SOCIAL SECURITY PROPOSAL: LEGISLATIVE SPECIFICATIONS AND MECHANICS OF PROPOSAL

OVERVIEW

Translating the Administration's Social Security proposal into concrete, specific language will require working through numerous policy and mechanical details. Some of these details should be addressed in authorizing legislation, others are better left to regulation. The description below aims to provide as comprehensive a description as possible of how the proposal would work in practice. It also identifies unresolved questions in need of further discussion.

CURRENT LAW

The Treasury is required to appropriate from the general fund to the Trust Funds amounts equal to estimated payroll tax revenue and other revenue sources dedicated to Social Security. The amounts appropriated shall be transferred "from time to time" from the general fund to the Trust Funds, based on estimated revenues, with adjustments made in subsequent transfers to correct for over- or underestimates. All amounts transferred and not needed for current withdrawals shall be invested by the Managing Trustee (Secretary of the Treasury) in interest-bearing obligations of the U.S. or obligations guaranteed by the U.S.

PROPOSAL

1. The surplus transfer.

In addition to the amounts appropriated to the Trust Funds under current law, the legislation would require Treasury to make additional transfers from the general fund to the Social Security Trust Funds. The amounts of these transfers would be equivalent to specified percentages of annual payroll subject to Social Security taxes, based on OMB FY00 estimates, in each of the next 15 fiscal years (see Table A).

The annual percentage figure would be hard-wired into the authorizing legislation. The eventual transfers would follow established budget conventions with regard to estimates and actuals. That is to say, the Trust Funds would receive transfers equivalent to the specified percentage of *actual* taxable payroll. *The objective here is to treat these transfers identically to the way we treat FICA/SECA transfers under current law.*

Issues: When (and/or how often during the year) would the transfers to the Trust Funds occur?

Treasury and SSA need to provide a detailed description of how the tax-transfer mechanism works under current law.

The percentages to apply to taxable payroll in each year are a function of OMB FY00 estimates of the unified budget surplus and taxable payroll over the next 15 years. The percentages are calculated to be equivalent to 62 percent, on average, of the cumulative net 15-year unified surplus. The share of the annual net unified surplus transferred under this provision will vary each year, from 50 to 72 percent (see Table A). However, for purposes of Part 1, the legislative language itself need not address this. It need only include a table showing the percent of taxable payroll applicable in each year.

These transfers would be split proportionally between the OASI and DI Trust Funds, based on the ratio of their payroll tax rates.

<u>An Example</u>
The transfer proposed for 2002 is 2.19 percent of taxable payroll. Under FY00 Budget projections, that equals $91.6 billion, or 50 percent of the unified surplus projected for 2002. The mechanism of converting current estimated surplus transfers into a percent of future payroll is necessary for the Social Security actuaries to score the transfers as improving the solvency of the system. Before the beginning of FY 2002, the Administration would estimate taxable payroll for that year. Treasury would make transfers to the Trust Funds equivalent to 2.19 percent of that estimate of taxable payroll. The transfers could occur at the same interval now used for FICA/SECA transfers, with adjustments made in subsequent transfers to correct for over- or underestimates of taxable payroll. The ultimate result is that the Trust Funds would be credited with amounts equivalent to 2.19 percent of *actual* taxable payroll, so the final amount may end up being more or less than $91.6 billion.

TABLE A.			
Year	Percent of Taxable Payroll Transferred to Trust Funds (SPECIFIED IN LAW)	Estimated Transfers Under Current Assumptions *Billions of dollars*	Share of Net Unified Budget Surplus
2000	2.20	84.5	71%
2001	1.74	69.7	53%
2002	2.19	91.3	50%
2003	2.07	90.1	52%
2004	2.40	108.6	55%
2005	2.54	120.3	55%
2006	3.06	151.3	57%
2007	3.43	176.7	59%
2008	3.79	204.2	62%
2009	4.12	231.8	64%
2010	4.32	253.2	64%
2011	4.49	274.1	65%
2012	4.58	291.0	65%
2013	4.60	303.7	65%
2014	4.51	309.6	65%

2. *Splitting transfer between Treasury securities and private equities.*

Language should specify that 21 percent of each year's transfer is to be invested in stocks until Trust Fund assets held in stocks reach 14.6 percent of total combined Trust Fund assets. Dividends and realizations from stocks are to be reinvested in stocks until the 14.6 percent threshold is reached. Once equities account for 14.6 percent of Trust Fund holdings, the combined Trust Funds are to remain at 14.6 percent equities, and the requirement to invest 21 percent of each year's transfer ceases to exist.

3. *Investment in Equities.*

A. Scheduling Investment and Disinvestment in Equities

Investment and disinvestment in equities would occur during three phases: 1) an accumulation phase (estimated from 2000-2014) during which Trust Funds' equity holdings increase until the Trust Funds contain stocks equal to 14.6% of the Trust Funds' total holdings; 2) a period in which the Trust Funds' holdings remain balanced at 14.6% in equities with only limited disinvestment; and 3) a period in which the size of the Trust Funds is shrinking and equity holdings are being disinvested. As the policy moves through these phases, the equity investment decisions move from issues regarding scheduling purchases of assets to managing a comparatively stable portfolio to managing the disinvestment of the portfolio.

<u>Scheduling Cash Transfers</u>
Language would specify how the cash flow would work between the Social Security Trust Funds and the private sector managers.

Issues: **Would the transfers be done on a daily or monthly basis?**

Is language needed that would explicitly lay out the role of the Secretary of the Treasury in making this transfer? (Treasury input needed.)

<u>Scheduling Investments</u>
One goal of legislation governing the private fund manager mechanism is to create a transparent process where the managers are making stock purchases in a clear and predictable manner. To prevent timing the market, language could require the private sector managers to buy set amounts of stock on specific dates. For example, the legislation could require fund managers to purchase equal amounts of stock on each trading day during the year. Other options that would give private sector managers more flexibility include setting periods of time (i.e. a week or month) during which the private sector managers would be required to buy a specified amount. There is a tradeoff between total transparency and fund manager flexibility.

Issues: **If legislation mandates that stock purchases have to be made on a specific date, would the market be liquid enough for managers to buy the amount of stock necessary to meet these requirements?**

If legislation gives private fund managers more flexibility (i.e. more time to make a specified amount of stock purchases), would that be perceived as allowing fund managers to time the market?

If legislation requires both the amount of stock purchases and the exact days when these purchases should be made, how will this affect the market (i.e. will the government pay artificially high prices for its stock purchases, as stock traders would know both the type of stock that the government wants to buy and the amount that it wants to buy)?

Rebalancing Trust Fund Holdings to Maintain 14.6%

Language should specify by how much fund managers can deviate from the 14.6% amount invested in stocks before they are required to rebalance the Trust Funds' holdings, as well as the time frame allowed for rebalancing. For example, language could specify that whenever the portfolio balance fluctuated by more than one percent (or one half or one tenth of a percent), the fund managers would have a month to rebalance the equity/stock split to the 85.4/14.6 percentages.

Issues: Similar to the "scheduling investments" section, there would be timing issues where transparency would be traded off against flexibility for the fund managers.

Disinvestment

In addition to the transactions necessary to keep the portfolio balanced, additional concerns arise from the requirement to divest stocks to meet benefit obligations. To maintain transparency, fund managers need to state on a regular basis, such as annually, a schedule for selling shares during the upcoming year. This schedule would rely upon predictions of future market performance (based upon some neutral measure, such as a 30-year average rate of return), in that the portfolio both pre- and post divestiture needs to maintain the 85.4/14.6 bond/stock ratio. As market performance diverts from earlier predictions, the schedule of share selling could adjust to maintain the portfolio balance. This would require additional market pronouncements to maintain market transparency. Alternatively, a prescribed schedule could be followed with any differences between projected and actual sale prices addressed in the same manner as other rebalancing requirements addressed in the previous paragraph.

B. Administrative Structure for Trust Fund Investment in Equities

The administrative structure for investment in equities should achieve the following objectives:

- Private sector managers selected by competitive bidding
- Independent and non-political management
- Broad-based, neutral and non-discretionary selection of assets
- Low cost administrative structure

Issue: Creating this administrative structure requires a host of decisions. Should the legislative requirements for the Thrift Savings Board be used as an initial reference point for creating this administrative structure?

4. Investment in Bonds.

The portion of the transfers not used to purchase equities under Section 3 are to be invested in U.S.-backed securities, as is the case under current law. Existing language in the Social Security Act governing investment of excess Trust Fund revenues (42 U.S.C. §401) should suffice.

The Congressional findings/intent section of the bill should include language emphasizing that reducing the public debt is a major objective of this legislation, and that the portion of the transfers not used to purchase equities should be invested in such a way as to enable Treasury to reduce publicly held debt. This point should address "reducing" debt, avoiding language related to "buying back" debt.

With respect to the objective of using these transfers to reduce publicly held debt, there is no *technical* need to add any further specification to existing language. **(Treasury will verify).** At most, the legislative language should state that all portions of these transfers not used to buy equities are to be invested consistent with current statute. Any further specification may reduce the Treasury's or the Trust Fund's flexibility in undesirable ways.

Issue: Does including language on debt reduction in the Congressional findings section give sufficient attention to this objective? The statutory language could include an explicit directive to Treasury. However, this could create debt financing problems for Treasury.

THE CASE FOR INVESTING PART OF THE UNIFIED SURPLUSES IN EQUITIES

In his State of the Union Address, the President proposed that 62 percent of the unified budget surpluses over the next 15 years be transferred to the Social Security Trust Fund, in order to increase the ability of that Fund to meet promised Social Security benefit obligations. The President further proposed that about a fifth of the transferred surpluses be invested in equities to achieve higher returns for Social Security, helping to extend the life of the Social Security trust fund to 2055. This action does, however, raise understandable concerns about the possible extension of political influence on investment decisions and the risks that this might pose to the economy and the Trust Fund. Any system of collective investment can and must address these concerns. That is why we will work with Congress to design a system that observes <u>five core principles</u>:

1. **<u>Private Sector Managers Selected by Competitive Bidding.</u>** Social Security beneficiaries deserve the same efficient management and market returns that people receive in their private pensions and personal savings. The actual investments should be managed by private sector money-managers selected by competitive bidding.

2. **<u>Independently Managed and Non-Political.</u>** There would need to be wholly independent oversight of investment that was insulated from political influence. The choice of investment managers should be done by an independent board whose sole responsibility would be to pick fund managers so as to maximize the performance of the investments. This would ensure that the investment of funds was carried out with zero government involvement.

3. **<u>Limited.</u>** The share of Trust Fund assets invested in equities ought to be kept at a very modest level -- both to limit risk to the Fund and to ensure that collective investments never account for more than a small fraction of the stock market as a whole.

4. **<u>Broad-based, Neutral, and Non-Discretionary.</u>** Assets should be invested proportionately in the broadest array of publicly listed equities, with no room for discretion in adding or deleting companies and no room for active involvement in corporate decisions. Neither the government nor the private sector managers it selects to undertake investment on its behalf should be involved in "stock picking." As a shareholder the Funds should be entirely passive; one way to accomplish this would be to mandate that proxies be voted in the same proportions as other shareholders. Alternatively, if the investments were spread among a number of managers so that no one manager had a large share of the total market, the managers could vote the shares in the interests of the share holders, just as mutual fund managers do today.

   - *No Market Timing or Stock Picking.* In essence, the managers should be on autopilot in investing the funds. They should have little or no discretion in the investment of Trust Fund assets -- so they cannot "time the market" or pick individual stocks.

5. **<u>Lowest-Cost.</u>** Collective investment needs to be administratively simple and achieved at the lowest available cost -- both to obtain the highest possible returns and to further enhance the system's transparency and independence.

WHY INVEST PART OF THE SURPLUSES IN EQUITIES?

1. **Investing Part of the Surpluses in Equities Would Raise the Rate of Return That Workers Would Experience on Their Contributions into the Social Security System.**

- Historically, the Trust Fund has been invested exclusively in government bonds. While these bonds have the upside that they are essentially risk-free, they have the downside that they pay a relatively low rate of return on average. Adding equities to the Trust Fund portfolio would allow the Social Security system to enjoy a higher rate of return, on average. Between 1959 and 1996, the difference between the average annual rate of return earned on stocks and the rate earned on bonds held by the Trust Fund -- the "equity premium" -- was 3.84 percent.

- Raising the rate of return on the Trust Fund would mean that the Social Security system could be brought into long-term actuarial balance with smaller reductions in benefits, or smaller increases in revenue, or both.

- Investing part of the transferred surpluses in equities accounts for about one-third of the improvement in the actuarial balance achieved under the President's framework.

