africa are making headlines with wars and natural disasters—presenting observers like *The Economist* with an image of a “hopeless continent”—other parts are making headway reforming their economies, attracting more interest from domestic and foreign businesses, and attracting foreign direct investment (FDI). Even with respect to HIV/AIDS, several countries have made significant progress in controlling the spread of the epidemic.

Reform delivers progress. In sub-Saharan Africa, average income per capita remains lower today than it was at the end of the 1960s. However, economic performance has varied widely across African countries, both recently (see upper chart) and over the longer term. While Botswana and Mauritius provide examples of sustained longer-term growth, countries such as Mozambique and Uganda, which have recently made key economic reforms (liberalizing markets and trade, improving economic management, and promoting private sector activity) have



seen faster growth, rising personal income, and reduced poverty. In fact, before Mozambique was hit by a devastating flood earlier this year, it was among the fastest growing economies in the world.

Rising foreign investment. Africa's share in total FDI inflows to developing countries dropped significantly from more than 11 percent in 1976-80 to 4 percent in recent years. However, as with economic performance, aggregate FDI inflow data conceal a diverse picture.

While larger countries such as Nigeria and Egypt continue to claim the largest *volume* of FDI, a number of countries have experienced high *growth* of FDI inflows, especially relative to the size of their economies (see lower chart).

Economic reforms, privatization, and efforts to improve the education levels of their citizens have all contributed to this rapid increase of FDI. And while rich natural resource reserves play an important role, FDI flows are increasingly going to the manufacturing and services sectors. Moreover, investment in Africa seems to be highly profitable for foreign companies. In the 1990s, rates of return on U.S. FDI in Africa hovered close to 30 percent and were consistently higher than

those in other regions. The example of Morocco (see box) illustrates many of these trends in FDI flows to Africa.

Morocco: Sustained Increase in FDI Inflows

Morocco has established itself as one of the largest recipients of FDI in Africa. According to a UNCTAD report, broad economic reforms during the 1990s, including privatization programs and the liberalization of the FDI regime, have transformed the investment climate in Morocco. FDI inflows to Morocco increased from an annual level of around \$200 million in the early 1990s to \$1.1 billion in 1997. The petroleum sector received the largest share of FDI, with the energy sector and the banking sector capturing significant shares as well. Morocco also hosts one of the largest multinational corporations in the continent, Conserverie Chérifiennes, a food company. Prospects for sustained FDI inflows are promising, with the modernization of the Morocco stock exchange, reforms of the banking sector, and the establishment of export processing zones.

Confronting AIDS. Despite the devastating effects of the HIV/AIDS epidemic, political commitment to fight AIDS remains weak in some African countries. Where there has been political will, AIDS has been met head on. Uganda and Senegal provide excellent examples. Timely and aggressive national prevention campaigns have helped Senegal maintain one of the lowest HIV infection rates in Africa (1.8 percent) and have lowered infection rates in Uganda significantly. In 1992, the HIV prevalence rate among Uganda's teenagers was almost 30 percent, but by 1996, it had been brought down to 10 percent.

Conclusion. Africa's challenges remain enormous. However, it is important not to let the negative image of the continent as a whole mask the diversity of economic performance and opportunities in individual countries that provide grounds for hope.

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

Beige Book: Continuing Solid Growth but Some Signs of Slowing. Reports from the 12 Federal Reserve districts indicate that solid economic growth continued in April and May, but with signs of some slowing from the rapid pace earlier in the year. Economic activity remains “hot” in Minneapolis; growth is said to be strong in Chicago and Richmond and moderate or steady in most of the other districts. All but Minneapolis said scattered signs of cooling are in evidence or the pace of growth is slowing. Indications of worsening price inflation, while not widespread, were reported by several districts. Labor markets are tight across all districts, but the tightness does not appear to have intensified since the last report. Base wages of permanent employees are not said to be accelerating in most districts, but seasonal help and temporary workers are being recruited only with sizable raises. Similarly, some occupations experiencing severe shortages—such as skilled building trades in New York and Internet and other technical workers in the Boston and Atlanta districts—have seen larger pay increases.

