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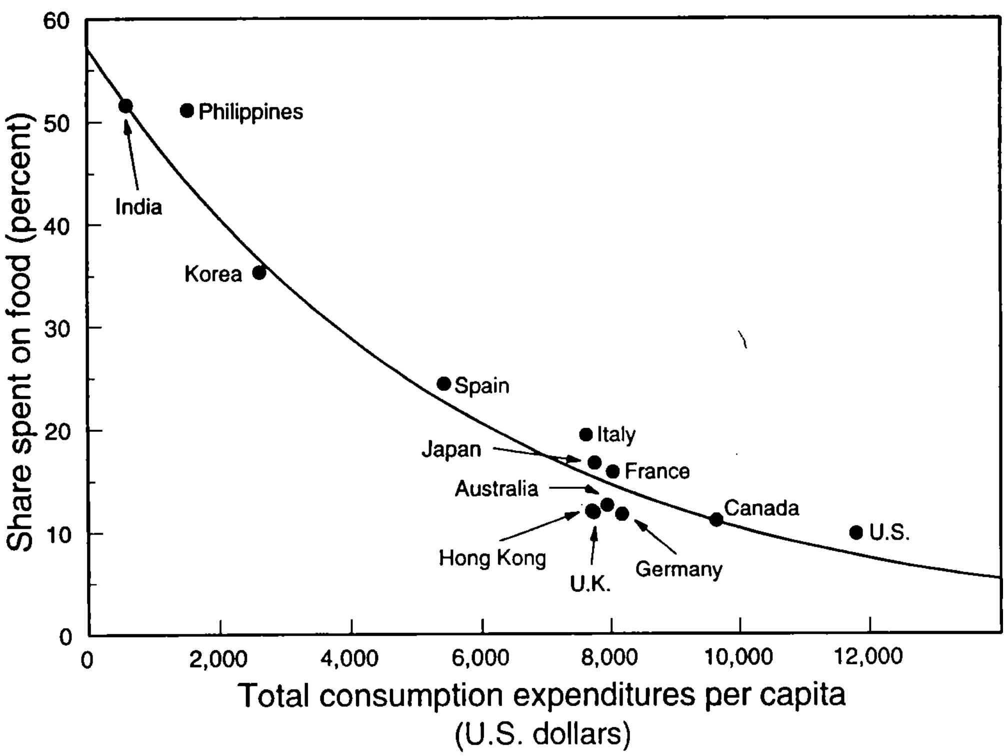
WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

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

April 3, 1995

CHART OF THE WEEK

Living Standards and the Share of Personal Spending Devoted to Food in 1985



On average, American families devote only about 10 percent of their family budgets to food for consumption at home (measure the U.S. dot against the vertical axis). Families in other countries spend a larger portion of their budgets on such food. In large part, this fact is attributable to the high overall standard of living in the United States (measure the U.S. dot against the horizontal axis). As standards of living rise, households tend to devote a larger fraction of their spending to goods and services other than food. However, there are important differences even among wealthy countries. For example, the share of food in the average budget in Japan is about half again as large as it is in the United States.

EYES ONLY

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"Believe me, the E-check is in the E-mail."

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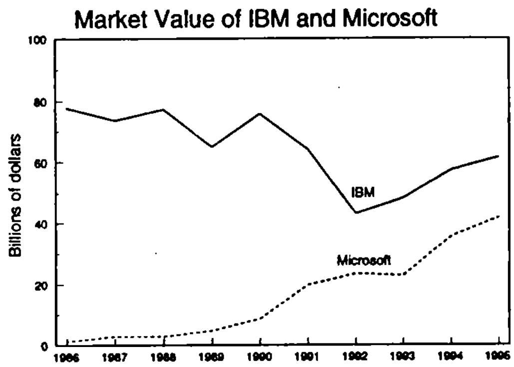

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IBM-compatibility became the industry standard: Software developers wanted to write applications programs for the computer system most users owned, users wanted to learn the system most businesses employed and for which the most software had been written, and businesses wanted to acquire hardware that most users had learned to use and for which the most software was available. This self-reinforcing standardization process helped IBM stave off competition in the early years of the personal computer. In the 1980s, for example, wide acceptance of the IBM standard preserved the dominance of IBM-compatibility even when Apple introduced what some considered a superior personal computer, the Macintosh.

As time passed, however, the market for PC hardware became a "commodity" market, characterized by fierce competition among many producers of highly similar products. Today, although IBM remains successful in the still-large mainframe market, it manufactures only 9 percent of personal computers sold worldwide.