2. **Investing Part of the Trust Fund in Equities Would Bring Social Security into Line with the "Best Practice" of Both Private- and Public-Sector Pension Plans.**

- The overwhelming number of private-sector defined-benefit pension plans invest part of their reserves in equities. Among large private-sector defined benefit plans (those with more than 100 participants), more than 40 percent of total assets of were invested in equities.

- Similarly, 65 percent of the portfolio backing the defined-benefit pension plan of the Federal Reserve System is invested in equities.

- In aggregate, state and local pension plans hold fully 10 percent of the overall stock market.

WHY IS EQUITY INVESTMENT BETTER UNDERTAKEN THROUGH THE TRUST FUND THAN THROUGH INDIVIDUAL ACCOUNTS?

1. **Administrative Costs Associated with Trust Fund Investment Would Be Much Lower.**

- For example, the equity-fund component of the Federal Thrift Savings Plan (TSP) incurs annual investment-management costs of only about one basis point (one one-hundredth of a percentage point). Thus, for every $100 in equity assets under management, the TSP pays only about one cent per year in management fees.

- By contrast, asset management fees for individual accounts such as IRAs typically run in the neighborhood of 100 basis points or more -- or about $1 per year for every $100 under management.

  - *The asset management fees associated with IRAs are thus typically at least 100 times larger than the fees associated with centralized investment.*

- Management fees are extremely important in determining the buildup of assets. A fee of one basis point paid every year for 40 years would reduce the accumulated balance by only about 0.2 percent. By contrast, a fee of 100 basis points would reduce the accumulated balance by about 20 percent.

2. Financial Risk Can Be Spread Much More Effectively If Equity Investment Is Undertaken Through the Trust Fund than Through Individual Accounts.

- Financial risk that arises through equity-investment of the Trust Fund can be spread both across the entire population participating in the system at any given point in time, and over time. Indeed, provided equity investment is undertaken through the Trust Fund, the consequences of market fluctuations can potentially be spread over many generations.

- By contrast, in a system of individual accounts, the consequences of market fluctuations must -- by definition -- be borne by each individual. If the market happens to do well during a certain individual's lifetime, that individual can enjoy a relatively prosperous retirement. If the market does poorly, that individual's financial security in retirement may be jeopardized.

WHY CAN WE BE CONFIDENT THAT TRUST FUND INVESTMENT IN EQUITIES WON'T DISRUPT THE MARKET?

1. This Is Not Direct Government Investment -- It Is Investment Undertaken by Private-Sector Managers Selected by Competitive Bidding.

- A bedrock principle of the President's program is that the government itself should not be a participant in the market. All transactions will be executed by private-sector managers.

- The Thrift Savings Plan selects managers in a similar way, placing its portfolio with managers that bid the lowest cost. These managers also vote the shares of stock they control.

2. **Institutional Rules Can Be Established to Create Very Strong "Fire Walls" Against Political Interference.**

- The experience of state and local pension funds points to several elements of institutional design that have been essential in that context in helping prevent political interference.

- Investments can be made in a broad-based, neutral, and non-discretionary way. Through passive investing in an index, private-sector managers will not be involved in "stock picking."

- History shows that political influence can be avoided. The overwhelming bulk of assets in state and local plans are invested wisely -- not in politically motivated ways.

- For example, the Federal Thrift Savings Plan (TSP) invests $77 billion in stocks and bonds, with more than half in stocks. Francis Cavanaugh, the first executive director of the Board responsible for TSP investments, says that investments have been made without political interference. Specifically, in a recent news article, Cavanaugh said, *"Can it be done? It's been done... We did it."*

3. **The Equity Holdings of the Social Security System under the President's Program Would Be Modest Relative to the Holdings of Other Major Players in the Market.**

- Under the President's program, the Social Security system would hold an average of about 4 percent of the aggregate U.S. stock market.

- The top 10 largest private-sector portfolio managers all have more than one percent of the market under management. Fidelity, the largest such private-sector manager, has about 4 percent of the market under its management.

- By contrast, state and local governments in aggregate already hold about 10 percent of the market.

Portfolio Rebalancing and Risk

The simple (but incorrect) story:

Because 75% of benefits will be financed from payroll taxes, and 85% of the other 25% of benefits will be financed from trust fund bonds, 96% of benefits could be paid even if stock prices fall to zero.

However:

This story is correct if stock prices fall to zero overnight. But if they fall to zero gradually, and the portfolio is rebalanced frequently, then:

stock prices fall --> trust fund sells bonds to buy stock to restore 85:15 balance -->
stock prices fall again --> trust fund sells more bonds to buy more stock --> etc.

At the end, the fund has no stocks and no bonds.

Fortunately:

This is only a problem for huge, protracted declines in stock prices.

Examples:

1. Start with $100 and maintain an 85:15 stock/bond split. (Bond return equals 0 for simplicity.)

Daily stock return	Total stock return after 25 days	Value of portfolio: no rebalancing	Value of portfolio: daily rebalancing
-.01	-.22	$96.57	$96.32
-.02	-.40	94.05	92.76
-.03	-.53	92.00	89.34
-.04	**-.64**	**90.41**	**86.03**
-.05	-.72	89.16	82.84
-.10	-.93	86.08	68.53
-.20	-.996	85.06	46.70

2. Same setup with total market decline of 2/3 but different daily patterns:

	No rebalancing	Daily rebalancing
1 drop of 67%	89.95	89.95
3 drops totaling 67%	89.93	86.69
9 drops totaling 68%	89.75	84.92

3. Start with $100 invested 85% in bonds earning 5.8% and 15% in the Nikkei 225 at the end of 1989. Over the following three years, the Nikkei lost 57% (annual pattern: -40%, -4%, -26%).

No rebalancing	107.19
Annual rebalancing	104.48
Monthly rebalancing	103.86

STRENGTHENING SOCIAL SECURITY AND MEDICARE BY PRESERVING FISCAL DISCIPLINE

BEFORE 1993: **A Surge in Deficits and Debt Left the Country in Poor Fiscal Shape to Meet Future Social Security Obligations.**

Before President Clinton took office, CBO projected that the budget deficit would increase from $290 billion in 1992 to over $600 billion in 2003 and would keep growing after that. Publicly-held debt had jumped from 26 percent of GDP in 1981 to 50 percent in 1993, and it was expected to rise much further. At the same time, the country had a commitment to pay future Social Security benefits so that people could enjoy secure retirements. Yet, with persistent, massive deficits, there were serious doubts about how the country could meet that commitment without boosting taxes, cutting benefits, or raising debt to levels that would threaten our economic health.

1993 TO 1998: **Tough Choices and Fiscal Responsibility Put Government on Course to Meet Social Security Obligations And Still Run Surpluses.**

The President's 1993 economic plan and the bipartisan balanced budget agreement of 1997 put the country on a path of prosperity and fiscal responsibility. In 1998 the surplus was $70 billion, and the mid-session outlook from both OMB and CBO projected substantial surpluses for decades to come. By turning the government's budget situation around, we have now created the financial capacity to meet our obligations to Social Security. In contrast to the outlook before 1993, we will be able to pay back bonds in the Social Security trust fund and still run surpluses.

BEYOND 1998: **President Clinton Proposes to Pay Down 2.9 Trillion Dollars of Debt and Allocate Most of the Savings to Social Security and Medicare.**

We face a fundamental choice about how to allocate the $4.5 trillion in projected surpluses over the next 15 years among spending, tax cuts, and debt reduction. The President's plan focuses on debt reduction while giving Social Security and Medicare a "first call" on the gains from reducing debt -- essentially, the plan creates a "debt-reduction lockbox" for these programs.

The dramatic decline in national debt would increase private capital investment, raise future national income, and free up government resources by reducing debt servicing costs. Some of the gains from this fiscal discipline would be locked in to finance our *existing* commitment to pay future Social Security and Medicare benefits. By not increasing that commitment -- but setting aside the resources to meet it -- we extend the solvency of the Social Security trust fund until 2055 and the Medicare trust fund until 2020. Because of the proposal's fiscal discipline, the government could meet all of our obligations to these programs while running surpluses for decades to come. On the other hand, if we devoted these surpluses to tax cuts or spending, we would not reap the economic benefits of debt reduction or extend the solvency of the trust funds, and we would endanger our ability to meet our existing obligations to the funds.

WHY DEBT REDUCTION IS IMPORTANT

The Plan Will Reduce the Nation's Publicly-Held Debt and Increase National Saving.

Between 1981 and 1993 our publicly-held debt rose from 26 percent to 50 percent of GDP. That trend has now been reversed, and debt has dropped to 44 percent of GDP. Under President Clinton's plan the runup in the debt-to-GDP ratio during the 1980s will be completely reversed by 2006, and by 2014 the publicly-held debt will only be 7 percent of GDP. This will be the lowest level of debt relative to GDP since 1917. National saving has increased from 3.1 percent of GDP when President Clinton took office to 6.7 percent today. By setting aside the surpluses rather than spending them, the extra government saving will raise national saving by about 2 percent of GDP over the next 15 years (leaving aside any private sector response). The USA accounts will add even further to national saving.

Debt Reduction Improves Our Nation's Ability to Meet the Existing Obligations of Social Security and Medicare.

Paying off debt means that the government owes less money to private individuals. Thus, it improves the government's financial position.

- **Paying Off Debt Generates New Capital Formation.** Paying off debt allows private savings to go into productive private investments rather than into government borrowing. The resulting increase in the capital stock raises workers' productivity and national income. These additional real resources will increase Americans' future standard of living, and make it easier to pay back the trust funds when they redeem bonds.

- **Paying Off Debt Reduces Debt Servicing Costs.** Paying off debt increases future budget surpluses and frees up additional resources for other uses, including meeting the obligations of Social Security and Medicare.

- **Paying Off Debt Gives the Government the Flexibility to Respond to Future Conditions.** Paying off debt now allows the government to issue new debt if necessary -- for example, if there was a transition period before Social Security's revenues and benefits were in line -- without threatening future economic performance, and while keeping the debt-to-GDP ratio below its current level.

The Rest of the President's Proposal Invests in the Future As Well.

In addition to strengthening Social Security and Medicare, the President's proposal provides USA accounts to help Americans build the wealth they will need to finance longer lifespans. The plan also makes important investments in military readiness and pressing national priorities that will enable the country to continue to be strong and prosperous.

ALTERNATIVES TO THE PRESIDENT'S APPROACH

Cut Taxes.

If we allocated most of the unified budget surplus to tax cuts, we would not lower our debt, increase our saving, or extend the life of the Social Security or Medicare trust funds. Moreover, we would jeopardize our ability to meet our obligations to Social Security between now and 2032. While the President commits the surplus for only 15 years, any allotment for tax cuts would be permanent, making it even harder for future lawmakers to meet the coming demographic challenges.

Increase Spending.

Some smart, targeted spending can improve the nation's productivity and create more resources in the future when the time comes to meet the obligations of Social Security and Medicare. But spending the entire surpluses would have similar consequences to reckless tax cuts -- we would not lower our debt, increase our saving, or extend the life of the trust funds, and we would jeopardize our ability to meet our existing obligations to Social Security.

Take Social Security Out of the Budget and Divide the Remaining Surplus Among Tax Cuts, Military Spending, and Individual Accounts.

Some people would simply take Social Security out of the budget and pay down $2.7 trillion of debt. Then they would battle over only how much of the remaining surplus would go to tax cuts, military spending, and individual accounts. This approach would not extend the life of the Social Security or Medicare trust funds by a single year, because it would not allocate any of the benefits of debt reduction to these programs. Social Security would then be able to pay only 72 cents per dollar of promised benefits after 2032. This approach would put the country in a better fiscal situation, just as the President's plan does, but it would leave open the allocation of the large future surpluses for various forms of spending and large tax cuts. In contrast, the President proposes to lock in much of the benefits of an improved fiscal outlook for Social Security and Medicare.

PRAISE FOR THE PRESIDENT'S DEBT-REDUCTION PLAN

The President's basic approach of paying down the debt to strengthen Social Security and Medicare has drawn support from experts including Alan Greenspan, Robert Reischauer, Henry Aaron, and Robert Greenstein.

Need to add quotes here ...

MEMORANDUM TO GENE SPERLING

FROM: Natasha Bilimoria

SUBJECT: SSA releases Actuarial Memo on the Social Security Guarantee Plan (Archer/Shaw Plan)

This afternoon, Chairman Archer held a press conference releasing the Social Security Actuarial Memo stating that the Social Security Guarantee Plan (SSGP) would be expected to eliminate the estimated long-term actuarial deficit of 2.07 percent of taxable payroll. The following is a summary of this memo.

