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Weekly Economic Briefing - March 3, 2000

WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

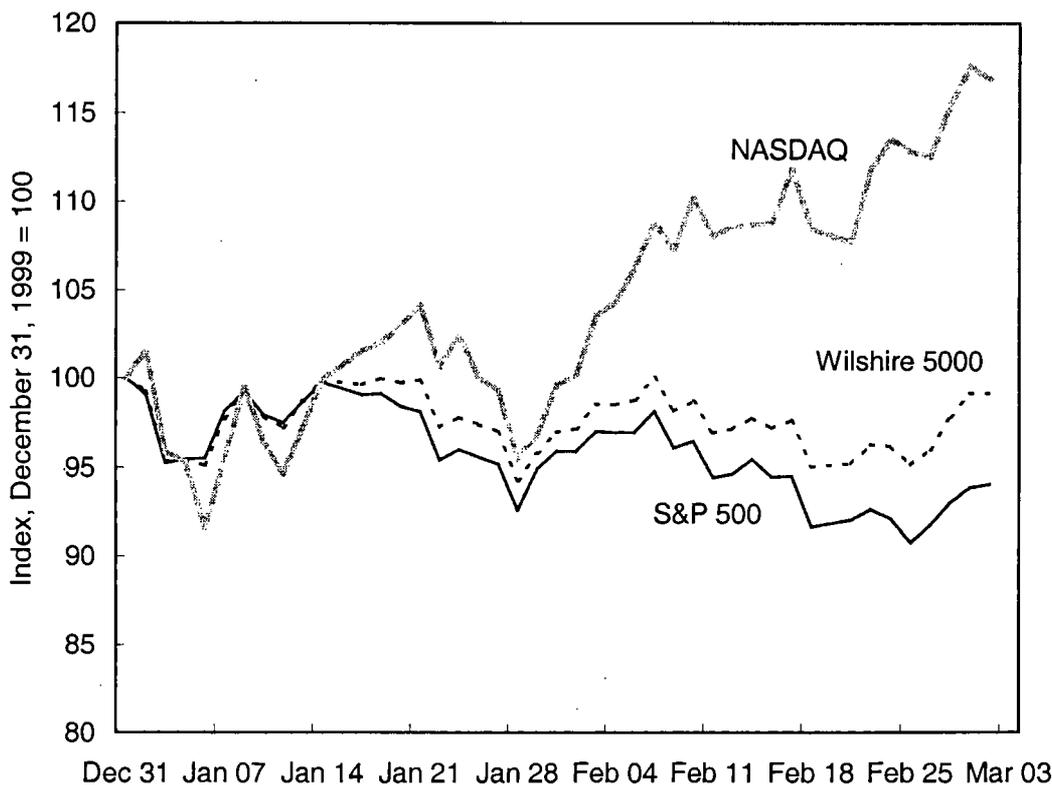
Prepared by the Council of Economic Advisers
with the assistance of the Office of the Vice President

March 3, 2000

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Entire report:
Bailey
Podesta
pg. 6:
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Berger*

CHART OF THE WEEK

A Tale of Two Stock Markets



Thus far in 2000, the technology-heavy NASDAQ stock market index has risen another 17 percent (after an increase of 86 percent in 1999). The Standard and Poor's 500 index (as well as the Dow Jones Industrial Index), by contrast, has fallen in value. Reflecting these divergent trends, the broadly based Wilshire 5000 index has been essentially flat.

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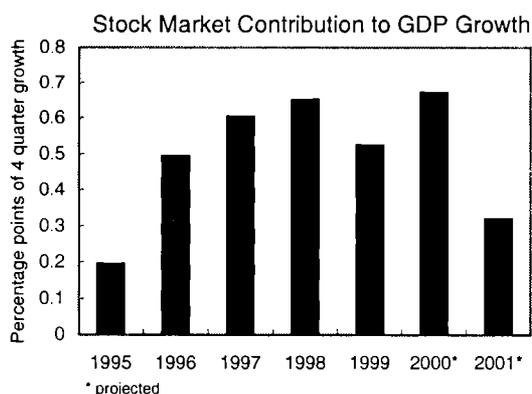


CURRENT DEVELOPMENT

The Wealth Effect: Past, Present, and Future

Despite the tepid performance of the stock market so far this year, last year's \$3 trillion increase in stock market wealth will continue to affect household spending this year and into the future. In recent testimony, Federal Reserve Chairman Alan Greenspan emphasized the role of the "wealth effect" in spurring high spending growth, which he cited as contributing to the widening current account deficit, increasingly tight labor markets, and potential inflationary pressures.

