FOIA Number: 2018-0275-F

FOIA MARKER

This is not a textual record. This is used as an administrative marker by the William J. Clinton Presidential Library Staff.

Collection/Record Group:	Clinton Presidential Records
Subgroup/Office of Origin:	Records Management - SUBJECT FILE
Series/Staff Member:	Subject Files
Subseries:	

OA/ID Number:	21904
Scan ID:	425383
Document Number:	

Folder Title:
BE

Stack:	Row:	Section:	Shelf:	Position:
S	83	4	4	1

425383

7-31-00

00 JUL 28 AM 7:59

BE

WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

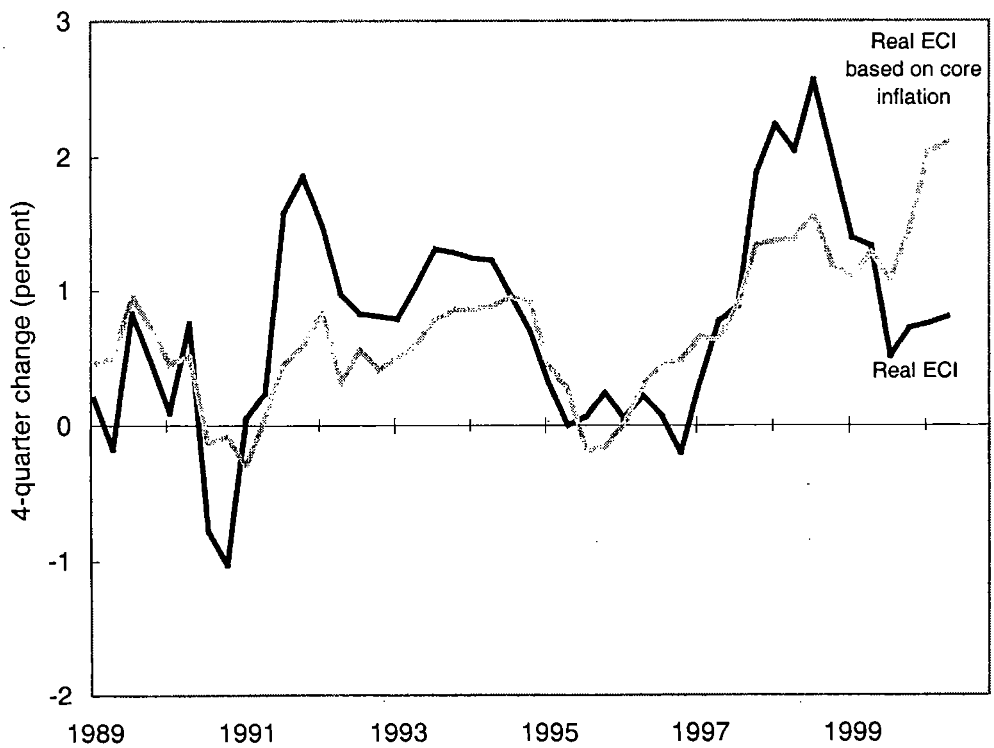
Prepared by the Council of Economic Advisers
with the assistance of the Office of the Vice President