Assumptions

- All estimates assume the elimination of the earnings test gradually from 2001 to 2006 (this has a very small effect on the overall financial status of the program.)

- Memo assumes a 5.35 rate of return, net of administrative expenses (An administrative cost of 25 basis points is assumed).

Key Points of SSA Actuaries Memo

- The Archer/Shaw plan would produce a net drain on the unified budget until 2054.

- SSGP does reach 75-year solvency.

- Transfers from the SSGP accounts to the Social Security trust funds are sufficient to allow a reduction in the payroll tax rate from 12.4 to 9.9 percent during 2050 to 2059. In 2060, payroll tax can be reduced by another 1 percent, making it 8.9 percent.

- With reductions in the payroll tax rate, the trust fund ratio is expected to stay stable at about 240 percent of annual outgo at the end of the 75 years. (Without the reductions in payroll tax, the trust fund ratio would be expected to rise to over 10 times annual outgo by the end of 75 years).

- The OASDI actuarial balance is improved by 2.15 percent of taxable payroll, leaving a balance of +0.09 percent of taxable payroll after 75 years. Without reducing the payroll tax, the deficit is improved by 2.71, leaving a balance of +0.65.

- The Social Security trust fund outgo as compared to what it takes in is expected to remain positive throughout the 75 year time period. Timely benefits made in full can be expected through 2073 and beyond.

Effect of the SSGP on Financial Status of OASDI Depends Greatly on the Actual Investment Return to the Accounts

April 16, 1999

MEMORANDUM FOR GENE SPERLING

FROM: BILL DAUSTER

RE: HOUSE LOCK BOX BILL

Earlier this week, House Republican Leadership ordered that the Herger-Shaw lock-box bill bypass the Budget and Ways and Means Committees and head directly to the floor next week. Republican Leadership may nonetheless postpone House consideration, both because of conflicts internal to the Republican Caucus, as well as the prospect of the nearly simultaneous consideration of a large Kosovo supplemental bill that would violate the terms of the lock box bill.

Consideration of the Herger-Shaw lock box presents the Administration with a fundamental decision that may warrant discussion at a Budget Principals meeting: Should we sharply criticize the Herger-Shaw lock box on the grounds that it fails to extend Social Security solvency, when we may find ourselves endorsing a lock box solution at the end of the year to have a Social Security victory? Or do we embrace the Herger-Shaw lock box (subject to modification of some failings) as the opportunity to move toward protecting Social Security and embracing on-budget accounting, when such a move might further dim prospects for moving on substantive Social Security reform?

The Herger-Shaw bill presents an opportunity for division in the Republican Caucus. Among its cosponsors are Chairman Archer and Congressmen Crane, Thomas, Houghton, McCrery, Ramstad, Nussle, Sam Johnson of Texas, Dunn, Portman, English, Watkins, Hayworth, Weller, Hulshof, Mcinnis, Lewis of Kentucky, and Bilbray. On the other side, Chairman Kasich has reportedly promised to offer his version of the Domenici-Abraham debt limit lock box. The Kasich-Domenici-Abraham version of the lock box (which would threaten default) makes the Herger-Shaw lock box (which mostly would add redundant points of order) look better by comparison.

As you know, House Republican Leaders hope with the lock box debate to inoculate themselves against the Social Security issue, and they have achieved some success. Majority Leader Lott has said that he hopes that House passage of the lock box would increase pressure on Democrats to drop what he calls their filibuster of the Domenici-Abraham bill, which he hopes to revive in June.

House Democrats will try to offer an amendment to eliminate the exception in the Herger-Shaw lock box for whatever legislation contains the magic words, "For purposes of the Social Security and Medicare Safe Deposit Box Act of 1999, this Act constitutes social security reform legislation." House Democrats will berate this "trap door" in the lock box, bemoan how the lock box does nothing to extend Social Security solvency, and stake out a stance more protective of Social Security. Having said that and having tried to improve it, most Democrats will probably vote for the Herger-Shaw bill in the end.

NEC, OMB, and Treasury staff met this morning to coordinate our strategy in response to the Herger-Shaw bill. Alan Cohen, with the assistance of OMB's Art Stigile, is preparing an analysis of the bill. Natasha Bilimoria and OMB's Jack Smalligan are researching what Democratic alternatives have been offered in the past. Based on our discussions this morning, the analysis will likely point out the following shortcomings to Herger-Shaw:

- It fails to extend Social Security solvency.

- It adds nothing to existing law that is not harmful.

- Because it does not provide an exception for cap adjustments (as for IMF funding and emergencies), it would create a point of order against bills (like the Kosovo supp.) that took advantage of them.

- Simply extending the pay-as-you-go process and appropriations caps would better protect Social Security, as those existing mechanisms prevent spending the on-budget surplus, while Herger-Shaw does not.

- It seeks to restrain the President's and others' use of unified budget data in ways that probably violates the State of the Union clause (not to mention First Amendment) power of the President "from time to time give to the Congress information of the state of the union,. and recommend to their consideration such measures as he shall judge necessary and expedient."

So far, our guidance for Joe Lockhart has been along the lines of:

> The President is committed to protecting Social Security and strengthening that vital program for the 21st Century. Although we have some concerns about the bill, the latest House "Social Security and Medicare Safe Deposit Box" does not share some of the worst features of the debt-limit lock-box that the Senate debated a while back.

OPTION 1: No Additional Financing		OPTION 2: Additional Tobacco Tax		OPTION 3: Surplus	
Base:		**Base:**		**Base:**	
Competition	-10	Competition	-10	Competition	-10
Modernize Medicare	-14	Modernize Medicare	-14	Modernize Medicare	-14
Income-Related Premium ($80/100)	-25	Income-Related Premium ($80/100)	-25	Income-Related Premium ($80/100)	-25
Cost Sharing		Cost Sharing		Cost Sharing	
Preventive buy-down	+3	Preventive buy-down	+3	Preventive buy-down	+3
Lab 20% coinsurance	-9	Lab 20% coinsurance	-9	Lab 20% coinsurance	-9
Nursing home 20%	-5	Nursing home 20%	-5	Nursing home 20%	-5
Indexing Deductible	-1	Indexing Deductible	-1	Indexing Deductible	-1
Provider Savings	-40	Provider Savings	-40	Provider Savings	-40
Subtotal:	**-100**	**Subtotal:**	**-100**	**Subtotal:**	**-100**
Additions:		**Additions:**		**Additions:**	
Income-Related Premium ($60/90)	-7	Tobacco Tax	-45	Surplus	**-90**
More Provider Cuts	-7	Income-Related Premium ($60/90)	-7		
Raise Deductible to $150 and index	-10				
Subtotal:	**-24**	**Subtotal:**	**-52**		
Drug Benefit:		**Drug Benefit:**		**Drug Benefit:**	
$5,000 Limit 50% Premium: $24/$48*	+123	$5,000 Limit 67% Premium: $16/$32*	+164	$5,000 Limit 67% Premium: $16/$32*	+164
		$10,000 Limit 50% Premium: $31/$55*	+142	$10,000 Limit 67% Premium: $21/$36*	+189
		No Dollar Limit 50% Premium: $24/$58*	+135	No Dollar Limit 67% Premium: $16/$39*	+180
State MOE	-5	State MOE	-5	State MOE	-5
TOTAL**	-6	**TOTAL ****	+7-22	**TOTAL ****	-6-31

*Monthly premiums in 2002 and 2009. Part B premium is $57 / $95 in 2002 / 2009.
** This amount is a necessary "cushion" pending final cost estimates.
Drug estimates assume about $5 billion in savings from state maintenance of effort.
NOTE: The policy with the $10,000 cap is more expensive than the catastrophic option only because it offers more generous coverage in the early years (00 to 06); the catastrophic option is more expensive in the out-years.

Copied
Sperling
Jennings
Podesta

THE PRESIDENT HAS SEEN
6-1-99

THE WHITE HOUSE

WASHINGTON

May 29, 1999

15% → How much over 10 yrs
→ How much to 2020
→ If un-less, give to tax cuts

MEMORANDUM TO THE PRESIDENT

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200

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FROM: Gene Sperling and Chris Jennings

SUBJECT: Briefing Memorandum for Medicare Meeting

On Tuesday, you will have a Medicare meeting in which we will review key elements and several packages of reforms, seeking your guidance as we develop a plan. Our goals for this plan include: (1) significant dedication of the surplus for Medicare, which will extend the life of the Medicare Trust Fund as well as reduce debt; (2) serious modernization of Medicare, including making it more competitive; (3) substantial prescription drug benefit; and (4) sufficient savings to make our prescription drug benefit fiscally responsible. These goals conform to your principles for reform articulated at the AARP in February.

Below, we describe the major elements of reform, key parameters of a prescription drug benefit, and illustrative packages. Ultimately, your primary decisions about the Medicare plan will hinge on how the prescription drug benefit is designed and financed. Packages showing options for drug benefits and financing options are shown at the end of the memo.

KEY ELEMENTS

Modernizing Traditional Medicare. One of the positive contributions of the Medicare Commission was to unanimously support making the traditional Medicare program more competitive (e.g., allow for more competitive pricing; greater ability to contract out for services; high-cost case management). Your Medicare advisors also unanimously agree that these policies are worth including in the plan. They save an estimated $14 billion over 10 years.

Competitive Managed Care Payments. A more controversial issue is whether to allow competition to determine Medicare premiums and government payment rates. Premium support, the centerpiece of the Breaux-Thomas proposal, would set all Medicare premiums competitively, including that of the traditional program. Because it would result in a lower government contribution for traditional Medicare, the actuary projects that the traditional program premiums would rise by 10 to 20 percent, effectively driving people into managed care. Your advisors are recommending an option that is fundamentally different because it would protect the traditional Medicare premium, assuring that competition is based on choice, not financial coercion. Although this option does not produce as much savings as does the Breaux-Thomas premium support model ($10 versus $50 billion over 10 years), it would be considered structural reform since it gives incentives to encourage beneficiaries to choose low-cost plans. There is a risk, however, that base Democrats will view it as a "voucher" or something akin to Breaux-Thomas and conservative Democrats and many Republicans may think that it does not go far enough. Regardless, all of your advisors are in favor of including this proposal.

Explain cannot we save more?

THE PRESIDENT HAS SEEN
6-1-99

Income-Related Premium. An income-related premium is a progressive form of increasing beneficiary contributions. You have supported this policy in the past (1992, 1993, and 1997) so long as it is designed well. All of your advisors recommend that it begin at $80,000 for singles, $100,000 for couples, which produces about $25 billion over 10 years and affects about 2 million beneficiaries. Some are willing to go lower to avoid the use of surplus funding to help finance the drug package.

Cost Sharing. Changes can both make Medicare's cost sharing more rational and help fund the prescription drug benefit. The following is the list of options under review:

- Eliminate preventive cost sharing: Cost sharing can inhibit beneficiaries from using their new Medicare preventive benefits. Eliminate all cost sharing would cost $3 billion over 10 years and is unanimously recommended by your advisors.

- Add lab 20% copay: Only lab and home health services do not have any copays, and most experts agree that a lab copay could decrease excess use (the typical 20% copay would be about $5-10). It would save about $9 billion over 10 years and is supported by your advisors.

- Change nursing home copay to 20% coinsurance: The nursing home benefit's current cost sharing structure is not rational. Beneficiaries pay nothing for the first 20 days, but then pay nearly $100 per day (about 33%) for days 21-100. This proposal would apply a 20% copay (about $60 per day) for all covered days. This helps sicker beneficiaries, but applies a new copay to short-term nursing home residents. While we aimed to make this cost neutral, it actually saves $4 billion over 10 years. It is possible to lower the copayment to make it budget neutral.

- Index the Part B deductible to inflation: The $100 Part B deductible has not been updated since the 1980s, and is lower than most private fee-for-service insurance plans. This proposal would simply index the current deductible to general inflation (by 2010, it would be $135) and save about $2 billion over 10 years. Most advisors recommend this, particularly if it eliminates the need for a home health copay. Some are willing to increase the deductible (to $150) if it would avoid the need for surplus spending.

- Add $5 home health copay. Most experts agree that a carefully designed home health copay can reduce excess use without harming beneficiaries. At the same time, home health users are among the most vulnerable (older, sicker); increasing this benefit's cost sharing has the appearance of being inconsistent with your long-term care initiative; and the new prospective payment system will reduce use without copays. Although a number of your advisors agree that this is good policy, they believe that it is not necessary in the context of the other beneficiary cost sharing proposals outlined above (saves $7 billion over 10 years).