Microsoft Reaps What IBM Sowed. Even as hardware manufacturers have proliferated, Microsoft has maintained its position as the only supplier of the standard operating system. A rival operating system could have succeeded only if a critical mass of users and software developers had been willing to switch to a new standard. However, this has not happened. As a result, Microsoft has been able to enhance its bargaining position relative to IBM and has probably been able to claim an increasing share of the profits from the establishment of an industry standard.

How Entrenched is Microsoft's Position? The Microsoft operating systems—MS-DOS and its successor, Windows—account for 82 percent of personal computer operating system sales in the United States. (Microsoft also captures 60 percent or more of the markets for leading types of applications software such as spreadsheet and word processing packages.) For fear of violating Microsoft's copyrights, potential competitors cannot offer a rival operating system that is too similar to MS-DOS. But offering a product that is too dissimilar might be no more successful for several reasons: It might not run existing DOS-compatible applications packages; there might not be sufficient applications available to run on it; and users might not want to take the trouble to learn to use it. As a result, Microsoft's market position may be quite secure, at least until another major industry innovation comparable to the development of the microprocessor dramatically changes the structure of the industry. Even now, however, Microsoft faces some limited competition in operating system software and has an incentive to keep prices low in order to attract buyers new to the personal computer market (who will later purchase Microsoft's operating systems upgrades and applications software).

Looking to the future. Microsoft expects to introduce in the near future a new operating system—known as Windows 95—intended as the successor to both MS-DOS and Windows. The firm hopes that Windows 95 will facilitate the creation of an enormous network of personal computer users, and give them access to relatively new—and potentially vast—markets for commercial and financial services. Microsoft's ownership of copyrights to what is likely to become the new standard operating system software for personal computers may eventually allow it to charge monopoly prices for access to network services, once it has achieved substantial market penetration. In turn, monopoly control of these markets could result in higher prices, reduced choice, and less innovation. On the other hand, domination by Microsoft could also lead to wider availability of on-line services, lower production costs, and higher quality. Moreover, it is far from certain that Microsoft will be able to accumulate significant power in these new on-line markets. It will likely face competition from a plethora of financial-service, retail and communications behemoths such as Citibank, Merrill Lynch, American Express, AT&T, and Sears.

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Analysis. Antitrust law allows firms to exercise monopoly power so long as that power was achieved and maintained by providing a superior product. (This approach ensures that the law does not have the perverse effect of punishing successful innovation, and avoids turning judges into price regulators.) Justice may have chosen not to pursue the issues raised by Judge Sporkin because the line between "unfair" and "fair" use of market power is difficult to draw, and Microsoft did not clearly step over that line.

If the Judge's ruling is overturned on appeal (as many analysts expect), and if the government were to decide to attack Microsoft's potential ability to leverage its market power, its only remedy might be legislation requiring the company to separate its operating systems and applications software businesses or limiting the scope of copyright protection for operating system software.

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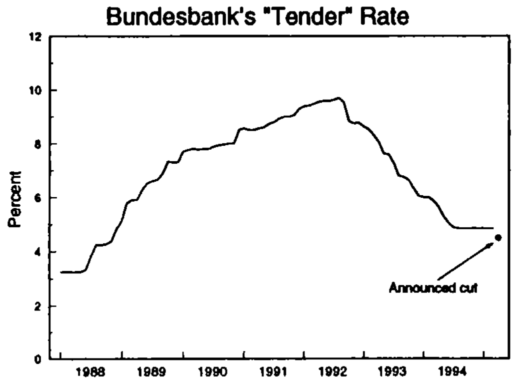

This easing was somewhat surprising. Prices of basic production and imported goods have accelerated significantly over the past year. Moreover, settlements in Germany's annual national labor bargaining sessions have been higher than anticipated. And strong growth last year has put the economy operating near its "full employment" level of activity.

Analysis. In explaining its move, the Bundesbank cited a decline in the money supply as well as the restraining effect of the mark's recent appreciation on economic activity and prices. (Because imports and exports are larger relative to GDP in Germany than in the United States, most analysts believe that currency fluctuations there have a greater impact on the domestic economy than they do in the United States.)

The reduction in German interest rates may help shore up the dollar. Austria, Belgium, the Netherlands, and Switzerland followed Germany's lead and cut interest rates as well. And the Bundesbank action may increase the likelihood of a similar move by the Bank of Japan in the near future.