July 28, 2000

copied
Baily
Podesta

CHART OF THE WEEK

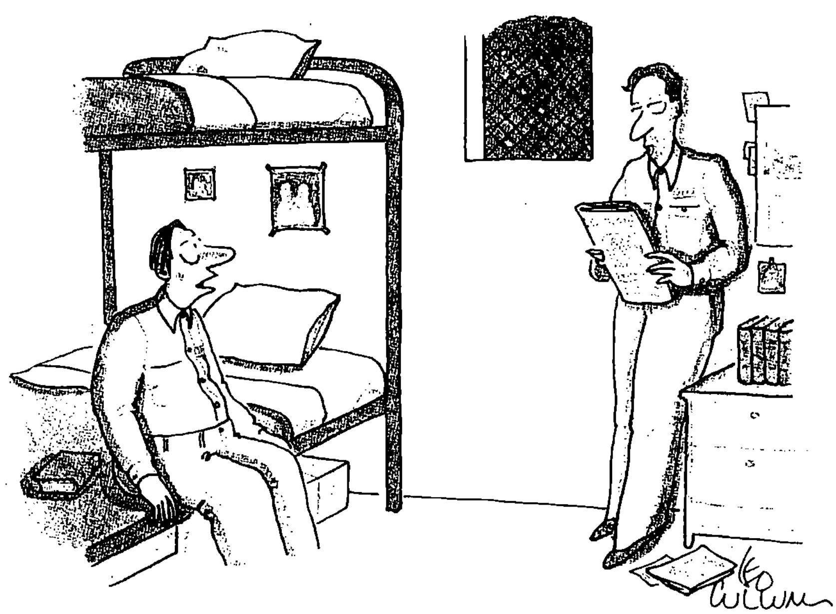
Growth in Compensation and Real Wages



Data released this week show that private compensation as measured by the employment cost index (ECI) rose 0.8 percentage points faster than inflation over the year ending in June. Fluctuations in consumer price inflation due to oil prices raised real wage growth in 1998 and lowered it in 1999 and this year. Growth in real ECI compensation measured using the core CPI (which excludes food and oil) generally shows an acceleration since 1995.

425383

CONTENTS



"I never should have tried to take my accounting to the next level."

CURRENT DEVELOPMENT

GDP Scorecard: Second Quarter 2000

Real GDP is estimated to have increased at a 5.2 percent annual rate in the second quarter. Consumption slowed significantly from its previous pace, and much of domestic demand was met by imports. Second-quarter growth was supported by strong gains in business investment and stockbuilding, as well as a rebound in Federal purchases. Inflation, as measured by the price index for GDP, was 2.5 percent at an annual rate in the second quarter, up from 1.8 percent during the previous four quarters.

Component	Growth*	Comments
Total consumer expenditures	3.0%	Consumption slowed from 6 percent growth during the previous four quarters. The slowdown was concentrated in goods, especially motor vehicles.
Equipment and software	21.0%	Business purchases of computers grew at a 63 percent annual rate. Other major categories of equipment and software investment grew at strong or solid rates.
Nonresidential structures	13.0%	Investment in structures has picked up in the first half of 2000 after stagnating in 1999.
Residential investment	3.9%	Growth in residential investment was accounted for by real estate brokers' commissions. Construction of residential structures was flat.
Inventories (change, billions of 1996 dollars)	$60.3	The pace of stockbuilding picked up in the second quarter, accounting for 1 percentage point of real GDP growth. Even so, inventories remain lean in relation to sales.
Federal purchases	17.5%	Defense purchases have been erratic, increasing sharply in the second half of 1999, crashing in the first quarter, and rebounding in the second.
State & local purchases	0.5%	Highway building, which had boomed in the previous two quarters, edged down in the second quarter.
Exports	7.3%	This was the fifth consecutive quarter of strong export growth, which suggests continuing expansion among our trading partners.
Imports	17.0%	Growth was especially strong for imports of capital goods.

*Percent real growth in the quarter at annual rates (except inventories). This advance estimate is subject to substantial revision—especially for exports, imports, and inventories, where the estimates are based on only 2 months of data.

SPECIAL ANALYSIS

Do Accounting Rules Matter?

A recent proposal by the Financial Accounting Standards Board (FASB) to change the way that accountants treat mergers and acquisitions has ignited a firestorm of controversy. The FASB argues that its proposal will make it easier for investors to interpret the balance sheet of merged firms; critics, often from high-tech New Economy firms, argue that it will hurt their ability to grow.

Everybody out of the pool? Under current practices, business combinations can be recorded either as "purchases," in which one firm acquires the assets of another, or "poolings of interest," in which assets are simply combined into a common balance sheet. Under the purchase method, any acquisition premium (the difference between the purchase price and the book value of the target firm) is typically recorded as an intangible asset called "goodwill," which is depreciated and charged against earnings over time. Because pooling allows the balance sheets of the two firms to be combined directly without any charges against earnings, acquirers can often report higher incomes by using this method.