THE PRESIDENT HAS SEEN
6-1-99

Provider Payment Reductions. Provider savings are difficult to find given (a) our FY 2000 budget used the limited options for the next few years; (b) the BBA of 1997 package relied heavily on providers savings; and (c) all major provider groups have launched a campaign not just against additional savings but in support of increased spending to offset the Balanced Budget Act in the near term. Even conservative Democrats like Senators Conrad, Moynihan, and Bingaman are considering "fixing" or undoing BBA '97 reductions, especially for academic health centers, rural hospitals, nursing homes, and other providers. Our goal is to have some fixes where clearly well justified while still getting some moderate new savings. As such, we are proactively seeking administrative interventions that could moderate the effects of the BBA. If we conclude that administrative actions are inadequate, targeted legislative fixes could help avoid a negative response to your proposal. However, because of the limited availability of on budget surplus dollars in 2000, finding early-year savings to offset these costs would be extremely difficult. Your advisors believe that a credible Medicare reform plan, taking into account provider constraints, could achieve about $40 billion over 10 years (more or less depending on the degree of fixes).

PRESCRIPTION DRUG BENEFIT. The part of your Medicare plan that will receive the most attention is its prescription drug benefit. The base Democrats will judge your plan in large part by how generous this benefit is. Many of them have signed onto the Kennedy-Rockefeller plan, which provides for 20 percent coinsurance up to a cap, and then provides 100 percent coverage after the beneficiary has spent $4,200 on drugs. This bill costs over $300 billion over 10 years. On the other hand, conservative Democrats are interested in the least costly benefit that can be validated, even minimally, as meaningful. The following table shows our major options.

PRESCRIPTION DRUG BENEFIT OPTIONS ($ BILLIONS – Preliminary – Excludes State Maintenance of Effort)

	2001	2002	2003	2004	2005	2006	2007	2008	2009	00-09
$5,000 LIMIT	Cap:	$2,000	$2,000	$3,000	$4,000	$5,000	indexed			
50% Premium	0	5.6	10.7	12.5	15.0	17.3	19.1	20.6	22.3	**123.0**
Premiums		***$24***	***$25***	***$31***	***$36***	***$41***	***$43***	***$45***	***$48***	
67% Premium	0	7.4	14.3	16.7	19.9	23.0	25.4	27.5	29.7	**164.1**
Premiums		***$16***	***$17***	***$21***	***$24***	***$27***	***$29***	***$30***	***$32***	
$10,000 LIMIT *	Cap:	$4,000	$4,000	$6,000	$6,000	$8,000	$8,000	$10,000	indexed	
50% Premium	0	7.2	13.8	15.6	17.2	19.0	20.8	22.9	25.1	**141.6**
Premiums		***$31***	***$33***	***$38***	***$40***	***$45***	***$47***	***$51***	***$55***	
67% Premium	0	9.6	18.4	20.8	22.9	25.4	27.8	30.5	33.5	**188.8**
Premiums		***$21***	***$22***	***$25***	***$27***	***$30***	***$31***	***$34***	***$36***	
NO LIMIT:	Cap:	$2,000	$3,000	$3,000	$4,000	$5,000	None			
50% Premium	0	5.6	12.0	13.3	15.1	17.3	21.0	24.1	26.5	**134.8**
Premiums		***$24***	***$30***	***$31***	***$36***	***$41***	***$51***	***$54***	***$58***	
67% Premium	0	7.4	15.9	17.7	20.2	23.1	28.0	32.1	35.4	**179.9**
Premiums		***$16***	***$20***	***$21***	***$24***	***$27***	***$34***	***$36***	***$39***	

** Note: The policy with the $10,000 cap is more expensive than the catastrophic option only because it offers more generous coverage in the early years of its design (00 to 06); the catastrohpic option is more expensive in the out-years*

THE PRESIDENT HAS SEEN
6-1-99

All of your advisors support a policy in which we cover 50 percent of the costs of prescription drugs up to at least $5,000. We believe that this will have a simple, clear message: if you choose to pay a modest premium, we will pay half of your prescription drug costs up to $5,000. Another reason that your advisors support this is that every year, every beneficiary will see a benefit every time that they buy a prescription drug because there is no deductible. The two issues of difference among your advisors are how much the premium (and overall benefit) should be subsidized and whether or not there should be catastrophic coverage.

On the subsidy issue, the Medicare actuary has concluded that 50 percent is the minimum subsidy amount that is necessary to attract enough healthy beneficiaries to avoid adverse selection. Some of your advisors think that a 50 percent premium is the most that we should do because anything higher will create too large of an entitlement that will be too hard to restrain in the future. Other advisors feel, however, that unless the premium subsidy is closer to 67 percent (and under $20 to start), the premium will be too high and the overall attractiveness of the plan could be hampered.

A second, major issue is whether the benefit is capped or covers catastrophic costs. Most policy experts believe that "true insurance" should not have caps and are concerned about capped options that leave the sickest beneficiaries unprotected. The Kennedy-Rockefeller bill, for this reason, includes catastrophic coverage. However, capped drug benefits have the advantage of constraining costs because the government's maximum spending growth is limited while the catastrophic coverage has the potential for more unconstrained growth in the out years.

FINANCING GAP. If all of the advisors' recommendations on key elements were adopted, there would be Medicare savings of about $100 billion over 10 years. This is about $30-90 billion below the cost of the drug benefits being considered. Options to fund this shortfall include one or more of the following:

- Making the drug benefit less generous. The level of the subsidy could be reduced from 67 to 50 percent, raising the premium by roughly $10 per month. One could also reduce the benefits, but most of your advisors believe that further diminishment of the base drug coverage package would be unappealing to beneficiaries and their advocates.

- Increasing provider and/or beneficiary savings: Most of your advisors are loathe to consider additional provider and/or beneficiary savings for fear that it would undermine the political support for the package. However, some would argue that it might be advisable, at least as an initial positioning strategy, to increase these savings (primarily by maximizing the BBA extenders and minimizing the BBA fixes) to avoid using the surplus.

- Including an additional tobacco tax: Because the tobacco tax in our budget is unlikely to be used by the Congress, an additional tobacco tax may not be viewed as a credible financing source. It is also unpopular with the House Democratic leadership. However, the Senate Finance Committee may be more supportive of the tobacco tax than the surplus as a source of funding. A $0.50 tax (on top of your budget's $0.55 tax) would generate about $45 billion in revenue from 2000-09.

THE PRESIDENT HAS SEEN
6-1-99

- Using the surplus: Using a portion of the surplus dedicated to Medicare solvency for prescription drugs could be justified given the tremendous drop in the Medicare baseline ($240 billion over 10 years from 1998 to 1999). While there are credible arguments for using the surplus, it clearly has to be considered in the broader Social Security / surplus context. Some fear that without more progress on Social Security solvency, tapping any portion of the surplus for prescription drugs before the solvency of Social Security and Medicare has been addressed could strengthen the Republicans' argument for using the surplus to finance a large tax cut.

No-tax wants - treat as MC reform advance

ILLUSTRATIVE PACKAGES. On the following page, you will find illustrative options that show combinations of drug benefits and additional offsets. Every option includes our recommended "base policy" which reflects the preliminary recommendations of your advisors. It assumes that each drug benefit design has a zero deductible and a 50 percent copayment. The elements of the drug benefit options that affect its cost are: (1) the degree to which it is subsidized (and therefore what the premium would be) and (2) the level to which the benefit is capped or alternatively, whether it provides for any catastrophic protection. It is likely that we will use some version of these options to help focus our discussion with you during the Tuesday Medicare reform meeting.

'99 MAY 21 AM10:45

REVISED

OPTION 1: No Additional Financing		OPTION 2: Additional Tobacco Tax		OPTION 3: Surplus	
Base:		**Base:**		Base:	
Competition	-10	Competition	-10	Competition	-10
Modernize Medicare	-14	Modernize Medicare	-14	Modernize Medicare	-14
Income-Related Premium ($80/100)	-25	Income-Related Premium ($80/100)	-25	Income-Related Premium ($80/100)	-25
Cost Sharing		Cost Sharing		Cost Sharing	
Preventive buy-down	+3	Preventive buy-down	+3	Preventive buy-down	+3
Lab 20% coinsurance	-9	Lab 20% coinsurance	-9	Lab 20% coinsurance	-9
Nursing home 20%	-5	Nursing home 20%	-5	Nursing home 20%	-5
Indexing Deductible	-1	Indexing Deductible	-1	Indexing Deductible	-1
Provider Savings	-40	Provider Savings	-40 was "10"	Provider Savings	-40
Subtotal:	**-100**	**Subtotal:**	**-100**	**Subtotal:**	**-100**
Additions:		**Additions:**		**Additions:**	
Income-Related Premium ($60/90)	-7	Tobacco Tax	-45	Surplus	-90
More Provider Cuts	-7	Income-Related Premium ($60/90)	-7		
Raise Deductible to $150 and index	-10				
Subtotal:	-24	Subtotal:	-52		
Drug Benefit:		**Drug Benefit:**		**Drug Benefit:** was "15"	
$5,000 Limit 50% Premium: $24/$48*	+123	$5,000 Limit 67% Premium: $16/$32*	+164	$5,000 Limit 67% Premium: $16/$32*	+164
		$10,000 Limit 50% Premium: $31/$55*	+142	$10,000 Limit 67% Premium: $21/$36*	+189
		No Dollar Limit 50% Premium: $24/$58*	+135	No Dollar Limit 67% Premium: $16/$39*	+180
State MOE	-5	State MOE	-5	State MOE	-5
TOTAL**	**-6**	**TOTAL ****	**+7-22**	**TOTAL ****	**-6-31**

*Monthly premiums in 2002 and 2009. Part B premium is $57 / $95 in 2002 / 2009.
** This amount is a necessary "cushion" pending final cost estimates.
Drug estimates assume about $5 billion in savings from state maintenance of effort.
NOTE: The policy with the $10,000 cap is more expensive than the catastrophic option only because it offers more generous coverage in the early years (00 to 06); the catastrophic option is more expensive in the out-years.

THE WHITE HOUSE

WASHINGTON

June 7, 1999

MEMORANDUM TO JOHN PODESTA

FROM: GENE B. SPERLING
CHRISTOPHER JENNINGS

SUBJECT: MEDICARE PLAN ROLL-OUT

We have listed below the schedule of actions necessary for a June 15 announcement. We want to make clear that everyone involved is committed to going the extra mile to make this timeline work if that is the decision. But, we also want to advise you of the concerns and risks that people have expressed.

The first is the very short time period between final decisions and the announcement. With luck, we can resolve all of the major issues by Friday (see attachment). This is the latest possible date to get the changes to the actuaries for final scoring of the savings/costs, 30-year projections and trust fund effects. Unfortunately, if we do not like the results of the scoring of the final package for any reason, there is no time to change the plan. While it is not uncommon to gather papers and briefing material in a short span over the weekend, in light of the large number of details here, this task would be significantly more complex both in terms of production and thinking through anticipated problems and questions.

While we plan only to give out the full details of our plan the night before the announcement at the earliest, Larry Stein still feels that it would be helpful for us to have another round of consultation with some of the key players in Congress so that we could make them feel as involved in our process and presentation as possible. Chris feels that it is also important that we meet with provider groups and, while not giving them the overall plan, vet some of the specific issues relative to provider fixes with the aim of securing their explicit support or, at a minimum, assuring that they do not oppose it. This will take significant time from the people who would be finalizing the plan.

While delaying by a week enhances the chances that we have a more controlled and polished roll-out, it also increases the possibility of leaks. So far, we have done well, but we would have to try to hold tight and minimize any circulation of paper.

DRAFT SCHEDULE

Wednesday, June 9:

Principals' Meeting:
Get recommendations on outstanding issues, described below.
Prepare for memo/meeting w/ POTUS, review roll-out plan
Outstanding issues:

- Drug benefit: premium / catastrophic or not
- Surplus financing: how much, if any, toward drug benefit
- Provider savings / fixes
- Sign-off on beneficiary proposals (e.g., level of income-related premium, lab copay, change in nursing home copay, indexing the Part B deductible).

