ECONOMIC OVERVIEW

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INTRODUCTION

You have inherited a two-part challenge of historic proportions. On the one hand, the federal budget deficit threatens to keep capital costs high, drain savings needed to finance private sector investment, and prevent the United States from using fiscal and monetary policy to respond to future recessions. On the other hand, the United States also has a public investment deficit -- particularly in lifetime learning and infrastructure. Either challenge by itself would be daunting but manageable. Both challenges together, with their contradictory elements (cutting the deficit, while increasing investment) amount to a formidable task.

While the short-term and long-term decisions are linked together by a vision of investment-led growth and the need for a comprehensive strategy and message, it is still helpful to consider them separately.

The long-term challenge is to increase both public and private investment, so that the United States will enjoy faster productivity growth and a higher standard of living. We can't expect to finish this task or see all of the results of a successful productivity-enhancing strategy, even within the next eight years. We can, however, make real progress. You have the capacity to get America back on track, and to create an ethic and understanding of the national imperative to invest in our people and our economic future.

Our short-term challenge is that we are not fully utilizing our current productive capacity. As a result, many Americans are unemployed, underemployed, and underpaid. Developing a short-term strategy involves an assessment of how the U.S. economy will perform over the next six to twelve months, instead of the next six to twelve years. Our capacity to ensure a stronger, investment-led recovery may be the economic challenge we face that will most affect the American people over your first term.

In the short-term, you must decide whether the economy needs a stimulus package, and if so, its size and shape. Furthermore, you have to decide how it should be linked thematically, strategically and even legislatively with your long-term package.

For the long-term, this memo presents you with a Core Budget. The presentation of a Core Budget is designed to highlight the trade-offs you will have to consider in developing a five year budget. There are a number of unknowns, such as differing views on the feasibility of deep defense cuts or significant savings from improved management. The basic message of the Core Budget is that you can accomplish much of your investment agenda and achieve significant deficit reduction, <u>without</u> resorting to the most controversial options such as middle-class tax hikes or cuts in Social Security. However, if you want to pursue a more aggressive investment agenda, implement universal health care coverage, or reduce the deficit in half in five years, you will have to consider some of the more controversial budget deficit options.

PART I: SHORT-TERM AGENDA

1. CONSTRAINTS AND CALENDAR:

The decisions you will make will take place within various timetables and deadlines. This is discussed in greater depth in the Wellford, et. al. memo, see Supplemental Material Book I, Tab 2. Essentially, there are four main legal deadlines.

- **January 21st:** The Budget Enforcement Act of 1990 automatically adjusted the "maximum deficit amount", based on economic and technical readjustments in 1991, 1992 and 1993. This avoided the possibility of a sequestration arising from re-estimates of existing deficit estimates. For 1994 and 1995, however, the BEA gives the President the option to adjust to the maximum deficit amounts -- instead of making the adjustment automatic. The decision has to be made on January 21, 1992, the day after President-elect Clinton takes office. If the President does not make the adjustment, the possibility of a sequester exists and there is nothing the President can do to alter this for FY1995, short of changing the law. Since this adjustment to the maximum deficit amount has been automatic over the last three years, the decision by the President to do so should be a non-event. It is possible that political opponents would use this occasion to attack President Clinton for "raising the deficit" on his second day in office. Almost all of those we have spoken with, however, believe that the adjustment should be made.

- **February 1st:** This is the date specified in statute for submission of the President's Budget. Normally, the outgoing President submits a budget that meets the legal requirements and the incoming President submits a budget that revises the outgoing President's document. In this case, Bush does not plan on submitting a budget that will technically meet the legal requirements, which thus creates the scenario in which you could be seen as needing to submit a budget by February 1, 1993. The Senate Budget Committee's legal opinion on this issue is that the intent of the law was never to have the February 1 deadline apply to an incoming President. The Committee's opinion points out that no law has ever required a new President to submit a budget in his first year in office, and that there is nothing in the history of the 1990 BEA to suggest a different legislative intent. Since World War II, the earliest a new President has ever submitted a new budget was Bush's first budget, which he submitted on February 9. This case was hardly the equivalent of a "new" Administration assuming office. Prior to Bush, incoming Presidents have submitted their budgets as follows: Reagan on March 10, 1981; Carter on February 22, 1977; Nixon on April 12, 1969; Kennedy on March 24, 1961; and Eisenhower on April 30, 1953.