EYES ONLY

SPECIAL ANALYSIS

The Long Arm of State Income Tax Law Reaches Retirees

Historically, pension income has been taxed at the state level only by the state in which the retiree is currently residing. Many retirees have taken account of this fact in deciding where they should reside during their retirement. Recently, however, several states (including California, Idaho, Kansas, Massachusetts, New York, and Oregon) have reached outside their own borders to tax the pension income of non-residents who earned their pension benefits while residing in-state. (One motive for this move could be that these states suffer a net outflow of residents at retirement.) This development may become a serious point of conflict between states because it threatens to undermine the efforts of some states to structure their tax systems so as to appeal to retirees (e.g., by not having an income tax). In response, several members of Congress have introduced legislation that would prohibit states from taxing the retirement incomes of non-residents. (Senator Reid of Nevada has had such a bill before Congress every year since 1989.) What are the arguments for and against allowing states to tax the pension benefits of non-resident retirees?

The case for. Pensions can be viewed as deferred compensation. State governments forgo the taxation of this compensation when it is earned (providing workers an incentive to save) , but they do not intend to forgo the taxation of it forever. According to this logic, states should be entitled to tax pension income when it is paid, regardless of where the recipient may be residing. An argument can be made that allowing states to tax pension income of non-residents prevents a "race to the bottom" in which states compete by lowering taxes on the elderly and skimping on services provided to the rest of the population.

The case against. Pension income often is subject to taxation by the state in which the recipient is residing. If, in addition, that income is subject to taxation by the state in which the recipient earned the benefits, the same income stream may be taxed twice. This problem is mitigated if the state of residence allows an income tax credit for taxes paid to other states. A second drawback of allowing states to tax the pension benefits of former residents is that it may impose significant administrative burden on both pension recipients and employers, who would have to allocate pension income to states where these benefits were earned. (Imagine the annual agony at tax time of a retiree who had lived in a different state every year of his/her working lifetime!)

Conclusion. State competition for revenue dollars is likely to intensify in the future. One battleground may be the pension benefits of state emigrants. The first shots have already been fired by states like California. Federal action may be necessary to clarify the situation. At a minimum, clear rules need to be established so that taxpayers and firms will know how to maintain the appropriate records needed to comply with the various state income tax regimes.

EYES ONLY

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For Poor Children, Clothes Dryers Are Up, But So Is Crime. Are poor children better or worse off than they were 25 years ago? A recent study offers a new perspective on this issue by focusing on specific indicators of material well-being, rather than taking the usual approach of attempting to measure total income. The evidence from these indicators is mixed. On the whole, the housing situation of poor children seems to have improved since the early 1970s: Fewer children in low-income households live in overcrowded housing, for example, while more have indoor plumbing and central heating. In addition, more of those households own major appliances such as clothes dryers and dishwashers, and poor children visit the doctor more regularly. But at least a few indicators suggest a worsening of the conditions in which poor children live. Poor households are now less likely to own their own homes: only 23 percent owned in 1990, down from 36 percent in 1970. And more poor children live in neighborhoods identified by their parents as having a crime problem. Lastly, a poor child is now more likely to live in a household that does not own a car.

USAir, Pilots Reach Tentative Agreement. After eight months of negotiations, USAir and its pilots' union have hammered out an accord. In return for a share of the company's profits and a seat on its board, the union has reportedly agreed to a 20 percent pay cut for its members in addition to other concessions, provided the airline is able to win similar agreements from other groups of workers. But USAir is not out of the woods yet. The contract must still be approved by USAir's share-holders and its rank-and-file pilots. Unless the airline achieves significant additional cost reductions, it is probably not viable in the long run (see Weekly Economic Briefing, May 6, 1994). Still, Wall Street seems relieved: On the first day of trading after the announcement, USAir's share price jumped 22 percent.

Japan Inc. Finally Shuts One Down. Nissan Motors shut the doors last week at its assembly plant in Zama, Japan, apparently marking the first time in postwar history that any Japanese auto factory had been closed. The plant had been in operation 30 years and had produced 11 million cars. True to its commitment to providing workers with lifetime employment, Nissan placed all 2500 of the Zama plant's former workers in new jobs, either in more modern Nissan assembly plants or in factories producing components, dies, and tools. For comparison, the Big 3 have closed at least 23 U.S. auto assembly plants and 8 truck assembly plants since 1979 alone. Overall employment in the U.S. auto industry has declined by tens of thousands of workers over the same period.