Thursday, June 10:

Submit memo to POTUS:
Includes all policies with recommendations

Begin issue-specific roll-out with provider groups

- American Hospital Association
- American Health Care Association (nursing homes)
- American Association of Medical Colleges (academics)
- National Association for Home Care (home health)
- Pharmaceutical interest groups (manufacturers, pharmacists, PBMs, generics)
- American Medical Association (to get support for drugs)

Friday, June 11:

POTUS sign-off on plan
Last day to submit policies to actuaries for scoring before June 15

Weekend:

Finalize Paper:

- Press paper
- Detailed policy descriptions
- Improvements for beneficiaries paper
- Competition paper
- Trust Fund / surplus paper
- Drug benefit paper
- Comparison to Breaux-Thomas
- Q and a (internal)

Begin validator roll-out

Monday, June 14:

Congressional Democratic leadership
AARP, trusted validators outreach

Tuesday, June 15:

Morning: Congressional briefings
Validators, press, other advocates briefings
EVENT

6-23-99

THE WHITE HOUSE

'99 JUN 12 PM3:08

WASHINGTON
June 11, 1999

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Sperling
Podesta

MEMORANDUM FOR THE PRESIDENT

FROM: GENE SPERLING

SUBJECT: NEC WEEKLY REPORTS

cc: JOHN PODESTA

Appropriations: You should know that Speaker Hastert and Chairman Young negotiated this past week over how to allocate $5-7 billion to the non-defense bills from reductions to the Defense, Agriculture, Legislative Branch, and Treasury bills. In a similar exercise, Senators Stevens and Byrd have been allocating funds from a "deficiencies" pot – this week $1.2 billion for the Commerce/Justice/State bill as it went to subcommittee Wednesday (6/9). On Tuesday (6/8) the Senate passed the Defense bill 93-4, and the House passed the Agriculture bill 246-183. The Senate will take up the Energy & Water bill Monday (6/14), and may take up the Transportation bill as well. No matter how the Leadership allocates the $5-7 billion, however, big problems remain for the Labor/HHS and VA/HUD bills at the end of the day.

Social Security: You should know on Wednesday (6/9) Congressman John Kasich held a press conference to introduce his Social Security reform plan. The key points are: (1) Initial Social Security benefit would no longer be indexed to real wage growth but to prices; and (2) The plan would allow for voluntary carve-out accounts with a progressive contribution. For each year of contribution to the account, the traditional Social Security benefit would be cut by 0.33 percent with a lifetime cap of 15 percent. The proposal does not affect anyone 55 or older. On Wednesday (6/9) and Thursday (6/11) the Ways and Means Committee held two days of hearings where Members testified on their Social Security reform plans. Only plans that have been scored by the Social Security Actuaries as extending solvency for 75 years were invited to testify. A number of plans were discussed, including Breaux/Gregg, Gramm, Moynihan/Kerrey, Kolbe/ Stenholm, Nadler, and Archer/Shaw. Also Monday (6/7), Jack Lew, Larry Stein, and I met with Senators Daschle, Conrad, Lautenberg, and Moynihan to discuss strategy on both the House-passed version and the Senate version (Abraham-Domenici) of the Social Security lock box.

Update on Medicare Reform: After some preliminary consultations with the Democratic leadership and other key Democrats, it appears that the general positioning of your Medicare reform package appears to split the different priorities of conservative and base Democrats. Congressman Gephardt and Senator Daschle seem generally comfortable with the parameters of the drug benefit design we have discussed. However, since we have not briefed them fully on the plan's offsets, it remains unclear whether their support for the drug benefit would be at all affected when they fully understood the details. Senator Kennedy and his office, after learning of some of the general parameters from Senator Daschle, is indicating that drug benefit is too modest; he believes that we are being too miserly on the use of the surplus. In contrast, Senator Conrad has indicated his concern about tapping too much into the surplus for any drug benefit. (Having said this, he has also indicated his desire for the premium to be as low as possible.) We are notifying the Congress, the interest groups, and the media that you have made no final decisions on your reform initiative and will not until after you return from next week's trip. This will give us the opportunity to hold meetings with the Congress and the groups in order to solicit their feedback and attempt to get them more invested without relaying the details of the plan. The slight delay in announcement will also serve to allow us to better choreograph a much more organized rollout for your plan.

4

6-23-99

Computer Export Controls: John Podesta, Jim Steinberg, and I met with the major computer company CEOs on Friday (6/11) to discuss computer export controls. They are arguing that our current definition of a supercomputer is obsolete, and will soon be shipping widely available, inexpensive computers that exceed the current definition of a supercomputer. This issue has obviously become more sensitive in the wake of the Cox Report -- but we made a commitment to have an Administration position on this by June 30th.

High-tech CEOs: John Podesta and I also met with John Doerr and other Silicon Valley CEOs to discuss accounting standards, the R&D tax credit, the need to increase R&D funding, and Y2K liability reform. I am also working to get them more involved in your "new markets" initiative and addressing the "skills gap" for high-tech workers.

Aviation Priorities: John Podesta and Dorothy Robyn of my staff met on Thursday (6/10) with 20 CEOs of airlines and related unions (pilots, machinists and flight attendants). The CEOs urged us not to issue in final form DOT's proposed competition guidelines, which they believe are unnecessary, especially given the recent antitrust suit against American Airlines, and would chill competition, giving (non-union) low-cost carriers a free ride at the expense of (unionized) dominant carriers. They expressed support for Rep. Shuster's proposal to take the aviation trust fund off budget, which they see as a way to increase spending on FAA operations. We have threatened to veto Shuster's bill over the off-budget provision, on the grounds that (combined with limits on general fund spending on the FAA) it could result in ***reduced*** spending on FAA operations relative to airport infrastructure. Finally, the CEOs said they had reached agreement on a voluntary program to address passenger complaints, and they may be close to getting key Members on board. Although we have not seen the details, the proposal appears to stop short of the comparable Administration proposal. Dorothy met on Friday (6/11) with Iowa's attorney general and representatives from five other state AG offices to discuss aviation competition. The stage attorneys general, who have become increasingly vocal about airline competition problems, urged us to issue the guidelines. They believe the guidelines, by curbing predation against the all-important low-cost carriers, represent the best opportunity we have to enhance competition.

GMO Meeting: The NEC held a Deputies Meeting on Monday, June 7 to discuss the Administration's current strategy on genetically modified organisms ("GMOs") and on gaining access for US agricultural products containing GMOs into European markets. The Deputies decided not to press for inclusion of the topic at the G8 Summit, but to press instead for more comprehensive work on GMOs within the US-EU Summit framework. The Deputies also recommended formation of an international "blue-ribbon" panel to bolster the already considerable body of science around the safety of GMOs. The Deputies will meet again in several weeks to review strategy for consideration of GMOs in the WTO Ministerial context. good

Steel Update: You should know that the Quota bill is set for next Tuesday (6/15). We are whipping Democrats, and will arrange Cabinet member (specifically Secretary Rubin) meetings with undecided members in advance of vote. It is still not clear if we have the votes to defeat a cloture motion. Although good we have stopped the surge, we are getting little credit so we are in the process of stepping up our communications campaign. The largest business groups (BRT, Chamber, NAM) are stone silent due to steel industry membership, but agriculture exporters and steel consuming manufacturers are belatedly stepping up activity. Senator Roth is attempting to put together a steel package that wavering members could say they support in lieu of the quota bill. He hopes to bring Moynihan and Baucus on board and mark it up on Wednesday (6/16) in Finance Committee, but does not plan to seek a floor vote. The Roth package would likely include Section 201 reform, strengthened import monitoring, ending international financial institution funding of additional steel capacity, and possibly requiring USTR to initiate a Section 301 to address global steel over capacity. We have difficulty with the Section 301 proposal, and are working with his staff to figure out options.

Bipartisan Social Security Agreement

THE PRESIDENT HAS SEEN
6-14-99

Senator Judd Gregg
(R-NH)

Senator Bob Kerrey
(D-NE)

Senator Fred Thompson
(R-TN)

Senator Craig Thomas
(R-WY)

Senator John Breaux
(D-LA)

Senator Chuck Grassley
(R-IA)

Senator Chuck Robb
(D-VA)

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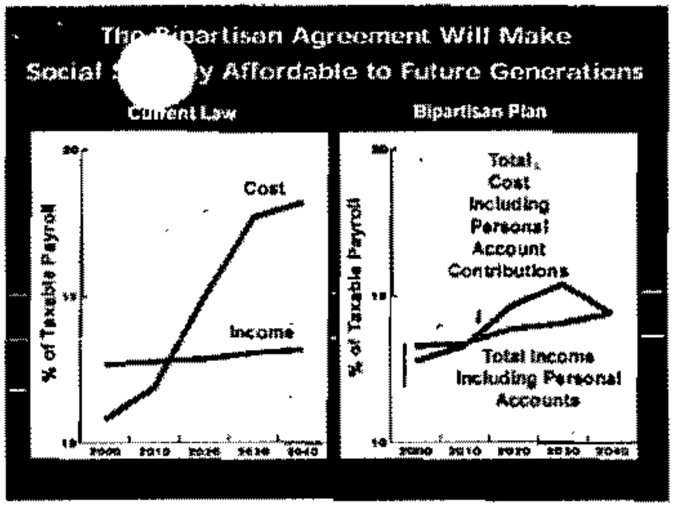
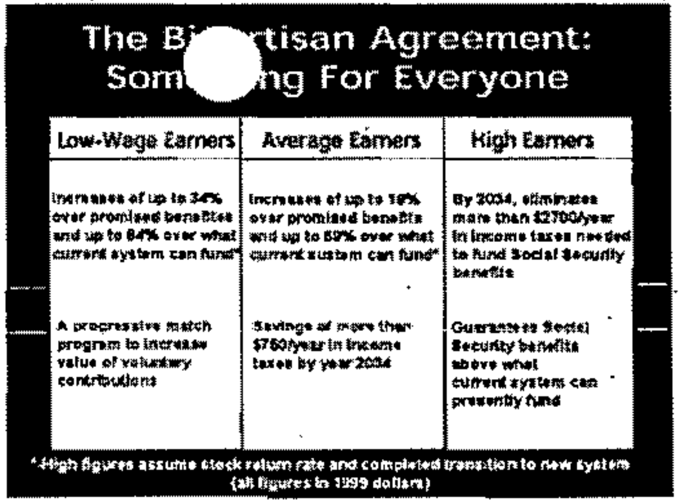
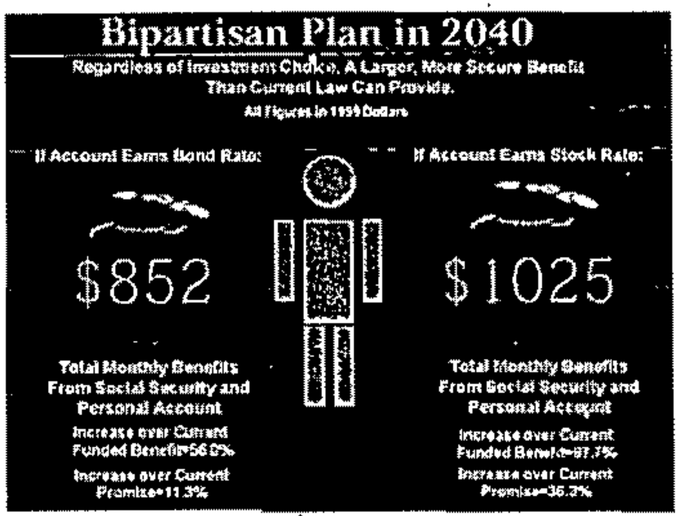
Sperling
Podesta

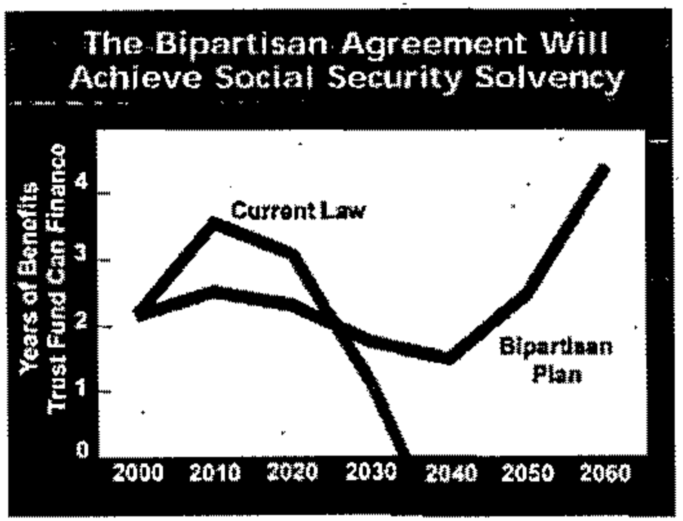
Gene

What question do these ideas really work - we support?
BC









TEN THINGS TO KNOW ABOUT THE BIPARTISAN SOCIAL SECURITY REFORM PLAN

- Creates ownership of personal savings accounts for all working

TEN THINGS TO KNOW ABOUT THE BIPARTISAN SOCIAL SECURITY REFORM PLAN

- Creates ownership of personal savings accounts for all working Americans.
- Uses surplus to boost contributions for low income Americans.
- Increases traditional Social Security benefit for low income earners
- Gives every child a chance to create retirement wealth by opening a savings account at birth (KidSave).
- Eliminates the earnngs test so that Social Security beneficiaries can continue to work.
- Saves taxpayer dollars by correcting cost of living indexes. Holds current seniors harmless from changes to the Social Security program, including reforms to the Consumer Price Index (CPI.)
- Keeps the Social Security trust fund solvent.
- Maintains women's Social Security benefits.
- Creates a life expectancy index for use in benefit calculation.
- There is no tax increase. Period.