  To the degree that it is a concern, an extension can be granted. The law clearly allows for Congress to grant authorization for submission at a later date, and indeed, this is a common event. Congress authorized Bush to submit two weeks late in 1991, and President Reagan received authorization and extensions for his 1984 and 1986 budget. Furthermore, there are methods to meet the technical requirements of the budget law by February 1 through a partial submission, while releasing a more specific and detailed budget later in the year. In any case, as you know, the "political question" doctrine makes it highly unlikely that the Administration's interpretation would even be the subject of serious litigation. Therefore, it is not clear that this date must serve as any kind of a constraint on our budget plans. From a political perspective, the public will be most attuned to what President Clinton lays out in his first major economic address to the nation soon after taking office.

- **March 7th:** The latest extension of emergency unemployment benefits expires on March 7th. After this date, states have the option of providing additional weeks of benefits if the unemployment rate in the state exceeds certain triggers; these benefits would be 50 percent state-funded. However, 100 percent federally-funded emergency benefits would no longer be available. If an extension is desired, the legislation must be passed by March 7 to avoid a gap in unemployment benefits for some recipients.

- **March 15th:** This is what most people believe is the earliest approximate date by which the Debt Ceiling Limit will be reached.

- **October 1st:** Start of Fiscal Year 1994.

The Centrality of the March 15th Date: It is imperative that you demonstrate leadership on making the "tough choices" prior to the March 15 debt ceiling deadline. Historically, the extension of the debt ceiling is the legislative vehicle for raising almost all harsh deficit schemes and balanced-budget constitutional amendments. If there is a public sense that nothing has been done on the deficit side by March 15, the day the debt ceiling is reached could be Halloween for every spooky balanced budget policy that exists. Phil Gramm and Ross Perot will take center stage. This potential problem goes far beyond politics. It will determine whether the Clinton Administration maintains control of the agenda. If there is no sense of action by March 15, the Gramms may be able to seize the agenda and shift the debate to their terms. However, if by March 15, you have presented a serious investment strategy combined with credible deficit reduction, the entire dynamic will be different. A serious deficit reduction plan will cause a great deal of discomfort and will put the Clinton Administration under siege by every interest group that has been injured by the plan. As unpleasant -- yet necessary -- as this scenario is, it will demonstrate exactly the courage on the deficit that will take the legs out from anyone trying to build political momentum for a balanced budget amendment. If the public debate is dominated by President Clinton standing up to aggrieved interest groups because of his tough deficit choices, it will be difficult for the Perots and Gramms to build a political movement around -- "more pain please". By taking away the raison d'etre of the deficit absolutists, you will keep the public agenda on your terms: deficit cuts within the context of an effort to increase investment, cut consumption, stop something for nothing policies, and increase tax fairness.

A willingness to make these tough choices can be demonstrated in a major speech soon after the Inauguration. In addition, Alice Rivlin and Chairman Panetta are confident that they can present a budget in February. Some of the background budget memos attached include a previous assumption that since OMB is not preparing a complete budget, it would be hard for us to get one done until mid-March at best. However, Chairman Panetta and Alice Rivlin believe that they can begin work on the budget almost immediately, and that it is actually a help that the Bush Administration did not try to complete a full budget that we would have had to alter. Their view is that we have the capacity to present to Congress a preliminary budget in early February to start the budget resolution process, and that they could aim to complete a full budget by March 15.

Such two-part submissions have taken place under both the Reagan and Bush Administrations over the last 12 years. In 1987, Reagan submitted a brief -- less than one inch thick -- document on January 5 and then submitted a much more detailed "supplement" 23 days later. Indeed, even in 1992, President Bush submitted a second budget 15 days after delivering his usual huge budget, with many revised numbers.

2. SHORT-TERM STIMULUS:

Clearly, the threshold question you must answer is whether you believe some form of short-term stimulus package, taking place before the FY1994 budget, will help the economy. The logic of a stimulus package is that demand is too weak to propel the economy toward full capacity, and that the government should increase demand through additional deficit spending.

