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WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

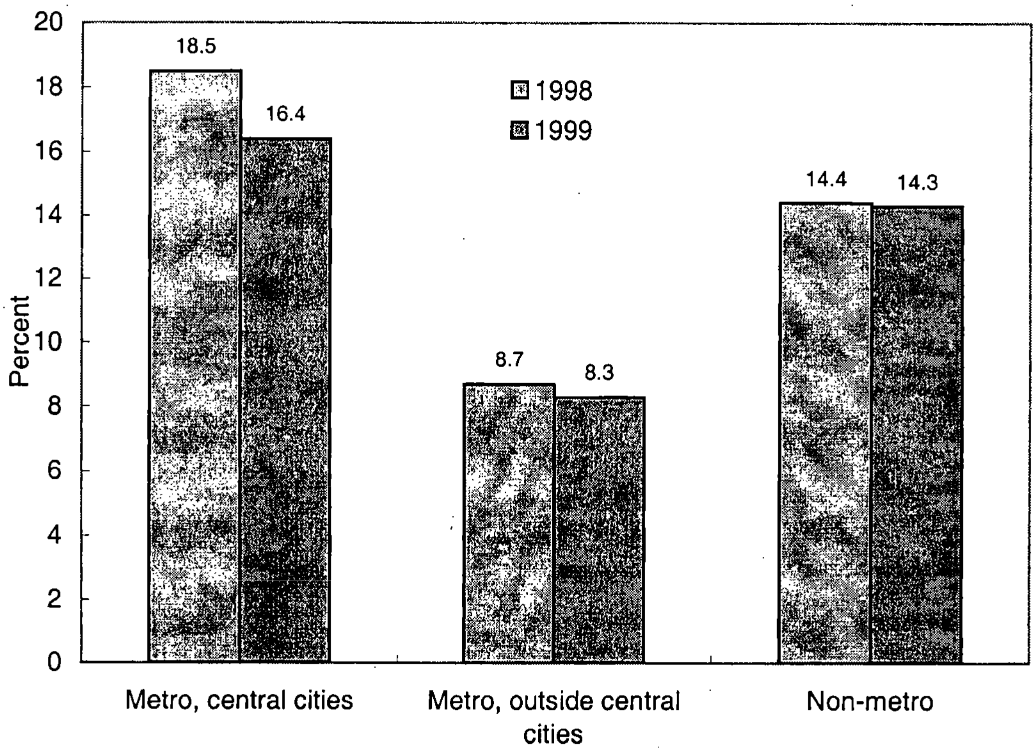
Prepared by the Council of Economic Advisers
with the assistance of the Office of the Vice President

Copied
Baily
Podesta

September 29, 2000

CHART OF THE WEEK

Metro and Non-Metro Poverty Rates



Poverty rates in central cities, while still relatively high, declined dramatically in 1999. This drop was large enough to account for over 80 percent of the overall decline in the number of people living in poverty. Non-metro areas showed the smallest decline.

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SPECIAL ANALYSES

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DEPARTMENTS

"Is this it? Are we going to spend the rest of our lives flailing around in the growing gap between rich and poor?"

THE ... SEEN
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SPECIAL ANALYSIS

Welfare Reform and Spatial Mismatches

A Brookings Institution study released this summer found that welfare caseloads are increasingly concentrated in the largest urban centers. Thus, further progress in reducing poverty and welfare dependency will increasingly depend on facilitating the move from welfare to work in these areas. Fortunately the latest income and poverty data provide reasons for optimism.

Caseloads fell less in urban counties. The Brookings study found that welfare caseloads fell by 51.5 percent nationwide from 1994 to 1999, but by a somewhat smaller 40.6 percent in the 89 urban counties containing the 100 largest cities. As a result, the share of caseloads in these counties increased from 47.5 to 58.1 percent of the national total. While a 40.6 percent decline in urban welfare rolls is hardly "bad news," it is worth trying to understand why it is less than the decline in non-urban areas.

"Spatial mismatch" as a possible explanation. Spatial mismatch occurs when low-skilled workers tend to reside in urban areas, but growth in jobs suited to their skills occurs in suburban areas that are difficult for them to reach. Some evidence that there might have been a spatial mismatch for welfare recipients in the early 1990s comes from a recent study of four cities using 1990-94 data. The study found that about half of all families on public assistance lived in the central cities, yet only 19 percent of new jobs for the very low-skilled were generated in the central cities. Additionally, a recent HUD study found that job growth between 1992 and 1997 was slower in the cities than in the suburbs and that the job mix in cities is shifting toward high-tech jobs that are unavailable to low-skilled workers.