According to one estimate, pooling accounting was used for only 5 percent of all acquisitions in 1999, but these acquisitions represented 36 percent of the total value of mergers and acquisitions during the year. Many of the largest recent U.S. deals were pooled, including Exxon-Mobil, Citicorp-Travelers, and Bell Atlantic-GTE. The FASB argues that pooling accounting allows firms to "hide" acquisition premiums from investors, and recommends that pooling be eliminated and all business combinations be treated as purchases.

Will high-tech firms be left high and dry? Critics swiftly charged that such a rule change would harm firms making acquisitions, particularly in the high-technology sector, and in March the Senate held a hearing where these concerns were aired. For companies with substantial intangible assets—human capital, technical blueprints, brand-name recognition, corporate culture, and the like—market value will substantially exceed book value. When such companies are acquired under the purchase method, this extra value must be treated as a cost that is then depreciated, resulting in significant charges against earnings over time. Such charges are not incurred under the pooling method, allowing reported earnings to be higher. This may be especially important for firms already struggling to achieve short-term profitability.

Are the critics of pooling all wet? The assumption behind the pooling method is that there has been no exchange of economic resources, but rather a combining of equity interests. Two firms have joined forces to better serve their combined clientele; neither has "purchased" the other. The FASB argues that few business combinations meet this criterion. Acquisitions are purchases, and any purchase—whether inventory or software or a patent—is recorded at the price paid and generally charged against earnings over its useful economic life. By this argument, acquisitions should be treated the same way, with goodwill premiums treated as intangible assets that depreciate over time. In cases where companies are purchased at share prices well above the market prices that prevailed prior to acquisition, the FASB is concerned that the pooling method effectively disguises these acquisition premiums from shareholders.

The FASB argues further that the coexistence of two accepted practices is confusing and can mislead investors. Additionally, firms that decide to use pooling must accept potentially harmful restrictive criteria (such as financing the merger with stock, rather than cash or debt) to achieve the perceived gains from higher reported earnings. Pooling may also impose a burden on regulators: the SEC Chief Accountant has said that his staff spends a large share of its time interpreting the complicated pooling-of-interests criteria. Finally, eliminating the pooling method would bring U.S. practices in line with those of most other countries and help harmonize accounting standards around the world.

Does it really matter anyway? Economic reasoning suggests that the value of the firm should be determined by future cash flows, which are not affected by the accounting treatment of acquisitions. Indeed, despite many efforts, academic researchers have failed to find compelling evidence that investors can be systematically misled by accounting practices. It is thus difficult to explain the intensity of the reaction to the FASB recommendation. Some investors may be misled by accounting practices, but the evidence suggests that, as long as there *are* standards, the market as a whole is not.

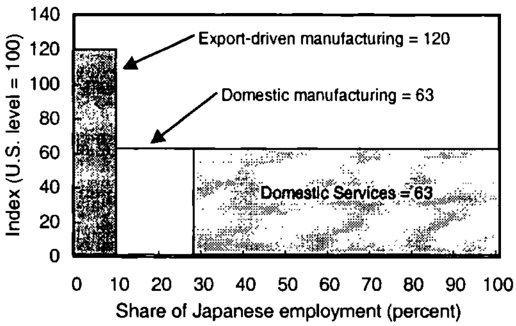
ARTICLE

Achieving Healthy Productivity Growth in Japan

While most economists have focused on weakness in demand to explain Japan's sluggish growth in the 1990s, a new study by a large consulting firm looks at problems of productivity and supply. The study finds that the Japanese economy generates considerable employment, but outside the export-driven manufacturing sector productivity is low. Overall, hours worked per capita in Japan were 11 percent higher than in the United States in 1999, but GDP per hour worked was only 69 percent of the U.S. level, even with 13 percent more capital per worker.

Japan's dual economy. Although overall productivity is low in Japan, the export-driven manufacturing companies have become household names and fierce competitors around the world. Labor productivity in the Japanese automobile industry, for example, was 45 percent higher than in the U.S. auto industry in 1999. The study estimates that, on average, this competitive sector of the Japanese economy was 20 percent more productive than the same U.S. industries in 1999. However, this productive part of the economy represents only about 10 percent of employment. The part of manufacturing that competes only domestically and the service sector each had labor productivity of only 63 percent of the U.S. level in 1999 (see chart).