EYES ONLY

RELEASES LAST WEEK

Gross Domestic Product

****Embargoed until 8:30 a.m., Friday, March 31, 1995****

According to revised estimates for the fourth quarter, real gross domestic product grew at an annual rate of 5.1 percent.

Consumer Confidence

Consumer confidence, as measured by the Conference Board, rose 1.6 index points in March, to 101.0 (1985=100).

MAJOR RELEASES THIS WEEK

Personal Income (Monday)
Leading Indicators (Wednesday)
Employment (Friday)

EYES ONLY

U.S. ECONOMIC STATISTICS

	1970–1993	1994	1994:2	1994:3	1994:4
Percent growth (annual rate)					
Real GDP	2.5	**4.1**	4.1	4.0	**5.1**
GDP deflator	5.5	2.3	2.9	1.9	1.3
Productivity					
Nonfarm business	1.2	1.4	–2.1	3.2	1.7
Manufacturing (1978-93)	2.1	4.6	5.6	3.5	3.1
Real compensation per hour	0.6	0.7	–1.8	–0.4	1.2
Shares of Real GDP (percent)					
Business fixed investment	11.0	12.6	12.4	12.7	13.0
Residential investment	4.7	4.3	4.4	4.3	**4.3**
Exports	8.0	12.3	12.1	12.4	**12.8**
Imports	9.2	14.4	14.2	14.6	**14.8**
Shares of Nominal GDP (percent)					
Personal saving	4.9	3.0	3.0	3.0	3.4
Federal surplus	–2.8	N.A.	–2.2	–2.3	N.A.
			Dec. 1994	**Jan. 1995**	**Feb. 1995**
Unemployment Rate	6.7*	6.1*	5.4	5.7	5.4

*Figures beginning 1994 are not comparable with earlier data.

			Dec. 1994	Jan. 1995	Feb. 1995
Payroll employment (thousands)					
increase per month			231	176	318
increase since Jan. 1993					6117
Inflation (percent per period)					
CPI	5.8	2.7	0.2	0.3	0.3
PPI-Finished goods	5.0	1.7	0.4	0.3	0.3

New or revised data in **boldface**.
GDP data **embargoed until 8:30 a.m., Friday, March 31, 1995**.

EYES ONLY

FINANCIAL STATISTICS

	1993	1994	Jan. 1995	Feb. 1995	March 30, 1995
Dow-Jones Industrial Average	3522	3794	3872	3954	4173
Interest Rates					
3-month T-bill	3.00	4.25	5.71	5.77	5.70
10-year T-bond	5.87	7.09	7.78	7.47	7.18
Mortgage rate, 30-year fixed	7.33	8.36	9.15	8.77	8.38
Prime rate	6.00	7.15	8.50	9.00	9.00

INTERNATIONAL STATISTICS

Exchange Rates	**Current level March 30, 1995**	**Percent Change from**	
		Week ago	**Year ago**
Deutschemark-Dollar	1.411	0.7	−15.7
Yen-Dollar	89.45	1.6	−13.1
Multilateral (Mar. 1973=100)	83.64	0.3	−10.6

International Comparisons	**Real GDP growth (last 4 quarters)**	**Unemployment rate**	**CPI inflation (last 12 months)**
United States	4.1 (Q4)	5.4 (Feb)	2.9 (Feb)
Canada	5.6 (Q4)	9.7 (Jan)	1.9 (Feb)
Japan	1.1 (Q3)	2.9 (Jan)	0.6 (Jan)
France	3.6 (Q4)	12.3 (Dec)	1.7 (Jan)
Germany	3.3 (Q4)	6.4 (Jan)	2.3 (Feb)
Italy	3.7 (Q3)	12.0 (Oct)	4.3 (Feb)
United Kingdom	3.9 (Q4)	8.7 (Jan)	3.4 (Feb)