Spatial mismatch tends to be worse for African Americans. The study of four cities found that the black central city areas offered only 8 percent of all very low-skilled jobs, and only 5 percent of non-college jobs. However, the white suburbs offered 68 percent of all very low-skilled jobs and 65 percent of all non-college jobs. Yet the black central cities contained 42 percent of all female-headed households in poverty, while the white suburbs contained only 25 percent of these women. These differences suggest that low-skilled female inner-city residents should find that suburbs are a more attractive place to look for work than the inner city. Indeed, the study found that among firms located in the white suburbs, the percentage of African American applicants for low-skilled jobs exceeded the percentage of African American residents in those suburbs by a wide margin.

The importance of transportation. Spatial mismatch is not a problem if workers can easily get to where the jobs are. However, the study found that nearly half of all new low-skilled jobs in the white suburbs were inaccessible by public transportation. Since 65 to 70 percent of all low-skilled jobs were located in the white suburbs, this finding suggests that at least a third of all low-skilled

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jobs are not accessible by public transport. The study also found that African Americans are a higher percentage of new hires when jobs are accessible by public transport.

Implications. Spatial mismatch appears to have been a significant factor slowing the transition from welfare to work. However, urban areas are likely to experience a multitude of interrelated problems—in addition to spatial mismatch—that can limit job access for welfare recipients. Urban poverty goes hand-in-hand with higher incidence of social problems, such as low educational attainment and crime. Other factors that make it hard to make the transition to employment may include high child care and transportation expenses.

However, the latest data on income and poverty show some of the strongest gains in income and reductions in poverty occurring in the central cities (see the Chart of the Week). Thus, a combination of policies designed to aid the transition from welfare to work and a very strong economy appear to have borne fruit.

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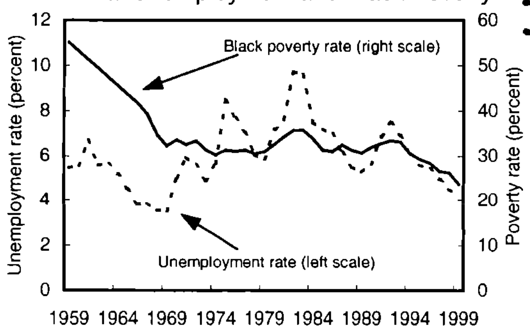
SPECIAL ANALYSIS

Tight Labor Markets and Black Poverty

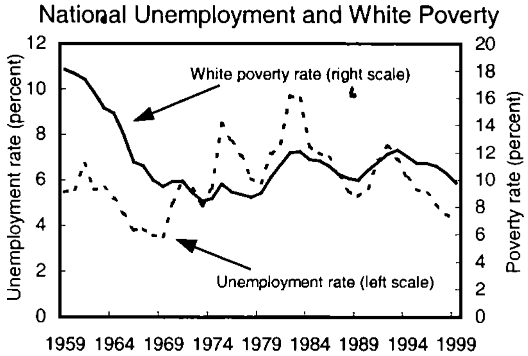
The latest income and poverty statistics show dramatic improvements in the economic status of American families. Gains for African Americans were particularly strong and mirror the gains of the 1960s that accompanied the enactment of civil rights legislation and the War on Poverty.

Trends. In the 1960s the black poverty rate fell 42 percent (22.9 percentage points) from its very high 1959 rate of 55.1 percent (see upper chart). The 29 percent decline between 1993 and 1999 from a rate of 33.1 percent to a rate of 23.6 percent represented an even faster drop on an annual basis. These declines stand in stark contrast to the relatively stable poverty rates of the 1970s, 1980s, and early 1990s.

National Unemployment and Black Poverty



National Unemployment and White Poverty



Cyclical changes. Changes in the unemployment rate might reasonably be expected to be associated with changes in the poverty rate—and they are for whites (see lower chart). But while the current cyclical decline in unemployment has brought the poverty rate for whites near prior cyclical troughs, the decline for blacks has been much sharper, with the poverty rate reaching an all-time low. A comparison with the trends of the 1960s suggests two possible explanations for this large drop: the extraordinary tightness of the labor market and the role of social policy.

Tight labor markets. In both the 1960s and the 1990s the unemployment rate fell to levels below standard estimates of the NAIRU. Under such conditions, employers compete strongly for workers, providing less skilled workers with new opportunities and higher wages that help reduce poverty. Expansions like those of the 1970s and 1980s, in which the drop in unemployment relative to the NAIRU is less dramatic, probably do not generate as much competition among employers or as many benefits for low-skilled workers.