Internet Economy Continues to Grow. The Internet economy performed well in 1999, with revenue growing by 62 percent and employment growing by 36 percent, according to a recent report. In 1999 annual revenue amounted to over \$500 billion, and the report estimates that if present conditions continue, it will reach about \$850 billion this year. This is 15 times the growth rate for the entire U.S. economy. The Internet economy, which includes the Internet-related activities of infrastructure companies (such as AOL), software companies (such as Microsoft), and e-commerce companies (such as amazon.com), now employs approximately 2.5 million workers. The report found that these employees are increasingly efficient, with revenue per employee jumping 19 percent from year-end 1998 to year-end 1999. And the vast majority of companies involved with the Internet respond that it increases productivity. For example, 73 percent of Internet economy companies report they saw gains in employee and equipment productivity, compared with only 29 percent of a sample of all firms.

Antitrust Trial of MasterCard and Visa Begins. The Department of Justice trial against MasterCard and Visa for antitrust violations began in New York this week. MasterCard and Visa have a combined share of about 75 percent of the U.S. charge card market, and the boards of both companies have representatives from many of the same banks. The government alleges that this joint board role by the banks has reduced competition between the two networks in developing new types of cards and services. In addition, the two networks have issued rules preventing member banks from issuing other types of cards (like American Express) even though the rules allow member banks to issue both MasterCard and Visa cards. MasterCard and Visa contend that there is a substantial amount of competition among member banks regarding the terms on which their cards are offered. Visa also notes that while its rules do restrict member banks in the types of cards they issue, the rules do not restrict consumer choice among competing card brands: with all of the solicitations sent out by card issuers, the rules do not prevent consumers from obtaining other companies’ charge card products.

INTERNATIONAL ROUNDUP

United States Is #1 in “E-business Readiness.” The United States is the world’s most “e-business ready” country according to a new study that ranks economies according to their overall ability to support and encourage e-business. In assessing e-business readiness, the study weighs both the general business environment and “connectivity.” Business environment indicators include the strength of the economy, the regulatory climate, taxation policies and openness to trade and investment. Connectivity factors include not only the state of the existing telephone network but other factors that affect Internet access such as dial-up costs and literacy rates. The Nordic countries (Sweden, Finland, and Norway) are ranked closely behind the United States by virtue of high scores on connectivity, while a poor score in the general business environment puts Japan at 21st overall, and last among the G-7. Some large countries (China, India, and Russia) are ranked very far down on the list as they suffer from infrastructure weakness. The study stresses that it is simplistic to say that the Internet is a borderless network that allows businesses to go global instantly, as the rankings show large differences between countries in readiness for e-business.

Costs of Agriculture Policies Are High in OECD Countries. A new OECD study estimates that the agricultural policies of its member countries cost \$361 billion (1.4 percent of GDP) in 1999. U.S. support (an estimated \$97 billion, or 1.1 percent of U.S. GDP) represents about 27 percent of the OECD total. Reform would not only reduce these considerable costs but also improve the efficiency of agricultural policies through more specific targeting of support to intended beneficiaries. The largest (and generally richest) farmers often receive the bulk of the support. The 25 percent of farms with the highest annual sales generally receive more than half—and in some countries as much as 90 percent—of support provided by governments (the U.S. figure is about 85 percent). In terms of producer support as a percentage of total producer receipts, however, the United States (at about 20 percent) is well below the OECD average of 40 percent and the EU average of more than half. Direct payments to farmers are relatively more important than price supports in the United States, hence the majority of U.S. support represents a transfer from taxpayers, while that in the OECD as a whole is a transfer from consumers. The study urges that the role of agriculture-specific policies be clarified and that damaging distortions be removed.

Drug-Resistant Diseases Threaten World Health. Curable diseases are in danger of becoming incurable as a result of increasing levels of drug-resistance, according to a new World Health Organization report. In poorer countries, underuse of drugs—patients who are unable to afford the full course of medicine—cause this antimicrobial resistance. In wealthy countries, by contrast, the overuse of drugs by patients and the overuse of antimicrobials in livestock is contributing to increased drug resistance. The report notes that the economic cost of antimicrobial resistance can be staggering. For example, the cost of treating a patient with multi-drug resistant TB is an estimated one hundred times greater than the cost of treating an unresistant strain.

