DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

September 9, 1997

To: The Secretary
The Deputy Secretary

From: Jon Gruber JG

Re: **Economic Policy Weekly Report**

Work on Presidential Initiatives

Electricity Restructuring: Last week's Deputies meeting was postponed until this Thursday to allow Treasury and DoE more time to work out an alternative to the proposed tax on electricity with the receipts earmarked for a Public Benefits Fund. Deputy Secretary Summers will meet with Deputy Secretary Moller from DoE before the Deputies meeting to discuss this alternative, in hopes of forming a consensus before that meeting. Secretary Rubin had asked about the politics of restructuring. We attach a memo that we sent yesterday responding to that question.

Climate Change: We are working with the Climate Change Steering Group to prepare a memo for the President on scenarios for U.S. climate change policy. A key objective of this memo will be to highlight that more aggressive approaches (e.g., 1990 emission levels by 2010) are predicted to accomplish little more environmentally than less aggressive approaches (e.g., 1990 by 2040), but impose vastly greater economic costs. We are also working on separate papers to examine skeptically the role of technology in climate change policy; the need for, and structure of, an "escape clause" from a domestic emissions trading system if permit prices rise too high; and alternative structures for domestic emissions trading systems.

Tobacco: Bruce Reed will be meeting with the President this week to discuss the settlement. We have provided a number of background papers for him, and we will be sending you a briefing package with this information.

Child Care: We have been attending initial meetings of the interagency process on child care policy. We intend to emphasize two principles. First, new funding in this area should come from the spending side (increased HHS subsidies to states for child care spending), and not the tax side, so as to avoid reopening the tax cut debate. Second, spending should focus on increasing access as opposed to subsidies to quality, and new standards should be avoided as they will drive children out of the formal sector.

Higher Education Financial Aid: As noted previously, the Department of Education has chosen to reduce the taxation of assets under their financial aid formula, which we support. We will be drafting a memo for the Deputy Secretary to send to Mike Smith, offering our support and providing evidence that the distributional impacts of their proposal will be minimal. We plan to work further with ED to evaluate the appropriate restructuring of their financial aid formula.

Personal Bankruptcy Reform: We have been tasked by the NEC with producing the options paper for personal bankruptcy reform. We are working on this options paper, emphasizing the benefits for *debtors* of restricting overly generous bankruptcy exemptions.

Encryption policy: The NSC Deputies will convene an interagency group this week to identify the countries with effective anti-money-laundering regimes. This is a necessary step in the further liberalization of export controls on encryption products. US producers would be able to receive licenses for general export of very strong encryption products without key recovery capability to banks and financial institutions in any of those countries. For banks and financial institutions in other countries, US exporters would be required to obtain licenses for each transaction, subject to case-by-case review. Treasury will be represented in the interagency group.

Major Economic Indicators Released in the Past Week (Through September 9)

Payroll employment increased by 49,000 in August, but after adjusting for the UPS strike the job gain was above 190,000. This followed an outsized 365,000 increase in July. Growth so far this year has averaged 226,000 per month (not including strike adjustment), which is a bit faster than the 212,000 monthly pace in 1996. The **unemployment rate** edged up to 4.9 percent from 4.8 percent in July and has been essentially flat over the past five months. Average hourly earnings rose by 0.4 percent in August and growth over the past twelve months remains subdued at 3.6 percent.

The report on total **manufacturing orders** and inventories in July revised up many of the advance estimates for the durable goods sector that had been reported in the previous week. Total factory orders edged up by 0.2 percent, but excluding the volatile aircraft component were up 0.8 percent. Orders for nondefense capital goods excluding aircraft (an advance indicator of capital investment) jumped by 6.1 percent in July and shipments of these goods (an indicator of current investment) were also very strong. This suggests continued rapid growth in equipment investment early in the third quarter.

Factory **inventories** rose by 0.5 percent in July while wholesale stocks declined by 0.6 percent after an outsized increase in June.

Productivity figures for the second quarter were revised up to a 2.7 percent annual rate of increase from 0.6 percent previously. A sharp mark-up to output estimates for the nonfarm business sector accounted for the improvement. Hourly compensation costs were little revised at a 3.2 percent annual rate increase. The combination of growth in compensation and in productivity resulted in a small 0.5 percent annual rate increase in unit labor costs, revised down from 2.4 percent and well below the 3.1 percent rate of growth in the first quarter.

Unit sales of new cars and light trucks continued to edge up in August following a large 9.2 percent rebound in July. Sales had been sluggish in the second quarter, affected by scattered strikes in the auto industry. Unit sales reached 15.6 million at an annual rate in August and so far in the third quarter are even a little higher than the strong first-quarter pace.

Growth in **consumer installment credit** picked up in July, partly because of a rebound in auto credit. The amount of credit outstanding rose by 6.4 percent at an annual rate, up from an average of 4.4 percent a month in the second quarter. Revolving debt (largely credit cards) accelerated in July, but this series is quite volatile and one month's data does not change the overall impression of a slowing in this category of debt.

Real construction expenditures rose by 0.4 percent in July, the first increase since February when spending surged by 2.9 percent due to the unseasonably mild weather. Private residential and nonresidential construction grew in July but spending by the public sector declined.

The **composite index of leading economic indicators** increased by 0.3 percent in July after edging up 0.1 percent in June. The index has increased in eight of the past nine months and its behavior suggests continued economic growth.

Indicators Scheduled for Next Week (Through September 16)

International Transactions (Current Account), Q-II (September 11)
Producer Price Index, August (September 12)
Retail Sales, August (September 12)
Consumer Confidence, Michigan, early September (September 12)
Consumer Price Index, August (September 16)
Industrial Production and Capacity Utilization, August (September 16)
Business Inventories, July (September 16)

EP Schedule (Robert Gillingham and Jon Gruber)

Tuesday, September 9

- Weekly Health Strategy Meeting (@OEOB)
- Interagency Superfund Meeting at Council on Environmental Quality

Wednesday, September 10

- Unemployment Insurance Meeting with CEA
- Meeting on NAAQ with Council on Environmental Quality

Thursday, September 11

- Interagency Superfund meeting at Council on Environmental Quality
- Climate Change Meeting (@OEOB)

Friday, September 12

- No external meetings scheduled

The Week Ahead:

Monday, September 15

- No external meetings scheduled

Tuesday, September 16

- Weekly Health Strategy Meeting (@OEOB)

Wednesday, September 17

- No external meetings scheduled

Thursday, September 18

- No external meetings scheduled

Friday, September 19

- No external meetings scheduled