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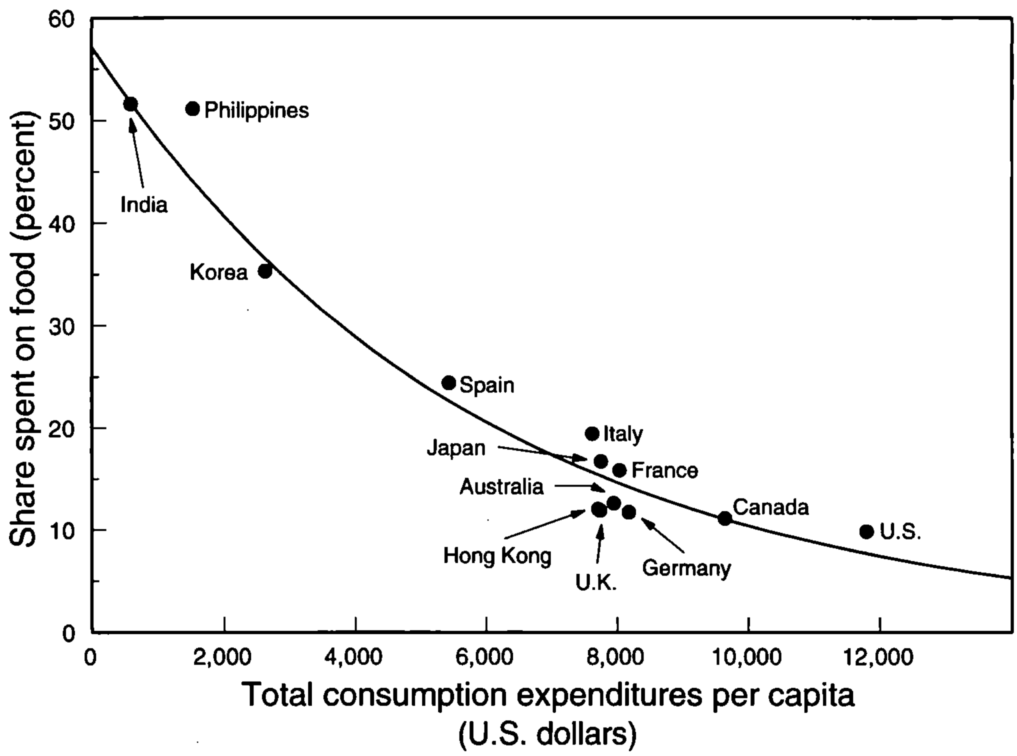

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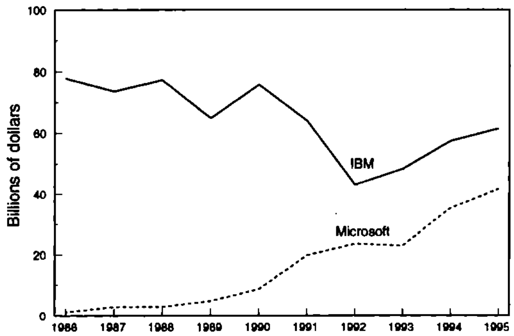

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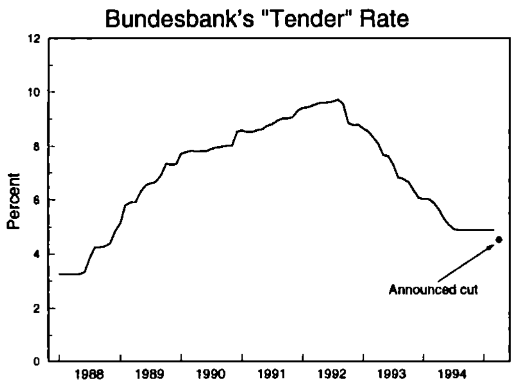

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For Poor Children, Clothes Dryers Are Up, But So Is Crime. Are poor children better or worse off than they were 25 years ago? A recent study offers a new perspective on this issue by focusing on specific indicators of material well-being, rather than taking the usual approach of attempting to measure total income. The evidence from these indicators is mixed. On the whole, the housing situation of poor children seems to have improved since the early 1970s: Fewer children in low-income households live in overcrowded housing, for example, while more have indoor plumbing and central heating. In addition, more of those households own major appliances such as clothes dryers and dishwashers, and poor children visit the doctor more regularly. But at least a few indicators suggest a worsening of the conditions in which poor children live. Poor households are now less likely to own their own homes: only 23 percent owned in 1990, down from 36 percent in 1970. And more poor children live in neighborhoods identified by their parents as having a crime problem. Lastly, a poor child is now more likely to live in a household that does not own a car.

USAir, Pilots Reach Tentative Agreement. After eight months of negotiations, USAir and its pilots' union have hammered out an accord. In return for a share of the company's profits and a seat on its board, the union has reportedly agreed to a 20 percent pay cut for its members in addition to other concessions, provided the airline is able to win similar agreements from other groups of workers. But USAir is not out of the woods yet. The contract must still be approved by USAir's share-holders and its rank-and-file pilots. Unless the airline achieves significant additional cost reductions, it is probably not viable in the long run (see Weekly Economic Briefing, May 6, 1994). Still, Wall Street seems relieved: On the first day of trading after the announcement, USAir's share price jumped 22 percent.