Labor Productivity In Japan, 1999



Why is productivity so low? The study finds that Japan is rife with protection for inefficient companies and even provides subsidies to help them stay in business. An example of a low-productivity service industry is retailing, which has 55 percent of employment in traditional mom-and-pop stores (the U.S. figure is 19 percent). Efficient large-scale retailers are prevented from expanding by local committees that must approve development. These committees include owners of the small stores that would be put out of business. In addition, loans and grants have been provided by the government to keep the small stores operating. The study argues that the lack of consolidation in retailing spills over into food processing—a large manufacturing industry that competes domestically. This industry is fragmented and operates plants with only a tenth of the scale of U.S. plants, on average, which results in much lower efficiency. Foreign competition is prevented by protective trade barriers.

Raising productivity: A deep dilemma. When evaluating how to increase productivity, the study confronts the serious dilemma that removing regulatory barriers and restructuring industries will lead to large-scale job losses in the short run. Even though the Japanese still work very long hours, labor input fell in the

1990s and unemployment rose. An important reason that Japan hangs on to its over-regulated economy is that it is afraid of worsening its already weakened labor market and scaring consumers who already are reluctant to spend.

Developing new opportunities. The study proposes a novel solution to this dilemma: generate a million new health care jobs. The study reaches this conclusion as a result of a detailed comparison of the U.S. and Japanese health care sectors. While Japan enjoys higher life expectancy, this appears to reflect factors such as diet and lifestyle differences; Japan's health care system provides inferior services. It is slow to use new technologies, provides far too little outpatient care, and overuses prescription drugs—a patient going to see a doctor waits in a long line, sees the doctor for 5 minutes, and comes out with a sheaf of prescriptions. Investment in improving service would seem to be worthwhile.

No panacea. If the Japanese economy is ever to achieve the combination of full-employment and high productivity that the United States enjoys, it will have to deregulate its markets in ways that both force restructuring and consolidation of old companies and encourage investment and job creation in new companies or lines of business. New jobs must be created to offset the inevitable job losses, and these potential jobs do exist, whether in health care or elsewhere. However, achieving sustained economic growth in Japan will require increases in both supply and demand, and the study is too dismissive of problems on the demand side arising from a fragile financial system and perceived constraints on monetary and fiscal policy.

The study may be correct, however, in suggesting that even if demand-increasing policies are successful, they may not be enough (after all, fiscal expansion did stimulate growth in 1996). Sustained growth will require restructuring to open up new productive investment and employment opportunities.

Conclusion. Japanese policymakers thus far have favored only incremental policy changes and seem content with a continuation of slow growth. Some Western economists have suggested more radical approaches on the demand side, such as monetizing part of the government debt. On the supply side, one can argue that deregulatory "shock therapy" may be needed to break the power of vested interests and open up new opportunities. Of course the experience of countries like Poland illustrate that shock therapy can be very painful along the way.

9-31-00

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

The Cost of Superfund Exemptions. Most businesses with Superfund liability are small firms or firms that contributed only a very small share of the toxic waste at a particular site. A recent study assesses the cost of exempting such firms from their liabilities in order to cut short the sometimes slow process of determining shares of liability when there are many firms involved. Sites with multiple firms are called generator/transporter sites. They make up just over half of the total number of sites, but they involve about 99 percent of total firms with Superfund liability and about 75 percent of total Superfund cleanup costs. For such sites, the study found that transferring the liabilities of firms with 75 or fewer employees to the Superfund Trust would cost the government about $100,000-225,000 per firm, or a total of $6-12 billion. The study estimates that a blanket exemption for small businesses, which would include owner/operators with exclusive responsibility at some sites, would cost $3-6 million per firm at such sites, or another $1.2-1.7 billion. A different and perhaps complementary approach would be to exempt firms that contribute only a small amount to any site from liability at that site. The costs of any of these proposals would have to be weighed against their effectiveness in speeding up the cleanup process.