The role of social policy. Just as the 1960s saw the War on Poverty and civil rights legislation, the current period has advanced a new policy of making work pay. Both the increase in the minimum wage and the expansions of the EITC have contributed to the reductions in poverty. While the direct income effect of

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the EITC is not included in the official poverty measure, an alternative poverty measure that does include the EITC suggests that in 1999 alone 1 million of the 4.1 million people moved out of poverty by the program were African Americans. Moreover, the EITC probably contributed indirectly to reducing poverty as officially measured by encouraging work. .

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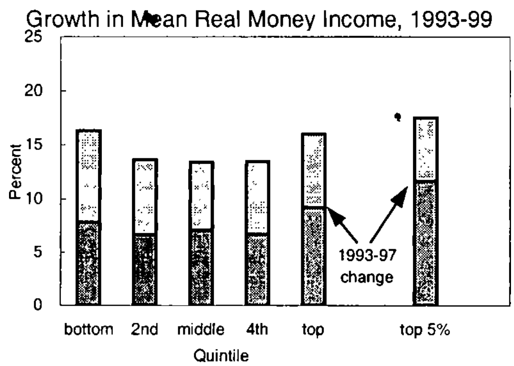
ARTICLE

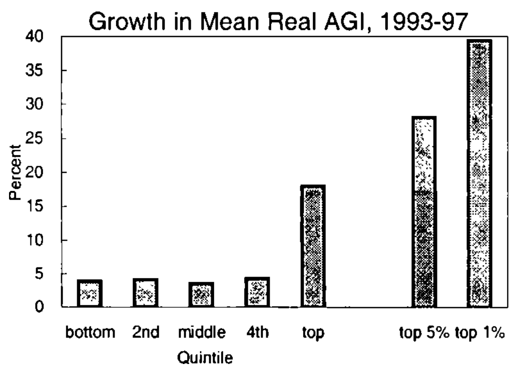
Capital Gains and Income Inequality

The latest data on money income from the Census show strong gains in income in all parts of the income distribution and that inequality has not changed much since 1993, after increasing over the previous two decades. Some observers have noted, however, that tax and wealth data show ~~disproportionate growth~~ in income at the very top of the distribution (which has ~~contributed to recent~~ revenue "surprises"). An analysis of differences between Census and tax data shows that the Census data probably do understate growth in income at the very top of the distribution. But this finding does not undermine the fact that income gains have been widely shared since 1993.

Trends in Census money income. Census money income measures are based on data collected in the annual March supplement to the monthly Current Population Survey (CPS) used to estimate household employment. Census's official definition of income is based on money income before taxes and includes government cash transfers. It does not include realized capital gains or losses, ~~nor does it include the EITC~~ or non-cash ~~benefits like food~~ stamps. Using this definition, each fifth of the income distribution has experienced strong gains, since 1993, with the largest increase coming in the bottom fifth (see upper chart).



Census reports on income in the top 5 percent of the distribution (which did grow slightly faster than the rest of the distribution), but not the top 1 percent. One reason is that the data collected in the CPS is "top coded," so that, for example, earnings of $1 million or more are entered as $999,999 rather than as their actual value. (Top coding may reduce coding errors and enhance response rates by providing greater confidentiality protection.) While top coding does not affect calculations of median income or poverty status, it does affect most measures of inequality.



Trends in pre-tax income. IRS tax data provide a somewhat different picture of trends in income inequality. In particular, the IRS data (through 1997) show more rapid growth in mean adjusted gross income (AGI) for the top 20 percent and particularly the top 1 percent of taxpayers than for the rest of the distribution (see lower chart, which has a different scale from the upper chart). Unlike the census data, the IRS data are not top coded and include capital gains realizations; hence, they probably provide a better picture of income growth at the very top. However, they are not a satisfactory substitute for Census data in describing overall trends in household income for a number of reasons, including the following:

- AGI is not a household-based measure. A tax-filing unit is different from a household. For example, a married couple filing separately would constitute two tax units but only one household. There were 122 million individual income tax returns filed for 1997, but only 103 million households in the CPS.

- Taxable income excludes cash transfers. While AGI includes capital gains (a relatively more important source of income at the top), it does not include many cash transfers from means-tested programs like welfare and SSI or child support (relatively more important sources of income at the bottom).

- Not all low-income families file tax returns. Although many low-income families file tax returns in order to claim the EITC, those who do not are not reflected in income distributions based on AGI. Census data cover the entire non-institutionalized population.