RELEASES THIS WEEK

Housing Starts

****Embargoed until 8:30 a.m., Friday, June 16, 2000****

Housing starts fell 3.9 percent in May to 1.592 million units at an annual rate.

Industrial Production and Capacity Utilization

The Federal Reserve's index of industrial production rose 0.4 percent in May. Capacity utilization was unchanged, at 82.1 percent.

Consumer Price Index

The consumer price index rose 0.1 percent in May. Excluding food and energy, consumer prices rose 0.2 percent.

Retail Sales

Advance estimates show that retail sales decreased 0.3 percent in May, following a decrease of 0.6 percent in April. Excluding sales in the automotive group, retail sales were unchanged, following a decrease of 0.4 percent.

MAJOR RELEASES NEXT WEEK

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

U.S. ECONOMIC STATISTICS

	1970- 1993	1999	1999:3	1999:4	2000:1
Percent growth (annual rate)					
Real GDP (chain-type)	2.9	4.6	5.7	7.3	5.4
GDP chain-type price index	5.2	1.6	1.1	2.0	2.7
<u>Nonfarm business (NFB) sector:</u>					
Productivity (chain-type)	1.7	3.7	5.0	6.9	2.4
Real compensation per hour:					
Using CPI	1.0	1.7	2.0	0.9	0.2
Using NFB deflator	1.5	2.9	4.0	1.8	1.8
Shares of Nominal GDP (percent)					
Business fixed investment	11.4	12.6	12.7	12.5	13.0
Residential investment	4.5	4.4	4.4	4.4	4.4
Exports	8.2	10.8	10.8	10.9	10.9
Imports	9.2	13.5	13.8	14.0	14.3
Personal saving	6.6	1.7	1.5	1.3	0.4
Federal surplus	-2.8	1.2	1.4	1.2	1.9
<hr/>					
	1970- 1993	1999	March 2000	April 2000	May 2000
Unemployment Rate (percent)	6.7**	4.2**	4.1	3.9	4.1
Payroll employment (thousands)					
increase per month			527	414	231
increase since Jan. 1993					22152
Inflation (percent per period)					
CPI	5.8	2.7	0.7	0.0	0.1
PPI-Finished goods	5.0	2.9	1.0	-0.3	0.0

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

New or revised data in **boldface**.

FINANCIAL STATISTICS

	1998	1999	April 2000	May 2000	June 15, 2000
Dow-Jones Industrial Average	8626	10465	10944	10580	10715
Interest Rates (percent per annum)					
3-month T-bill	4.78	4.64	5.66	5.79	5.67
10-year T-bond	5.26	5.65	5.99	6.44	6.05
Mortgage rate, 30-year fixed	6.94	7.43	8.15	8.52	8.22
Prime rate	8.35	8.00	9.00	9.24	9.50

INTERNATIONAL STATISTICS

Exchange Rates	Current level June 15, 2000	Percent Change from	
		Week ago	Year ago
Euro (in U.S. dollars)	0.953	-0.2	-8.5
Yen (per U.S. dollar)	106.5	0.6	-11.7
Major currencies index (Mar. 1973=100) (trade-weighted value of the U.S. \$)	96.66	0.0	0.9

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	5.0 (Q1)	4.1 (May)	3.1 (May)
Canada	4.9 (Q1)	6.8 (Apr)	2.1 (Apr)
Japan	0.7 (Q1)	4.9 (Apr)	-0.8 (Apr)
France	3.3 (Q1)	9.8 (Mar)	1.3 (Apr)
Germany	2.3 (Q1)	8.4 (Apr)	1.6 (Apr)
Italy	2.1 (Q4)	11.3 (Jan)	2.3 (Apr)
United Kingdom	3.1 (Q1)	5.8 (Feb)	3.0 (Apr)

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