Crime Doesn't Pay (Enough). Improved labor market conditions over the past 7 years are an important reason for the decline in crime, according to a recent study. Offenders and ex-offenders are often low-wage workers with limited employment opportunities. Decreasing unemployment and strong economic growth have provided more jobs, and thus increased the opportunity cost of devoting time to crime. The study estimates that decreases in unemployment between 1992 and 1997 accounted for 30 percent of the decrease in crime over that same period. Therefore, policies promoting full employment, a higher minimum wage, improved educational and job-training opportunities, and expansion of work support (such as the Earned Income Tax Credit) may be valuable tools in lowering crime rates. Undoubtedly increased policing and "get tough" laws help to reduce crime. However, debates over crime reduction should not ignore the important link between crime and labor market opportunities.

Merchant Trafficking in Food Stamps Remains Small. About 3½ cents of every dollar of food stamps issued between 1996 and 1998 were illegally redeemed for cash instead of food, according to a recent USDA study. About 12 percent of stores illegally traffic in food stamps, but among the large groceries and supermarkets, which redeem 84 percent of food stamps, only 2 percent do so. Stores in poorer neighborhoods are more likely to redeem stamps for cash. As a result of increased activity since 1993, rural stores have become as likely as urban stores to traffic in food stamps. Overall, trafficking has decreased by ½ cent per food stamp dollar since 1993. The total number of households receiving food stamps has declined by 24 percent, the total amount of food stamps issued has declined by 11 percent, the number of retailers authorized to accept food stamps has declined by 16 percent, and half of food stamps issued have been converted from paper coupons to electronic benefit transfer cards.

INTERNATIONAL ROUNDUP

Preparation for Euro Is Slow. The European Commission reports that firms and individuals are slow in preparing for the euro launch on January 1, 2002. While use of the euro rose to 25 percent of the value of firm transactions, such payments were only 2.4 percent of transaction volume. Only 20 percent of large companies and 15 percent of small and medium enterprises reported having switched entirely to the euro, with a respective 40 and 25 percent expecting to change over by the end of 2001. Likewise, the first quarter of 2000 saw only 2.4 percent of transaction volume paid in euros by individuals. The Commission noted that while dual pricing was widespread in EU member countries, there appeared to be little effect on consumer knowledge of the euro. To aid implementation, the EC urged public administrations to ensure the adequacy of their own preparations and to intensify efforts to educate small and medium enterprises and the general public for the turnover.

Average Hospital Stays Are Falling in the OECD. Lengths of hospital stays have been falling in all OECD countries in the last two decades, but they have fallen faster outside the United States, which always had the shortest stays. This is the featured finding in the OECD's latest release of comparative health figures. Other countries appear to be converging gradually toward U.S. levels. Differences remain, however: the average stay for appendicitis in Germany is still almost 7 days (down from over 12 in 1980), while it is less than 4 days in the United States. OECD data provide a wide range of other findings. For example, people are generally becoming healthier in the OECD area; the share of health spending in GDP has stabilized, on average, since the early 1990s; the United States is still by far the largest spender on health care, both per capita and as a share of GDP; and the United States and Korea are the only two OECD countries in which private health care spending still exceeds public.

Undernourishment Should Decline Significantly by 2030. World per capita food consumption will grow significantly, from less than 2,800 calories per day in 1996 to 3,100 calories per day in 2030, according to the Food and Agriculture Organization of the United Nations. Above all, this change will reflect rising food availability for consumption in developing countries (the basis for calorie estimates). The proportion of the world's population living in countries with per capita consumption above 3,000 calories per day will rise to 75 percent, compared with only 21 percent in 1996. However, 412 million people (6 percent of the world's population) will still be living in countries with very low levels of food consumption in 2015. Sub-Saharan Africa will remain the most undernourished region. With the highest projected population growth rate, it should also experience the greatest growth in demand for agricultural products—a demand that is projected to exceed slightly the rate of growth of production in the region. Growth of both aggregate demand and production of agricultural products in industrial countries is projected to continue to slow.