Only 3½ cents on the dollar (but there are a lot of dollars). According to the standard "life-cycle" model of consumer behavior, an increase in wealth is not spent all at once; instead, people generally aim to raise their living standards over the remainder of their lives by spending only a portion each year. The evidence



suggests that each dollar change in stock market wealth leads to a permanent change in the level of consumer spending in the future of about 3½ cents per year, with the full response kicking in after several years. Although the wealth effect is thought to be permanent, only *changes* in wealth affect the growth rate. The contribution of household spending to GDP growth from the rise in stock market wealth relative to overall

income over the past 5 years has averaged about one-half percentage point (see chart, which assumes that the stock market grows in line with income during 2000 and 2001). Some of the increase in spending owing to the wealth effect goes to imported goods, however, which offsets a portion of the contribution to GDP growth.

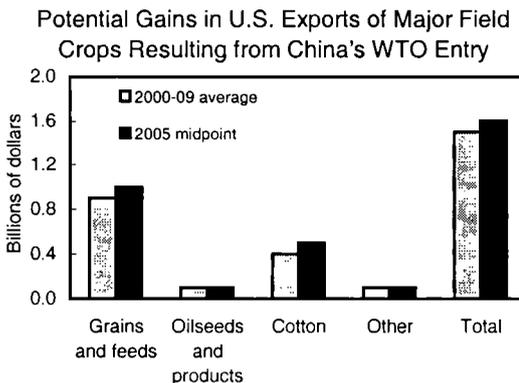
The legacy of past stock market gains. Because the effects of last year's booming stock market have yet to be realized fully, the wealth effect will continue to contribute strongly to spending growth this year and, to a lesser extent, next year. An open question—discussed by Chairman Greenspan in his testimony and one we will examine in a later *Weekly Economic Briefing*—is the extent to which the stock market boom and other developments in aggregate supply and demand are related to the apparent acceleration in productivity growth.

SPECIAL ANALYSIS

China, the WTO, and U.S. Agriculture

U.S. agricultural exports and farm income are projected to rise with China's entry into the World Trade Organization, according to a recent analysis by the USDA's Economic Research Service (ERS). Increased demand for agricultural products and higher farm prices would also raise consumer prices slightly.

More U.S. exports. The ERS estimates that with China's WTO accession, U.S. global exports of major field crops over the 2000-09 period would rise above baseline levels by an average of \$1.5 billion per year, based on China's market opening commitments in our bilateral agreement. By 2005, the increase would be



about \$1.6 billion. Much of the increase in field crop exports would come from direct U.S. sales to China arising from significantly greater access to that large market. The largest absolute gains would be in grains and feeds, followed by cotton (see chart). Exports of oilseeds and products are expected to rise overall, with a shift from soybeans to processed soybean products. Other commodities not explicitly treated in the analysis (such

as fruit and vegetables, animal products, and tree nuts) would also enjoy increased access once reductions in Chinese duties are implemented.

Higher farm income. ERS estimates that net farm income would rise above baseline levels by an average of \$1.1 billion annually in the 2000-09 period, after accounting for changes in Federal government payments.

- Higher cash receipts. Stronger crop demand, resulting in higher prices, would raise annual cash receipts from crops by \$1.5 billion per year. An additional \$1.2 billion per year would come from sales of livestock products. However, this latter increase is driven by higher production expenses, which lead to lower output and higher prices for livestock products. In fact, ERS projects that overall farm production expenses would rise by roughly the same amount as livestock product sales, primarily as a result of higher feed costs. (Some additional net farm income might come from reduced tariffs for poultry, pork, or beef, which would boost U.S. exports of these products.)
- Lower government payments. Higher farm prices are projected to reduce Federal spending on loan deficiency payments by about \$300 million per year.

A slight rise in consumer prices. ERS estimates that with higher prices for agricultural products, especially livestock products, under the WTO accession

scenario, the consumer price index for all food would be about 0.2 percent higher, on average, over the 2000-09 period than under the baseline scenario. This translates into increased average annual food expenditures of about \$1.2 billion (roughly 0.1 percent higher than in the baseline scenario).