The most complete picture of trends in income distribution would require an appropriate merging of IRS and Census data, but this is a technically daunting task because of the differences in coverage and income definition. While the Congressional Budget Office has attempted such exercises in the past, its most recent estimates based on actual data are for 1995.

Conclusion. Census data are most likely understating growth in income at the top of the distribution. Nevertheless, they provide an accurate and unmistakable picture of improvements for the vast majority of households, including those at the bottom of the distribution and traditionally disadvantaged groups.

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BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

Are Managers and Professionals Working Longer Hours? Despite the perception that managers and professionals have been working longer and longer hours, average weekly hours for people in these occupations were nearly constant throughout the 1990s, following slight increases during the 1980s. In these occupations the greatest increase in number of hours worked occurred among professional women, who saw their average hours rise from 35 per week in 1982 to 37 per week in 1993, with no further changes since. The proportion of managers and professionals working very long hours has also been stable: about 18 percent of female and 38 percent of male managers and professionals worked more than 49 hours per week in 1999, nearly the same percentages as in 1989. However, there has been an increase in the number of Americans in managerial and professional occupations, especially among women. Growth in the total number of people who hold such jobs has averaged 3 percent per year since 1982, and 5 percent among women.

Impact of 401(k) Plans on Wealth Varies by Earnings Level. Eligibility for 401(k) plans rises steadily with earnings, and participation rates in 401(k) plans also increase somewhat with earnings. Thus, 401(k) balances are concentrated among higher-income Americans. However, a new study finds no evidence that the 70 to 80 percent of 401(k) contributions that come from households with annual earnings above $40,000 represent a net increase in saving by these households. Instead these households appear to finance their 401(k) contributions with some combination of reducing other assets, shifting saving that would have taken place anyway into 401(k) saving, or increasing debt. By contrast, the study found that the 401(k) contributions of households earning $30-40,000 per year probably were a net contribution to saving. The savings impact of 401(k) plans on households earning less than $30,000 annually was hard to discern, in part because the contributions were relatively small for this group. Thus, it is unlikely that more than 30 percent of 401(k) contributions represent new net private saving, with those earning less than $40,000 per year doing most new saving.

Hunger and Food Insecurity Fall. The number of Americans experiencing food insecurity fell by 11 percent between 1995 and 1999, based ~~on~~ sample responses to the question: at some time during the previous year, were you not certain of acquiring food adequate to meet your basic needs at all times. Of the 31 million people reporting food insecurity in 1999, 8 million were in households reporting that at least one member went hungry at some time during the year~~—a 30~~ percent decline since 1995 (the first year of the survey). All demographic, racial, and geographic groups saw declines in food insecurity, although people in income groups between 50 and 130 percent of poverty reported increases in food insecurity. Nonetheless, reports of hunger declined for all groups—especially for female-headed households, black households, Hispanic households, and households earning less than half of poverty income. However, in 1999, children were still about twice as likely as adults to live in households experiencing food insecurity, and were more likely to live in households experiencing hunger.

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INTERNATIONAL ROUNDUP

Oil Prices Expected to Lower OECD Growth. With a substantial increase in its estimates of world oil prices, the OECD has revised downward its growth predictions. It now forecasts that the U.S. economy will grow 4.8 percent in 2000, 0.1 percentage point less than previously projected. Growth in 2001 was revised downward a more substantial 0.3 percentage point to 2.7 percent. The EU and Japan, along with the OECD as a whole, are projected to follow a similar pattern, with relatively small declines of 0.1 or 0.2 percentage point in 2000 and a larger impact in 2001. Because of its high reliance on imported oil, Japan is predicted to grow at only 1.6 percent in 2001, down from the original forecast of 2.2 percent. The impact of sustained high oil prices on inflation is predicted to be small across the OECD in 2000, but to worsen in 2001, boosting the consumer price level by 0.8 percent in the EU and 0.5 percent in the United States.

Quality of Growth Matters for Living Standards. A new World Bank report argues that countries can dramatically improve the quality of peoples' lives by blending pro-growth policies with those that embrace wider access to education, protection of the environment, civil liberties, and anti-corruption. The report includes a new survey of the fairness of education availability. The United States and Poland are the top two countries based on this measure. The high degree of inequality in countries such as Algeria and Pakistan implies that vast numbers of people have very limited access to education, imposing a significant cost on society at large. The report also argues that environmental degradation disproportionately hurts the poor, who rely on such natural capital as land, forests, and biodiversity for survival. While global finance may provide benefits for developing countries, the poor suffer most during financial crises. Sound macroeconomic policies and strengthening domestic financial systems are thus an important component of alleviating poverty. Finally, the report argues, poor governance (corruption and bureaucratic harassment) allows elite vested interests to influence the policies of the state unduly, with potentially large social costs.