RELEASES THIS WEEK

Gross Domestic Product

****Embargoed until 8:30 a.m., Friday, July 28, 2000****

According to advance estimates, real gross domestic product grew at an annual rate of 5.2 percent in the second quarter of 2000.

Employment Cost Index

The employment cost index for private industry workers increased 4.6 percent for the 12-month period ending in June.

Advance Durable Orders

Advance estimates show that new orders for durable goods increased 10.0 percent in June, following an increase of 7.0 percent in May.

Consumer Confidence

Consumer confidence, as measured by The Conference Board, rose 2.5 index points in July, to 141.7 (1985=100).

MAJOR RELEASES NEXT WEEK

NAPM Report on Business (Tuesday)
Leading Indicators (Wednesday)
Employment (Friday)

U.S. ECONOMIC STATISTICS

	1970-1993	1999	1999:4	2000:1	2000:2
Percent growth (annual rate)					
Real GDP (chain-type)	2.9	**5.0**	**8.3**	**4.8**	**5.2**
GDP chain-type price index	5.2	1.6	**1.6**	**3.3**	**2.5**
Nonfarm business (NFB) sector:					
Productivity (chain-type)	1.7	3.7	6.9	2.4	N.A.
Real compensation per hour:					
Using CPI	1.0	1.7	0.9	0.2	N.A.
Using NFB deflator	1.5	2.9	1.8	1.8	N.A.
Shares of Nominal GDP (percent)					
Business fixed investment	11.4	**12.9**	**13.0**	**13.4**	**13.8**
Residential investment	4.5	**4.3**	**4.3**	**4.3**	**4.3**
Exports	8.2	**10.6**	**10.8**	**10.8**	**10.8**
Imports	9.2	**13.4**	**13.9**	**14.2**	**14.5**
Personal saving	6.6	**1.6**	**1.1**	**0.1**	**0.2**
Federal surplus	-2.8	1.2	1.2	2.1	N.A.

Note.—Revised data for Federal surplus are not yet available.

	1970-1993	1999	April 2000	May 2000	June 2000
Unemployment Rate (percent)	6.7**	4.2**	3.9	4.1	4.0
Payroll employment (thousands)					
increase per month			410	171	11
increase since Jan. 1993					22099
Inflation (percent per period)					
CPI	5.8	2.7	0.0	0.1	0.6
PPI-Finished goods	5.0	2.9	-0.3	0.0	0.6

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

New or revised data in **boldface**.
GDP data **embargoed until 8:30 a.m., Friday, July 28, 2000. Data revised beginning 1997.**

FINANCIAL STATISTICS

	1998	1999	May 2000	June 2000	July 27, 2000
Dow-Jones Industrial Average	8626	10465	10580	10583	10586
Interest Rates (percent per annum)					
3-month T-bill	4.78	4.64	5.79	5.69	6.04
10-year T-bond	5.26	5.65	6.44	6.10	6.02
Mortgage rate, 30-year fixed	6.94	7.43	8.52	8.29	8.13
Prime rate	8.35	8.00	9.24	9.50	9.50

INTERNATIONAL STATISTICS

Exchange Rates	**Current level July 27, 2000**	**Percent Change from**	
		Week ago	**Year ago**
Euro (in U.S. dollars)	0.933	0.4	-12.2
Yen (per U.S. dollar)	109.2	1.2	-6.1
Major currencies index (Mar. 1973=100) (trade-weighted value of the U.S. $)	97.94	0.0	2.8

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	**6.0** (Q2)	4.0 (Jun)	3.7 (Jun)
Canada	4.9 (Q1)	6.6 (May)	2.9 (Jun)
Japan	0.7 (Q1)	4.6 (May) [2]	-0.7 (May)
France	3.4 (Q1)	9.8 (May) [2]	1.7 (Jun)
Germany	2.3 (Q1)	8.3 (May)	1.9 (Jun)
Italy	3.0 (Q1)	10.8 (Apr)	2.7 (Jun)
United Kingdom	3.0 (Q1)	5.7 (Mar)	3.3 (Jun)

U.S. GDP data **embargoed until 8:30 a.m., Friday, July 28, 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.