TEN THINGS TO KNOW ABOUT THE BIPARTISAN SOCIAL SECURITY REFORM PLAN

1. Creates ownership of personal savings accounts for all working Americans.

   - Allows all workers to divert 2 percentage points of their payroll (FICA) tax into individual retirement savings accounts.

   - Supplements the worker's traditional Social Security check at retirement. The accounts will be modelled after the Federal Employees' Thrift Savings Plan: the accounts will be administered by the government, managed by private fund managers, and owned and controlled by individual workers.

   - Stipulates that individuals own all proceeds from their personal accounts and can "pass on" their accounts to their heirs.

   - Offsets the monthly benefit a worker is entitled to from Social Security by the amount the worker's account would have accumulated if it was annuitized and grew at the T-Bill rate.

2. Uses surplus to boost contributions for low income Americans.

   - Includes a progressive matching fund program to increase the value of voluntary savings contributions made by low-income workers.

   - Provides all workers an opportunity to contribute (at a minimum) an amount equal to 1% of the taxable wage base in their individual account (1% of this year's taxable wage base is $726 based on the 1999 base of $72,600). Specifically, wage-earners whose 2% contribution is less than 1% of the taxable wage base will:

     — Receive a $100 contribution by the federal government when they make their first dollar of voluntary contribution.

     — Receive a dollar-for-dollar match by the federal government on voluntary contributions, up to a total account contribution limit of 1% of the wage cap.

   In sum, the total contributions made from the payroll tax contribution, plus the added $100 federal government contribution, plus the 1:1 government match is limited to 1% of the current wage base annually.

   - Allows all workers to contribute up to $2000 of additional savings to their individual accounts each year.

3. <u>Increases traditional Social Security benefit for low income earners.</u>

- Includes a provision which will add an additional "bend point" to the Social Security benefit formula to boost the traditional Social Security benefit replacement rate for low income workers.

4. <u>Gives every child a chance to create retirement wealth by opening a KidSave savings account at birth.</u>

- Qualifies all children with a Social Security number and born after 1995 for a $1,000 savings account at birth.

- Adds $500 to the KidSave account for each of the first five years of life, for a total contribution of $3,500.

- Provides for individuals to roll KidSave accounts into the Social Security individual account to serve as a nest egg for each worker's retirement.

5. <u>Eliminates the earnings test so Social Security beneficiaries can continue to work.</u>

- Eliminates the earnings for all beneficiaries age 62 and older so that retirees may continue to contribute to the American economy without being penalized. Under the current earnings test, benefits are reduced for over one million beneficiaries because their wages exceed the earnings limit (currently the earnings limit is $9,120 for those aged 62 to 64 and $15,500 for those aged 65 and older). The Social Security Administration has estimated that the long-run cost of eliminating the earnings test is zero.

- Rewards work by correcting the actuarial adjustment for early and late retirement. Under current law, individuals do not receive back the value of extra payroll taxes contributed if they delay retirement. This proposal increases both the early and delayed retirement adjustments to the level appropriate to recognize additional tax contributions.

6. <u>Saves taxpayer dollars by correcting the cost-of-living indexes.</u>

- Makes an adjustment of .5 % to maintain more accurate cost-of-living indexes.

- Applies corrections to all indexed programs (both revenues and outlays) except Supplemental Security Income. Increases in revenues that occur due to CPI adjustments on the tax side will be credited to and "recaptured" for the Social Security Trust Funds.

- Guarantees that all persons currently age 62 and older will not be affected by the adjustments to the cost-of-living indexes.

7. Keeps the Social Security Trust Funds solvent.

- Restores the Social Security Trust Funds to actuarial solvency over a 75-year period.
- Ensures that there will not be a substantial funding shortfall beyond the 75-year window.
- Recaptures Social Security revenues currently diverted to the Hospital Insurance Trust Fund and redirects them back to the Social Security Trust Funds (phased in between 2010 and 2019).

8. Maintains women's Social Security benefits.

note what Patty Murray said —

- Credits all years of earnings in calculating benefits. Under current law, only an individual's top 35 years are used to determine one's Social Security benefit. Under this proposal, every year of earnings, no matter how small, would be included in the Social Security benefit formula. (The denominator of the AIME formula would gradually be phased to 40).
- Provides five "dropout years" to the individual with lower earnings from every two-earner couple, in recognition of the likelihood that a spouse may have taken time away from work to raise children.

9. Creates a life expectancy index.

- Allows workers to continue to receive early old-age benefits at age 62.
- Continues to gradually phase in an increase in full eligibility for old-age benefits to 67 by 2011.
- Applies a life expectancy index to the Social Security benefit formula after the current-law eligibility age increase is fully phased in. If projections of life expectancy or other factors cause a significant change in projected solvency, for better or worse, the Social Security Trustees will be required to present Congress with a proposal to alter the life expectancy factors, upon which Congress must act or take an alternate action to restore the system to balance.

10. There is no payroll tax increase.

- Includes NO increases in the payroll (FICA) tax rate.
- Maintains the taxable wage base at 86% of total wages.

6-15-99

THE WHITE HOUSE

WASHINGTON

June 14, 1999

MR. PRESIDENT:

John asked me to forward the attached memo to give you the lay of the land on the "lock box" issue on the Hill – but wants you to know the issue is essentially how we can improve the Herger/Shaw legislation while we continue to oppose cloture on the Abraham/Dominici proposal.

The memo presents three options: (1) oppose cloture on Abraham/Dominici and try to fix Herger/Shaw; (2) allow cloture on Abraham/Dominici and work to fix it in conference or veto it; and (3) oppose cloture on Abraham/Dominici and accept Herger/Shaw. John believes Option 2 is not feasible at this point, given where the Senate Dems are, and wants to focus on preparing for Herger/Shaw.

Sean Maloney

Podesta

OK – but it isn't worth fretting over w/ the Democrats to get #2 –

BC

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Podesta
Lew
Sperling
Stein

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THE WHITE HOUSE

WASHINGTON

June 11, 1999

6-15-99

MEMORANDUM FOR THE PRESIDENT

FROM: Jacob J. Lew
Gene Sperling
Larry Stein

SUBJECT: Legislative Strategy on Social Security Lockbox Proposals

This memorandum presents options for dealing with the lockbox proposals under consideration in the Congress and seeks your decision on the strategy we should pursue in the context of the Social Security and budget debates this year.

The lockbox debate in Congress has solidified around two proposals, the Herger-Shaw bill, and the Abraham-Domenici bill. The Herger-Shaw proposal would establish a 60-vote point of order in the Senate against any bill that causes or contributes to an on-budget deficit (with the exception of Medicare). The Abraham-Domenici bill would establish a new limit on debt held by the public that would decline over time, resulting in a breach of the debt limit provision if currently projected on-budget surpluses do not materialize.

The Herger-Shaw proposal passed the House 416-12. In deference to House Democrats, we did not provide Administration views on the bill, though we do have concerns with the 60-vote point of order in the event of a recession. A cloture motion on the Abraham-Domenici bill was defeated by a vote of 54-45. We have indicated that your senior advisers would recommend veto of the bill.

Tuesday afternoon, following the policy luncheons, the Senate is scheduled to vote on cloture on the Abraham-Domenici bill. Absent a change in strategy from us, the Democratic leadership is expecting a repeat of the 55-45 vote. We see essentially three strategic options, which are discussed below.

Option 1: Oppose cloture on Abraham-Domenici, work to fix Herger-Shaw.

Under this option, we would continue to oppose cloture on Abraham-Domenici. In the event we are successful, the Senate majority leadership will likely turn to the Herger-Shaw bill. We would work in the Senate, particularly with Senators Conrad and Domenici, to fix the most problematic aspect of the Herger-Shaw bill, the anticyclical nature of the strict on-budget balance that it would require. The bill could force tax increases or spending cuts absent sixty votes on a budget resolution that assumed an on budget deficit resulting from a recession. Our position would be that, if fixed in this respect, the bill would do no good, but also little harm. We would therefore sign the bill.

The majority would no doubt claim that they had achieved some sort of victory and "fixed" the Social Security problem; however, the bill in reality would support neither proposition. One potential problem with even this modified Herger-Shaw bill would be that 60 votes would be required for an end-game omnibus appropriations bill. However, it is unlikely that the bill would seriously hamper our overall budget objectives.

The difficulty with this option is that it would be an uphill battle to achieve any amendment of the bill. It passed with 416 votes in the House. The Senate Republican leadership has little incentive to fix the bill to our liking, though some Members may agree with us that the bill as currently drafted unwisely constrains future fiscal policies in the event of a recession or low growth. For example, Chairman Stevens has urged Chairman Domenici to fix the recession problem with Herger-Shaw. It should also be noted that Chairman Domenici is considering offering an amendment to strike the Medicare exception from bill which, as written would allow the use of the Social Security surplus for Medicare reform.

Option 2: Allow a vote on Abraham-Domenici, and Fix in Conference or Veto

The second option is to not oppose the cloture vote on Abraham-Domenici but continue to oppose the bill. If we pursued this option, the bill would then probably pass the Senate. There would be a conference on the House passed Herger-Shaw bill and the Senate Abraham-Domenici bill. We believe that this conference would be extremely contentious. We could well succeed in developing an acceptable lockbox. However, if the result of the conference were unfavorable, and the Abraham-Domenici lockbox passed both Houses, you would be presented with the decision of whether to veto the bill. We believe that an essential part of this option is that you would be prepared to make it clear that you would veto the Abraham-Domenici bill.

Allowing a conference debate to proceed on a lockbox proposal that you have indicated you would veto, could easily precipitate calls for an early budget summit. The inherent pressures of the key Social Security and budget issues presented in such a conference would not be resolvable without at least some influential Members calling for a summit. There is also the danger that the conference could also be used for enacting other budget process reform changes, under the cover of Social Security protection, such as exempting tax cuts from pay-go requirements. However, this option could also result in delayed action on the bill if Republicans can not reconcile the significant differences between the two bills.

Senate Democrats would be surprised by this option (given their previous cloture vote and our veto statements) so if it is selected, one of us would need to meet with Senator Daschle prior to the Tuesday policy luncheons. It might well be that Democrats are unwilling, or unable, to pivot as quickly as this option would require.

Option 3: Continue to Oppose Cloture on Abraham-Domenici, Accept Herger-Shaw

Under this option, we would continue to oppose cloture on Abraham-Domenici, and accept the Herger-Shaw bill if we are unsuccessful in modifying it to remove the anticyclical feature. This option, then, assumes we follow the course of option 1 but are unsuccessful in modifying the bill.

In this option, the majority would be able to claim a substantial victory, and it would arguably allow them to claim to have "fixed" Social Security to the extent that they, and perhaps others, would no longer view Social Security as an immovable object blocking a large tax cut. We would be in a weaker position if they tried to pass a large tax cut or if we later engage in summit talks. We would also have to live with an extra hurdle in the appropriations debate this year and bad fiscal policy in future years.

Recommendation

Option 3 is actually the likely outcome. Republicans have little incentive to incorporate countercyclical protections in Herger/Shaw since changing the House bill in anyway would probably force a protracted conference. Because it is, therefore, not in our power to guarantee Option 1, we are concerned that without a creative solution we will get jammed by Herger/Shaw. We strongly recommend that we further explore the potential benefits and costs of Option 2 with Senator Daschle and with House Democrats.

THE PRESIDENT HAS SEEN
6-23-99

DRAFT MAJORITY RECOMMENDATION FOR MEDICARE REFORM PLAN

The majority of your advisors have agreed on the Medicare reform plan outlined below. It would make Medicare more competitive and efficient; modernize the program's benefits, including the provision of a long-overdue prescription drug benefit; and dedicate 15 percent of the surplus to strengthen Medicare. By constraining Medicare growth and dedicating a portion of the nation's surplus to help finance its demographic challenges, the proposal extends the life of the Trust Fund through at least 2027.

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Podesta
Sperling

REFORM PROPOSALS

- **Smoothing Out Provider Savings in the Balanced Budget Act:** The plan would implement administrative actions and dedicate a 10-year, $7.5 billion set-aside to moderate the BBA provider policies. This would not be allocated to specific providers; rather it would serve as a placeholder for policies developed in consultation with Congress and as evidence of problems is strengthened.