Japan Inc. Finally Shuts One Down. Nissan Motors shut the doors last week at its assembly plant in Zama, Japan, apparently marking the first time in postwar history that any Japanese auto factory had been closed. The plant had been in operation 30 years and had produced 11 million cars. True to its commitment to providing workers with lifetime employment, Nissan placed all 2500 of the Zama plant's former workers in new jobs, either in more modern Nissan assembly plants or in factories producing components, dies, and tools. For comparison, the Big 3 have closed at least 23 U.S. auto assembly plants and 8 truck assembly plants since 1979 alone. Overall employment in the U.S. auto industry has declined by tens of thousands of workers over the same period.

RELEASES LAST WEEK

Gross Domestic Product

****Embargoed until 8:30 a.m., Friday, March 31, 1995****

According to revised estimates for the fourth quarter, real gross domestic product grew at an annual rate of 5.1 percent.

Consumer Confidence

Consumer confidence, as measured by the Conference Board, rose 1.6 index points in March, to 101.0 (1985=100).

MAJOR RELEASES THIS WEEK

Personal Income (Monday)
Leading Indicators (Wednesday)
Employment (Friday)

U.S. ECONOMIC STATISTICS

	1970–1993	1994	1994:2	1994:3	1994:4
Percent growth (annual rate)					
Real GDP	2.5	**4.1**	4.1	4.0	**5.1**
GDP deflator	5.5	2.3	2.9	1.9	1.3
Productivity					
Nonfarm business	1.2	1.4	–2.1	3.2	1.7
Manufacturing (1978-93)	2.1	4.6	5.6	3.5	3.1
Real compensation per hour	0.6	0.7	–1.8	–0.4	1.2
Shares of Real GDP (percent)					
Business fixed investment	11.0	12.6	12.4	12.7	13.0
Residential investment	4.7	4.3	4.4	4.3	**4.3**
Exports	8.0	12.3	12.1	12.4	**12.8**
Imports	9.2	14.4	14.2	14.6	**14.8**
Shares of Nominal GDP (percent)					
Personal saving	4.9	3.0	3.0	3.0	3.4
Federal surplus	–2.8	N.A.	–2.2	–2.3	N.A.
			Dec. 1994	**Jan. 1995**	**Feb. 1995**
Unemployment Rate	6.7*	6.1*	5.4	5.7	5.4
*Figures beginning 1994 are not comparable with earlier data.					
Payroll employment (thousands)					
increase per month			231	176	318
increase since Jan. 1993					6117
Inflation (percent per period)					
CPI	5.8	2.7	0.2	0.3	0.3
PPI-Finished goods	5.0	1.7	0.4	0.3	0.3

New or revised data in **boldface**.
GDP data **embargoed until 8:30 a.m., Friday, March 31, 1995**.

FINANCIAL STATISTICS

	1993	1994	Jan. 1995	Feb. 1995	March 30, 1995
Dow-Jones Industrial Average	3522	3794	3872	3954	4173
Interest Rates					
3-month T-bill	3.00	4.25	5.71	5.77	5.70
10-year T-bond	5.87	7.09	7.78	7.47	7.18
Mortgage rate, 30-year fixed	7.33	8.36	9.15	8.77	8.38
Prime rate	6.00	7.15	8.50	9.00	9.00

INTERNATIONAL STATISTICS

Exchange Rates	**Current level March 30, 1995**	**Percent Change from Week ago**	**Percent Change from Year ago**
Deutschemark-Dollar	1.411	0.7	–15.7
Yen-Dollar	89.45	1.6	–13.1
Multilateral (Mar. 1973=100)	83.64	0.3	–10.6

International Comparisons	**Real GDP growth (last 4 quarters)**	**Unemployment rate**	**CPI inflation (last 12 months)**
United States	4.1 (Q4)	5.4 (Feb)	2.9 (Feb)
Canada	5.6 (Q4)	9.7 (Jan)	1.9 (Feb)
Japan	1.1 (Q3)	2.9 (Jan)	0.6 (Jan)
France	3.6 (Q4)	12.3 (Dec)	1.7 (Jan)
Germany	3.3 (Q4)	6.4 (Jan)	2.3 (Feb)
Italy	3.7 (Q3)	12.0 (Oct)	4.3 (Feb)
United Kingdom	3.9 (Q4)	8.7 (Jan)	3.4 (Feb)