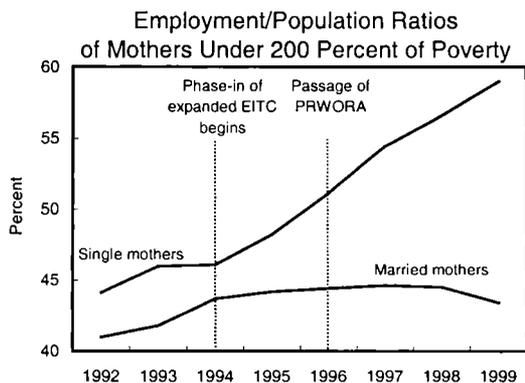
Conclusion. USDA's analysis, which focuses on major field crops, suggests that China's WTO accession would result in additional U.S. exports, higher farm incomes for some producers, and lower government payments. The increase in demand for agricultural products would also result in a modest increase in retail food prices. On balance, the gains to U.S. producers, combined with the reduction in Federal spending, would outweigh the impact on U.S. consumers by an average of about \$200 million annually.

ARTICLE

Recent Growth in the Employment of Single Mothers

The strong labor market has surely been one reason for the rapid growth in employment among single mothers in recent years. But a forthcoming review of the research literature by the CEA and the Treasury presents persuasive evidence that policies such as the EITC expansions and welfare reform have played an important role as well.

Employment of low-income mothers. A comparison of employment growth among low-income single and married mothers (see chart) illustrates the nature of this evidence. In March of 1992 the employment/population ratio was only 3 percentage points higher for the single mothers than for the married mothers,



percentage points higher for the single mothers than for the married mothers, but by 1999 this gap had increased to 16 percentage points. This comparison is instructive because reforms to welfare policy substantially affect the first group but not the second. And the EITC unambiguously encourages labor supply by single parents, while having ambiguous effects on work incentives for second earners in married households. (The EITC can reduce

incentives to work for second earners in some households because the additional income would cause the couple to lose some or all of their EITC credits.)

The EITC. By raising the after-tax return to employment, the EITC is a powerful incentive to work for single parents. Single mothers receive more than two-thirds of EITC dollars. (The bulk of the remainder boost incomes of married taxpayers.) As a result of the expansions in the program enacted in 1993, the maximum EITC credit increased dramatically in 1994, 1995, and 1996. Over these same years, the employment/population ratio of single mothers increased relative to that of similar married mothers, and also relative to those of two other groups less affected by changes in the EITC, African American men and single women without children. A detailed statistical analysis concludes that the EITC accounted for about 36 percent of the increase in employment of single mothers between 1992 and 1996.

Welfare reform. The 1996 Personal Responsibility and Work Opportunity Reconciliation Act (PRWORA), and the Federal waivers that preceded the Act, transformed welfare by allowing states to establish work requirements, time-limit assistance, and improved child support. In addition to lowering caseloads dramatically, these policy changes have also affected employment, as many individuals previously on welfare get jobs. An aggregation of recent state reports indicates that more than 1.3 million welfare recipients nationwide went to work in just the 1-year period between October 1997 and September 1998. Further

evidence comes from an analysis of Current Population Survey data. For the years 1988 to 1992 there was a 20 to 21 percent employment rate (in March of the year) for individuals on welfare the previous year. This rate increased steadily starting in 1993, rising to more than 36 percent by March 1999. Statistical analysis indicates that over the span 1992 to 1996, about 33 percent of the increase in employment of single mothers was due to the state-level changes in welfare policy that preceded PRWORA.

Other policies. There is some evidence to suggest that other policy changes, notably expanded funding for child care and the provision of training to welfare recipients, have effectively provided additional work incentives for low-income women. Among the proposals in the 2001 budget that can be expected to encourage additional labor supply are policies that reduce the “marriage penalty” for low- and middle-income families, proposals involving child care expenses, and further expansion of the EITC.

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

Census Provides First Official E-Commerce Estimate. Retail E-commerce sales were \$5.3 billion in the fourth quarter of 1999, according to the first official estimate of such sales, released this week by the Census Bureau. Such sales, defined as sales of goods and services over the Internet and other online systems, were 0.64 percent of total retail sales of \$821.2 billion in the quarter. Available evidence suggests that about 15 percent of retail firms are involved in E-commerce sales.