- **Managed Care Competition and Private Sector Purchasing Tools for Traditional Medicare:** The proposal would inject true price competition between managed care plans and the traditional fee-for-service program. Both options would offer a defined and updated benefit package – including prescription drug coverage – and compete over cost and quality. However, unlike the premium support proposal recommended by Senator Breaux, beneficiaries staying in the traditional fee-for-service program could do so without an increase in premiums.

- **Reducing Out-Year Growth in Provider Spending.** Beginning in 2003, the Medicare actuary and CBO project Medicare growth to return to high rates as most of the policies in the BBA expire. This plan would extend but moderate some of the BBA policies; it would not extend growth rate reductions in home health, disproportionate share hospital (DSH) and nursing home payments.

- **Rationalizing Cost Sharing:** This proposal would eliminate cost sharing for all preventive services, removing an important barrier to using these important services. It would also add 20 percent coinsurance to clinical laboratory services, one of the few Part B services without cost sharing. This would help cut down on unnecessary use and fraud.

- **Income-Related Premium:** The plan would reduce from 75 to 50 percent the Medicare premium subsidy to beneficiaries with income of $100,000 or more ($120,000 for a couple). This would affect approximately 1 million beneficiaries (less than 3 percent of all beneficiaries).

when would it start?

PRESCRIPTION DRUG BENEFIT

- **Base Package: No deductible, 50% copay up to $4,000 limit:** Medicare would provide an optional drug benefit that would cover half of all drug costs up to $4,000 when fully phased in. The policy would assure that beneficiaries choosing this option would benefit from the estimated 13 percent discount obtained through bulk purchasing of prescription drugs by private sector pharmacy managers. This premium would cost about $24 per month in 2002, $36 in 2006 when fully implemented. Low-income beneficiaries would not pay premiums and cost sharing, as under current Medicaid protections

- **Catastrophic Option:** Any and all funds produced from the Justice Department Medicare law suit would be explicitly allocated to providing coverage for expenses above the $4,000 limit.

SURPLUS

- The plan would dedicate 15 percent of the unified surplus to Medicare. It would lock away at least the same amount that was dedicated for solvency in the President's budget. Less than 10 percent of this amount (about $35 billion of the over $350 billion over 10 years) would help offset the cost of the prescription drug benefit. $35 billion is less than half of the drop in Medicare baseline spending between January and June alone, indicative of the major contribution that Medicare has made towards no deficit and increasing prosperity. The remaining surplus, in combination with the savings, will guarantee that the Medicare trust fund is solvency through at least 2027.

6.131

SUMMARY TABLE: DRAFT RECOMMENDATION

POLICIES	SAVINGS/SPENDING
Savings:	
Managed Care Competition	-7
Modernize Traditional Medicare	-20*
Provider Savings	-47
- Set-aside for BBA moderations	+7.5
Eliminate Preventive Copays	+3
Add 20% Lab Copay	-10
Income-Related Premium: $100/120,000 phased down to 50% subsidy	-8*
Interactions/Premium offset	+7
Subtotal:	**-$75 billion**
Drug Benefit:* No deductible, 50% cost sharing up to $4,000 limit in 2006 Premiums: $24/mo in 2002; $36/mo in 2006	**+$110 billion**
Surplus:	**-$35 billion**

*** Rough estimates/ waiting for official scoring.**

OPTIONS TO SUPPLEMENT THE MAJORITY RECOMMENDATION

The majority recommendation is a solid, defensible policy. Its primary shortcoming may be that its drug coverage policy will be viewed as excessively modest. Because of the fiscal constraints we are rightly imposing on ourselves, there are not many more dollars available to liberalize the benefit. However, for a relatively modest $13 billion over 10 years, it would be possible to raise the coverage limit from $4,000 to $5,000. About 900,000 people have more than $4,000 in drug costs. Raising the limit does, however, raise the premium if the subsidy is held at 50 percent.

It may be possible to pay for the $13 billion needed to raise the limit to $5,000 through: (1) scoring of an employer maintenance of effort for prescription drugs; (2) re-scoring of the traditional program modernization policies; (3) adjusting the income-related premium; and/or (4) adding the Part B deductible adjustment. We assume that we are carrying the first two policies regardless. The latter two, while recommended, would require additional guidance from the President and you. As a note, we think that it is important to carry the maintenance of effort policy, even if it does not produce much savings, because the unions, Federal retirees, and business community want incentives to keep their current coverage.

INCOME-RELATED PREMIUM. Savings from this policy could be increased by phasing down the subsidy at a faster rate and lowering the income thresholds for the payment.

Begins Subsidy Phase-Down	Full Subsidy Phase-Down	Number of Beneficiaries Affected	Savings 2000-04 2001-09
$90,000 for Singles $115,000 for Couples*	$100,000 $125,000	1 million	$8 billion / $22 billion
$80,000 for Singles $100,000 for Couples	$100,000 $125,000	2 million	$9 billion / $25 billion — down to 10 B
$50,000 for Singles $75,000 for Couples**	$100,000 $150,000	4 million	$15 billion / $40 billion

*Health Security Act; ** BBA

History of catastrophic coverage. This benefit, implemented in 1989 and repealed in the same year, had a deductible between $600-700, indexed so that 16 percent of beneficiaries would always have access to coverage. This benefit, plus the catastrophic cost sharing protections, were funded in part through an income-related premium. This premium was based on tax liability – for every $150 in tax liability, beneficiaries would pay an extra $22.50 per year, with a maximum payment of $800. If this $800 were trended to 1999, it would be equivalent to about $1,110 per year, or $92 per month. This is roughly equivalent to reducing the Part B premium subsidy from 75 to 50 percent, as is proposed in this policy.

PART B DEDUCTIBLE. The Part B deductible is set at $100 a year. It is less than most private indemnity insurance plans. The deductible has been increased only three times since Medicare began in 1966, when it was set at $50. In relation to average annual per capita charges under the SMI program, the deductible has fallen from 45 percent in 1967 to about 3 percent (projected) for 1999, according to CBO. Indexing the deductible to inflation does not really increase it, but maintains its current value of $100 in future years. It would rise by about $3 per beneficiary per year ($135 in 2010). Relative to other cost sharing proposals, it is the most evenly spread change since virtually all Medicare beneficiaries meet their Part B deductible in a year. It has been supported by organizations like the Congressional Budget Office and analysts like Marilyn Moon.

Gene & Chris

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6-28-99

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Lew
Sperling
Podesta

THE WHITE HOUSE

WASHINGTON

June 23, 1999

MEMORANDUM FOR THE PRESIDENT

SUBJECT: Release of FY 2000 Mid-Session Review (MSR)

FROM: SEAN MALONEY
DAVID GOODFRIEND

The attached Lew/Sperling memo asks you to approve a new budget framework and presentation of discretionary spending priorities in light of improved budget surplus forecasts in the MSR. *Jack and Gene ask for your guidance as soon as possible because they would like to release the MSR this Monday, June 28, in anticipation of CBO's July 1 release of revised estimates.*

MSR projections. The MSR projects the following increases over the February estimates in the unified budget surplus: $20 billion in 1999; $25 billion in 2000; $112 billion in 2014; $1.061 trillion total over 15 years. About ¼ of this increase comes from the on-budget (non-Social Security) surplus, but the on-budget surplus remains relatively small in the early years ($5 billion in 2000 and $25 billion in 2001), leaving little maneuvering room in the next two years.

New budget framework. The on-budget surplus estimates present an opportunity to frame the current budget debate; Congress only supports the on/off-budget construct and Jack and Gene say that the MSR's estimated on-budget surplus therefore allows you to move the debate forward. Their proposed framework would maintain your current commitment to targeted tax relief through USA accounts, rather than beginning a tax-cut bidding war with Congress, and still would eliminate public debt by 2013. Your advisers all agree on the following framework (and seek guidance from you on how to present the discretionary spending, in #4 below):

1. **Social Security off-budget.** The revised surplus estimate allows you to do this while still funding your discretionary spending, USA Accounts, and Medicare reform at strong levels. On the other hand, using most of the improved surplus this way will prohibit significant additional funds for tax cuts, Medicare, or discretionary spending over the next 5-10 years.
2. **New Social Security "lock-box."** Taking Social Security off-budget would allow putting the Social Security surplus in a lock-box for debt reduction and then, starting in 2010, transferring from on-budget the resulting interest. Unlike the current proposal (*i.e.*, lock-box to pay down debt, then give additional bond to trust fund to increase solvency), this would be easier to describe and would avoid transferring general revenues to Social Security, among other things.
3. **Medicare.** Increase proposed Medicare transfers over 15 years by about $150 billion, with a new prescription drug benefit. Jack and Gene say that this still would provide the same measure of solvency as did the February framework and, among other things, presents the best way to block a dangerously large tax cut.
4. **Discretionary spending.** Increase discretionary spending by $53 billion over 15 years. Jack and Gene suggest that, in presenting this increase, you could emphasize funding for

THE PRESIDENT HAS SEEN
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education programs and children, but caution that allocating specific areas could invite requests for funding in others. They ask whether you would like to (1) stay with the current approach of not allocating discretionary funds to specific programs; (2) highlight military readiness and education; or (3) highlight a longer list of priorities (*e.g.*, readiness, education, veterans, biomedical research, agriculture). *Please see attached Table 4 for more details.*

Action:

Approve budget framework √_____ Disapprove _____ Discuss _____

If you approve budget framework, present increased discretionary spending by:

Maintaining current approach of not specifying allocations _____

Highlighting military readiness and education _____ or

Highlighting a longer list of priorities (*e.g.*, readiness, education, agriculture) _____

Discuss _____

THE WHITE HOUSE

WASHINGTON

June 23, 1999

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MEMORANDUM FOR THE PRESIDENT

FROM: Jacob J. Lew
Gene Sperling

SUBJECT: Release of FY 2000 *Mid-Session Review* – DECISIONAL

We are currently preparing the *Mid-Session Review* (MSR) of the fiscal year 2000 budget in advance of the July 15 statutory deadline. The revised budget projections suggest a substantial increase in the surplus from our February budget estimate. The size of the surplus projections suggests a need to update your budget program to control the policy debate, because with these new estimates the Congress could easily draft a popular package that meets some of our goals and still provides a large and irresponsible tax cut. We believe that by acting aggressively, we can increase the likelihood of achieving your Social Security, Medicare, debt reduction, tax cut, and discretionary goals. This memorandum presents for your consideration a recommendation for a new budget framework, and a rollout strategy for this framework and your Medicare policy in the context of the MSR. The only decision we need quickly is whether to adopt the new budget framework described below.

The Mid-Session Budget Projections

The MSR projects increases over our February estimates in the unified budget surplus of $20 billion in 1999 and $25 billion in 2000, rising to $112 billion in 2014 (see Table 1). The MSR projects a total increase of $1.061 trillion over the full 15 years. About three-quarters of this increase comes from the on-budget (non-Social Security) surplus. The ten-year on-budget improvement is $336 billion – almost equal to the $350 billion that your February framework transferred to Medicare over the same period. When CBO issues its new estimates on or near July 1, we expect CBO to increase its estimated surpluses, though probably by a smaller margin than we did because their estimates were already higher.

Even with the large increases described above, the on-budget surplus remains relatively small in the early years ($5 billion in 2000 and $25 billion in 2001) leaving little budgetary maneuvering room in the next two years (see Table 2). Further, while the recent improvements in our fiscal condition are undeniable, large surpluses remain only a projection, and less desirable outcomes are certainly possible.

The Need to Shape the Debate, and the Opportunity to Address Concerns

Although the basic construct of our budget framework (i.e., allocate all of the surplus among key priorities including Social Security, Medicare, Universal Savings Accounts, and discretionary program needs) is sound, we recommend several changes in light of the larger projected surpluses.

Under the new Mid-Session estimates, as noted earlier, the ten-year improvement in the on-budget surplus is $336 billion. The total on-budget surplus over ten years is $1.086 trillion. Thus, it would be possible for Congress to accommodate your $350 billion Medicare proposal from just the improvement to the on-budget outlook, and pay for an extremely large tax cut that creates substantial risk to the economy if we have any decline in the forecast -- while doing nothing to save Social Security, provide for USAs, or meet discretionary needs. Furthermore, at that point, the on-budget surplus would be fully allocated, and any subsequent bad news would likely fall fully on the core functions of government.