Entrepreneurship Is Greater in the United States than in Europe. A new study released by the Bureau of Labor Statistics examines the role of new firms in creating jobs in Europe and the United States. Entrepreneurship, or the birth of new establishments, is important to job growth in the United States, accounting for 57 percent of new jobs between 1995 and 1996. Small establishments (1 to 19 workers) play a much larger role in job growth in the U. S. service industry than they do in manufacturing. Similarly, in Europe most enterprises started in 1994-95 were in the trade, hotel and restaurant, and service industries. Nonetheless, a second study, based on international survey data, found that the rate of entrepreneurial activity (measured by the proportion of the population involved in startups) was higher in the United States than in nine other developed countries. While many factors are probably responsible, the study notes capital availability. In 1996 private equity exceeded $33 billion in the United States, compared with about $9 billion in Europe; in 1998 only 17 percent of Europe's fixed-income issues were considered high-risk, while 60 percent were in the United States.

RELEASES THIS WEEK

Gross Domestic Product

According to revised estimates, real gross domestic product grew at an annual rate of 5.6 percent in the second quarter.

Advance Durable Orders

Advance estimates show that new orders for durable goods rose 2.9 percent in August, following a decrease of 13.1 percent in July.

Consumer Confidence

Consumer confidence, as measured by The Conference Board, rose 1.1 index points in September, to 141.9 (1985=100).

MAJOR RELEASES NEXT WEEK

NAPM Report on Business (Monday)
Leading Indicators (Tuesday)
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	**5.6**
GDP chain-type price index	5.2	1.6	1.6	3.3	**2.4**
Nonfarm business (NFB) sector:					
Productivity (chain-type)	1.7	4.1	8.0	1.9	5.7
Real compensation per hour:					
Using CPI	1.0	2.2	1.3	0.0	1.7
Using NFB deflator	1.5	3.3	2.9	1.1	2.9
Shares of Nominal GDP (percent)					
Business fixed investment	11.4	12.9	13.0	13.4	13.7
Residential investment	4.5	4.3	4.3	4.3	4.2
Exports	8.2	10.6	10.8	10.8	11.0
Imports	9.2	13.4	13.9	14.2	14.6
Personal saving	6.6	1.6	1.1	0.1	0.2
Federal surplus	-2.8	1.3	1.5	2.4	2.4

	1970-1993	1999	June 2000	July 2000	August 2000
Unemployment Rate (percent)	6.7**	4.2**	4.0	4.0	4.1
Payroll employment (thousands)					
increase per month			57	-51	-105
increase since Jan. 1993					21989
Inflation (percent per period)					
CPI	5.8	2.7	**0.5**	0.2	-0.1
PPI-Finished goods	5.0	2.9	0.6	0.0	-0.2

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

New or revised data in **boldface.**

FINANCIAL STATISTICS

	1998	1999	July 2000	August 2000	Sept. 28, 2000
Dow-Jones Industrial Average	8626	10465	10663	11015	10824
Interest Rates (percent per annum)					
3-month T-bill	4.78	4.64	5.96	6.09	6.07
10-year T-bond	5.26	5.65	6.05	5.83	5.82
Mortgage rate, 30-year fixed	6.94	7.43	8.15	8.03	7.88
Prime rate	8.35	8.00	9.50	9.50	9.50

INTERNATIONAL STATISTICS

Exchange Rates	**Current level September 28, 2000**	**Percent Change from Week ago**	**Percent Change from Year ago**
Euro (in U.S. dollars)	0.883	3.1	-16.0
Yen (per U.S. dollar)	107.6	1.0	1.4
Major currencies index (Mar. 1973=100) (trade-weighted value of the U.S. $)	100.6	-0.7	8.9

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	6.1 (Q2)	4.1 (Aug)	3.4 (Aug)
Canada	5.3 (Q2)	6.8 (Jul)	2.5 (Aug)
Japan	0.8 (Q2)	4.7 (Jul)	-0.5 (Jul)
France	3.4 (Q2)	9.6 (Jul) [2]	1.7 (Aug)
Germany	3.6 (Q2)	8.3 (Jul)	1.8 (Aug)
Italy	2.6 (Q2)	10.8 (Apr)	2.6 (Aug)
United Kingdom	3.2 (Q2)	5.5 (May)	3.0 (Aug)

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.