Boskin Commission Members See Smaller CPI Bias. Members of the Boskin Commission believe that methodological changes implemented by the Bureau of Labor Statistics have reduced the bias in the CPI from the 1.1 percentage point level reported by the Commission in 1996. Responding to a survey by the General Accounting Office, the individual members put the remaining bias at between 0.73 and 0.9 percentage point annually, and they attribute the remaining bias to what the Commission referred to as "new products/quality change bias."

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Expanded Insurance Can Mean Fewer Avoidable Hospitalizations. By increasing access to hospital care, expansion of public health insurance should lead to more hospitalizations. At the same time, however, it might reduce avoidable hospitalizations—defined as those that might not have occurred had patients received effective, timely, and continuous outpatient medical care for certain chronic disease conditions. In the case of children, a recent study found that expansions in Medicaid eligibility between 1983 and 1996 led to a net increase of 10 percent in overall pediatric hospitalizations but a decline of 22 percent in avoidable ones. The study notes that because an average inpatient hospital visit is roughly 40 times more expensive than an average outpatient visit, this reduction in avoidable hospitalizations makes medical care more efficient. The eligibility expansions also appear to have been associated with a significant shift in the types of hospitals where children are treated, from public hospitals to for-profit facilities.

Homelessness Persists but Services Improve. Between 2.3 and 3.5 million people, nearly 40 percent of them children, are estimated to experience homelessness at least once during a year, according to a recent Urban Institute study based on 1996 data. People living at or below the poverty line are the most vulnerable to experiencing a homeless episode; between 6.3 and 9.6 percent of those in poverty are likely to be homeless at some point during the year. At the same time, the network of homeless services is larger and more diverse than it was in the late 1980s. The nation's shelter and housing capacity grew by 220 percent between 1988 and 1996. Soup kitchen and meal distribution services in central cities nearly quadrupled between 1987 and 1996, from 97,000 to 382,100 meals on an average day in February. Much of the new growth, according to the study, is due to new funding and to priorities placed on developing transitional and permanent housing.

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INTERNATIONAL ROUNDUP

ECB Holds the Line on Rates. This week the European Central Bank decided to leave interest rates unchanged, keeping the main refinancing rate at 3.25 percent. A pickup in inflation, plus the recent decline of the euro, have provoked speculation that the ECB may raise rates in the near future.

African Skills Flight Hurting Development. According to United Nations data, an average of 20,000 African professionals (including doctors, university lecturers, and engineers) have emigrated from the continent annually since 1990, up from about 12,000 per year in the 1985-90 period. This human capital flight, or "brain drain," reduces the availability of skilled human resources that African countries badly need for self-reliant and sustainable development. The flight of doctors is most striking. For instance, 60 percent of all Ghanaian doctors trained locally in the 1980s left the country, and Nigeria suffers from an acute shortage of health personnel even as 21,000 Nigerian doctors practice in the United States. In part because of the brain drain, the entire continent has only 20,000 scientists, or 3.6 percent of the world total. Poor economic conditions, political violence, repression of human rights, and a lack of an open political atmosphere have contributed to the brain drain. Another contributing factor may be scholarship programs for study abroad coupled with a lack of training institutes in Africa.

*Ca Sandy
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Blurred a bit
Program like
the Green Water
by Benita to pay
Scientist - Miss
to May at work*

India PM Vajpayee's First Budget. Amidst concern about growing fiscal deficits and sluggish progress in reducing poverty, India's Ministry of Finance released its budget for fiscal 2000/01 this week. The budget proposes to cut the central government's deficit from an estimated 5.6 percent of GDP to 5.1 percent, and to "abolish" poverty by boosting annual growth to 7 to 8 percent from the current rate of around 6 percent. In addition to loosening foreign investment rules and reducing state controls on banks, the budget continues to channel substantial resources into energy, transport, and communications. The budget disappointed some, however, because it fails to take tougher measures to reduce the fiscal deficit and makes little progress in eliminating subsidies to the power and irrigation sectors. The new budget proposes to increase defense expenditures by 28 percent, the largest-ever rise for the world's fourth-biggest military.

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British Woman Files Patent Application on Herself. According to Reuters News, a British woman has become the first person to attempt to patent herself. The UK national patent office confirmed on Tuesday that it has received an application with the title "myself" from a poet and casino waitress who was angered at the patenting of gene sequences by businesses. "It has taken 30 years of hard labor for me to discover and invent myself, and now I wish to protect my invention from unauthorized exploitation, genetic or otherwise," the woman said. The patent office, however, said, "It is not really worth patenting something unless you make a lot of money from it."