New Budget Framework

The current on-budget surplus estimates present a crucial opportunity with regard to framing the current budget debate. As you know, there is no support from Congress for anything but an on/off construct, and the fact that the MSR estimates an on-budget surplus (even though small in the early years) gives us the chance to move the overall debate forward. Within the new budget framework we are recommending, we would stress the dramatic turnaround in the Nation's fiscal situation over the last six years and the fact that not only are we going to run a budget surplus – the first in 30 years – but also that we will run an on-budget surplus. This is the only issue that we need your immediate guidance on to finalize the MSR (see Table 3). We can work out the remainder of the details at the end of the week. It is our recommendation that this new framework incorporate the following:

- **Moving To Take Social Security Off-Budget.** When doing our initial budget -- many of us, including yourself – saw a significant political attraction in taking Social Security off-budget. The problem was that, at that time, taking Social Security off-budget would have had the following two downsides: (1) it would have left significant on-budget deficits for years to come taking away the notion of a balanced budget and probably forcing more cuts of discretionary spending; and (2) it would not have allowed for funds for military readiness, Medicare, and USA Accounts. As you will recall, when the Republicans sought to go off-budget with a large tax cuts they could only do so if they allocated zero funds for Medicare and submitted a draconian discretionary budget.

  The increase of the surplus in the MSR offers us the opportunity to take Social Security off-budget, while still being able to fund our discretionary spending, USA Accounts and Medicare reform at strong levels. Indeed, as you will see below, with the MSR improvement we will be able to move social Security off-budget and still maintain or even increase our commitments to discretionary spending, Medicare and USA tax cuts over a ten to fifteen year period.

On the other hand, it is important to understand that because most of the improvement will be used to take Social Security off-budget and continue to make it so we are able to afford our existing priorities, the MSR "bump up" will not allow us significant additional funds to increase tax cuts, Medicare or discretionary spending over the first five to ten years.

- **New Social Security Lock-Box.** As we take Social Security off-budget, we would recommend proposing a new Social Security "lockbox." In the State if the Union proposal, as you know, we essentially had a lock-box that paid down the debt and then gave an additional bond to the Social Security Trust Fund to increase solvency. In our new budget framework, we would present a cleaner, crisper, presentation of how a strong Social Security debt reduction lock-box would increase solvency. Under the new Social Security "lockbox," we would put the Social Security surplus in a "lockbox" for debt reduction and then starting in 2010 we would transfer from on-budget the interest savings generated from the Social Security debt reduction "lockbox." The advantages of this lock-box are the following: (1) easier to describe that debt reduction creates interest savings and that only those interest savings are going to Social Security solvency; (2) takes away the confusion created by the transferring of two bonds for each portion of the surplus; (3) all transfers are going from on-budget (when it would be afforded) so there is less of an appearance of double counting; and (4) for those who don't like transferring general revenues to Social Security, this is an "eat what you sow" approach; the only general revenues being transferred are those that are created by the interest savings from the debt reduction in the Social Security "lock-box". We can describe our Social Security "lockbox" as providing double protection against diverting social security payroll taxes. First, it protects Social Security taxes by locking them up for debt reduction, then it ensures that interest savings from the "lockbox" go to Social Security solvency instead of being diverted to other uses.

- **Medicare.** Our new budget framework would increase our proposed Medicare transfers over fifteen years by nearly $150 billion compared to the original framework, and would provide a new prescription drug benefit that would modernize Medicare, increase efficiency in our overall healthcare system, and relieve a significant out-of-pocket burden on much of our senior population. Our new budget framework would provide essentially the same measure of solvency as under the February framework. We believe that Medicare is the most effective way to block a large tax cut and is a proxy for debt reduction which is the best way to protect against the possibility of an economic downturn. Under this recommendation, Medicare transfers would represent 15 percent of the on-budget surplus, as was the case in the February plan. Because of the increased surplus available, a lower percentage of the surplus could be dedicate to Medicare transfers while continuing to increase the dollars available for Medicare over the February plan.

- **Discretionary Spending.** Finally, our new budget framework would provide for an additional $53 billion over fifteen years for discretionary spending. Combined with our original discretionary proposals, this would bring the total to $534 billion, 10 percent of the surplus. There is a strong argument to present much of our discretionary spending as funding for priority education programs and children.

  As a block to a tax cut, education would be more effective than "funding for critical priorities." In February, however, we decided not to allocate these funds to specific purposes to avoid having to indicate what specifically would not be provided for in the outyears. We would be called upon to explain why we singled out education and not agriculture, veterans, research, or other popular programs. If we specify too many priorities, it will make clear that "core" government, such as international funding, will be unacceptably tight. We will need your decision on whether to stay with the approach in our February budget or add education and other specific commitments. Attached are three possible presentations (see Table 4).

- **Tax Cuts.** Our new framework would maintain your current commitment to target tax relief through a new USA account that will make retirement savings universal. We anticipate USA transfers that fully implement the SOTU policy, but cost somewhat less in the early years because of a slower phase-in. We have argued that the USA accounts are our tax cuts done the right way. Also, as you remember, your February budget contained an additional $76 billion of tax cuts over ten years for child care, making health care more affordable, expanded education initiatives, and other programs. Some would argue that we should factor into our framework a reasonably sized tax cut in addition to USAs and these tax proposals. However, such a proposal would likely begin an upward bidding cycle with Congress and would make it impossible to maintain or increase funding in other areas. Since there is no room in the early years to increase the tax cut, the only option for a larger tax cut would resemble what we have criticized as fiscally dangerous "exploding" tax cuts,

- **Debt Reduction.** Under the new budget framework, debt held by the public would be eliminated in 2013. This is roughly the same time period projected in our original framework. Taking Social Security off-budget and allocating the on-budget surplus for a targeted tax cut, Medicare, debt reduction, and important discretionary investments will give us the opportunity to shape the budget debate and maintain the fiscal discipline and investments in our future that have helped create the surplus we now enjoy.

The *Mid-Session Review* Rollout

We plan to release the MSR before the scheduled CBO midyear update of July 1. We believe that this is essential, because Congressional critics will seize on any news of larger surpluses to press their case for a tax cut without regard to the impact on discretionary priorities or Medicare. If we present our projections first, we can frame the debate to highlight both our fiscal policy and our priorities, e.g., Medicare and education.

We have tentatively concluded that the best rollout would have the release of the MSR on Monday, June 28. This release would include the new budget numbers, the budgetary transfers for Social Security and their implications for solvency, and the budget transfer amount for Medicare. This means reaching final decisions on our Medicare proposal in the next few days is crucial.

The coincidence of the completion of the MSR and the Medicare policy also raises communications issues. The MSR document and rollout materials would make reference to our Medicare principles, and would state that our Medicare program savings and our prescription drug policy would be announced on the next day, Tuesday, June 29. In that rollout, we would reveal the specific Medicare policies, and explain their interaction with the new budget numbers in detail. If it was deemed appropriate, we would have a further Social Security event later in the week, perhaps to discuss and explain our approach to a lockbox for the off-budget surpluses as part of our new on-budget/off-budget framework.

Decision

- **Budget Framework:**

  Approve New Framework ____ Retain Original Framework ____

  Let's Discuss ____

- **Discretionary Spending:**

  Option 1. ____ Option 2. ____

  Option 3. ____ Retain Original Framework ____

  Let's Discuss ____

Table I

15-YEAR BUDGET TOTALS PENDING SOCIAL SECURITY AND MEDICARE REFORM

(In billions of dollars)

	Budget Estimates						
	1999	2000	2001	2002	2003	2004	2005
February Budget Policy Pending Social Security and Medicare Reform:							
Unified surplus	79	117	134	187	182	208	231
On-budget	-42	-12	0	44	31	50	58
Off-budget	121	129	134	142	151	158	173
Mid-Session Policy Pending Social Security and Medicare Reform:							
Unified surplus	99	143	169	220	223	254	287
On-budget	-25	5	25	66	58	79	94
Off-budget	124	137	144	154	165	175	193
Changes from the February Budget to the Mid-Session:							
Unified surplus	20	25	35	34	41	46	55
On-budget	17	17	25	22	27	29	36
Off-budget	3	8	10	12	14	17	19

	Budget Estimates				Projections 1/				
	2006	2007	2008	2009	2010	2011	2012	2013	2014
February Budget Policy Pending Social Security and Medicare Reform:									
Unified surplus	283	320	354	393	429	464	495	520	536
On-budget	103	131	156	188	221	253	284	312	333
Off-budget	179	190	198	205	208	211	211	208	203
Mid-Session Policy Pending Social Security and Medicare Reform:									
Unified surplus	344	389	428	474	517	568	603	635	665
On-budget	142	174	203	240	283	328	364	398	432
Off-budget	202	215	225	233	234	237	239	238	233
Changes from the February Budget to the Mid-Session:									
Unified surplus	61	68	74	80	88	101	108	115	129
On-budget	39	44	47	52	63	75	80	86	98
Off-budget	22	25	27	29	26	26	28	29	31

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February Budget Policy Pending Social Security and Medicare Reform:			
Unified surplus	828	2,409	4,854
On-budget	114	750	2,153
Off-budget	714	1,659	2,701
Mid-Session Policy Pending Social Security and Medicare Reform:			
Unified surplus	1,009	2,929	5,915
On-budget	233	1,086	2,891
Off-budget	776	1,843	3,024
Changes from the February Budget to the Mid-Session:			
Unified surplus	181	520	1,061
On-budget	$\boxed{119}$	$\boxed{336}$	$\boxed{738}$
Off-budget	62	183	323

1/ Projections are an OMB extension of detailed agency budget estimates through 2009.

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Table II

FRAMEWORK FOR SOCIAL SECURITY AND MEDICARE REFORM
(Dollars amounts in billions)

	Subtotal 2000-2004	Subtotal 2000-2009	Total 2000-2014
Reserve pending Social Security and Medicare reform	1,009	2,929	5,915
Off-budget	776	1,843	3,028
On-budget	233	1,086	2,887
Allocation for Social Security solvency and debt reduction:			
Off-budget surplus	776	1,843	3,028
On-budget transfers to extend Social Security solvency and reduce debt	0	0	503
Total allocation	776	1,843	3,532
Allocation of remaining on-budget surplus:			
Transfers to strengthen Medicare and reduce debt	53	363	833
Universal Savings Accounts	25	263	544
Discretionary investments:			
Military readiness	55	127	183
Investments for a secure future	55	127	183
Children First fund	28	74	168
Total discretionary investments	138	328	534
Financing costs	16	132	472
Total allocation	232	1,086	2,383
Total allocation of surplus	1,008	2,929	5,914
Off-budget	776	1,843	3,028
On-budget	232	1,086	2,886
Memorandum, total debt reduction	810	2,156	4,353

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Table III

CHANGE IN RESOURCES, 2000 THROUGH 2014
(Dollar amounts in billions)

	February Budget		Mid-Session Review	
	Surplus Amount	Percent of total	Surplus Amount	Percent of total
Amount of surplus available:				
Off-budget	2,701		3,028	
On-budget	2,153		2,887	
Total	4,854		5,915	
Allocation for Social Security solvency and debt reduction:				
Off-budget	2,701		3,028	
On-budget	63		503	
Total	2,764	62%	3,532	65%
Allocation of remaining on-budget surplus:				
Transfers to strengthen Medicare and reduce debt	686	15%	833	15%
Universal Savings Accounts	536	12%	544	10%
Discretionary investments	481	11%	534	10%
Total	1,703		1,911	
Total allocation of surplus excluding financing costs:				
Off-budget	2,701		3,028	
On-budget	1,766		2,414	
Total	4,467	100%	5,442	100%
Financing costs	387		472	
Total allocation of surplus including financing costs:				
Off-budget	2,701		3,028	
On-budget	2,153		2,886	
Total	4,854		5,914	

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Table IV

ALTERNATIVE PRESENTATIONS OF DISCRETIONARY RESOURCES CONTINGENT ON SOCIAL SECURITY AND MEDICARE REFORM

(Dollars in billions)

	Subtotal 2000-2004	Subtotal 2000-2009	Total 2000-2014
1. February Budget Structure (With Additional Funding)			
Discretionary investments:			
Department of Defense	55	127	183
Non-DOD --(maintains a freeze at 2000 levels)	60	105	139
Reserve for Priority Initiatives (plus added funding)	23	96	212
Total discretionary investments	138	328	534
2. Highlight Military Readiness and Education			
Discretionary investments:			
Military readiness	55	127	183
Investments for a Secure Future (equals defense)	55	127	183
Education trust fund	28	74	168
Total discretionary investments	138	328	534
3. Highlight a Longer List of Protected Priorities			
Discretionary investments:			
Military readiness	55	127	183
Education trust fund	28	74	168
Veterans care	10	20	30
Biomedical research	10	20	30
Fund for American Agriculture	10	20	30
Investments for a Secure Future (reduced by priorities)	25	67	93
Total discretionary investments	138	328	534

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