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RELEASES THIS WEEK

Employment and Unemployment

****Embargoed until 8:30 a.m., Friday, March 3, 2000****

In February, the unemployment rate was 4.1 percent; it was 4.0 percent in January. Nonfarm payroll employment increased by 43,000.

Leading Indicators

The composite index of leading indicators increased 0.3 percent in January.

NAPM Report on Business

The Purchasing Managers' Index increased 0.6 percentage point in February to 56.9 percent. (A reading above 50 percent indicates that the manufacturing economy is generally expanding.)

Consumer Confidence

Consumer confidence, as measured by The Conference Board, declined 2.9 index points in February, to 141.8 (1985=100).

MAJOR RELEASES NEXT WEEK

Productivity (Tuesday)

U.S. ECONOMIC STATISTICS

	1970- 1993	1999	1999:2	1999:3	1999:4
Percent growth (annual rate)					
Real GDP (chain-type)	3.0	4.5	1.9	5.7	6.9
GDP chain-type price index	5.2	1.6	1.3	1.1	2.0
<u>Nonfarm business (NFB) sector:</u>					
Productivity (chain-type)	1.7	3.3	0.6	5.0	5.0
Real compensation per hour:					
Using CPI	1.0	1.8	1.2	2.0	1.1
Using NFB deflator	1.5	2.9	2.9	4.0	1.8
Shares of Nominal GDP (percent)					
Business fixed investment	11.4	12.6	12.6	12.7	12.5
Residential investment	4.5	4.4	4.5	4.4	4.4
Exports	8.2	10.8	10.7	10.8	10.9
Imports	9.2	13.5	13.4	13.8	14.0
Personal saving	6.6	1.7	1.8	1.5	1.3
Federal surplus	-2.8	N.A.	1.3	1.4	N.A.
<hr/>					
	1970- 1993	1999	December 1999	January 2000	February 2000
Unemployment Rate (percent)	6.7**	4.2**	4.1	4.0	4.1
Payroll employment (thousands)					
increase per month			309	384	43
increase since Jan. 1993					20823
Inflation (percent per period)					
CPI	5.8	2.7	0.2	0.2	N.A.
PPI-Finished goods	5.0	3.0	0.1	0.0	N.A.

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

New or revised data in **boldface**.

Employment and unemployment data **embargoed until 8:30 a.m., Friday, March 3, 2000.**

FINANCIAL STATISTICS

	1998	1999	January 2000	February 2000	March 2, 2000
Dow-Jones Industrial Average	8626	10465	11281	10542	10165
Interest Rates (percent per annum)					
3-month T-bill	4.78	4.64	5.32	5.55	5.60
10-year T-bond	5.26	5.65	6.66	6.52	6.40
Mortgage rate, 30-year fixed	6.94	7.43	8.21	8.33	8.27
Prime rate	8.35	8.00	8.50	8.73	8.75

INTERNATIONAL STATISTICS

Exchange Rates	Current level	Percent Change from	
	March 2, 2000	Week ago	Year ago
Euro (in U.S. dollars)	0.962	-3.1	-12.0
Yen (per U.S. dollar)	107.4	-3.2	-10.9
Major currencies index (Mar. 1973=100) (trade-weighted value of the U.S. \$)	95.88	0.4	0.6

International Comparisons ^{1/}	Real GDP growth	Unemployment rate	CPI inflation
	(percent change last 4 quarters)	(percent)	(percent change in index last 12 months)
United States	4.5 (Q4)	4.1 (Feb)	2.7 (Jan)
Canada	4.7 (Q4)	6.9 (Dec)	2.3 (Jan)
Japan	1.0 (Q3)	4.6 (Nov)	-0.9 (Jan)
France	3.2 (Q4)	10.4 (Dec)	1.6 (Jan)
Germany	2.3 (Q4)	8.8 (Dec) ^{2/}	1.7 (Jan)
Italy	1.2 (Q3)	12.1 (Apr)	2.2 (Jan)
United Kingdom	2.9 (Q4)	5.9 (Oct)	1.9 (Jan)

U.S. unemployment data **embargoed until 8:30 a.m., Friday, March 3, 2000.**

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 unified Germany.