Thus, the primary question is whether or not we feel the economy is strong enough to be self-sustaining without a stimulus. Our line to date is that it is too early to tell. Summers and Altman found, after consulting many forecasters, that there were three basic economic scenarios without a fiscal stimulus. They found that since most forecasters are assuming some fiscal stimulus, they tend to assume somewhat greater growth than the "no fiscal stimulus" range of forecasts presented below:

> 1.(50% likelihood) **Moderate recovery. Growth during 1993 and averages 2.5-3.2 percent and unemployment declines to 6.8-7.0 percent from its current 7.2 percent.** Real wages grow slowly. Continuing structural changes and financial strains hold down employment and income growth, reducing consumer spending. The current growth momentum is maintained. There is still significant excess capacity in the economy by the end of the year. Inflation stays very low. Interest rates remain near their current levels, perhaps edging up slightly.
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> 2. (30% likelihood) **Rapid Recovery. The economy grows at 3.5 percent or higher during 1993 and the unemployment rate falls below 6.5 percent.** After two false starts, the current recovery proves to be real. Reduced financial strains on households, firms, and banks lead to increased borrowing and spending. The substantial corporate

restructuring of the last few years pay off in increased competitiveness. The absence of inflationary pressure allows the Fed to keep interest rates low even as demand picks up. Recent productivity gains continue and provide the basis for rising real wages which increase consumer confidence. Very affordable housing leads to revival in a key sector.

3.(20% likelihood) False start. **The economy grows at 2.5 percent or less over the next year and there are no appreciable declines in unemployment.** Consumer confidence, after rising following the election, turns down just as it did after Desert Storm. US exporters are badly hurt by slowdowns in Europe, Japan and Latin America. Continuing layoffs by large corporations hold down job and income growth. Interest rates fall as a weak economy reduces credit demand, and a nervous Federal Reserve eases. The stock market falls sharply as expected increases in 1993 profits do not materialize. With no strong sector, the economy stagnates.

Most economists agree that if we have a false start, we will definitely need a stimulus. Most also agree that if we have strong growth, a stimulus will probably be unnecessary. Because we are most likely headed toward the middle ground -- weak to moderate recovery -- this is not a self-evident call.

Furthermore, the above scenarios leave unanswered two remaining questions that will determine whether or not we will move towards a moderate-strong recovery. One is whether consumer demand will continue to increase. In the recent GDP numbers, as much as half of the increased consumer spending came from consumers dipping into their personal savings. That is clearly not sustainable unless incomes and jobs pick up. Summers finds it "very unlikely that growth in consumer spending can be maintained." Furthermore, while consumer confidence is up -- mostly due to the election -- it is still not high in historic terms and it is unclear if it can be maintained without a stronger economy. Certainly, the recent numbers on retail sales for the Christmas season were a good sign. Summers points out that consumer confidence also spurted after Desert Storm but then soon declined.

A second area of uncertainty is whether or not the financial strain that households and firms have suffered from is now behind us. It is now generally agreed that financial strain on indebted households and firms (especially on banks) has been a major factor behind the current economic slowdown. While the constraints on the recovery associated with high debt levels may have moderated as families have lowered their personal debts, and firms have issued equity and redeemed bonds, the Summers memo finds signs of continued strain. Namely, "the spread between the prime interest rate, which influences the interest cost of bank loans to businesses, and other short term interest rates is now at a record high, suggesting a continuing reluctance of banks to lend. While recent figures on bank lending suggest increased lending, the increase is largely due to several major corporations on the brink of bankruptcy running through their credit lines. Nonetheless, the worst financial strains are probably behind us."

Within this context, the most common arguments against a stimulus package are threefold:

1. Self-Sustaining Recovery: Many argue that with the strong third quarter GDP growth numbers and recent reductions in unemployment insurance claims, the recovery may be self-sustaining. The labor market is gradually strengthening. Households, firms and banks are not experiencing the financial strains that they have in recent years. Banks have enjoyed record profits, improved their balance sheets, and are poised to expand loans to the commercial and industrial sector.

2. The lag involved in any fiscal stimulus would be too long. Many economists doubt that increased infrastructure spending is likely to have any significant impact on the job market until early 1994. By the time legislation has been introduced and passed, bids have been made, and workers hired, the economy may no longer be in need of stimulus. Indeed, the stimulus can be inflationary by the time it actually affects the economy.

3. The "Backfire" Potential: Some believe that a fiscal stimulus package could spook financial markets and drive up interest rates. There is a further "backfire" effect if such demand kicks in at the wrong time and actually causes the Fed to tighten monetary policy and thus further increase interest rates. These higher interest rates will reduce private sector investment and damage long-term productivity. In other words, a stimulus package that is too large and too late could cause a recovery that is not sustainable because it triggers contractionary monetary policies. Larger deficits will also make it more difficult to mobilize support for significant new public investments. When and if the economy slows down in 1995-96, it will be impossible to stimulate it with expanded deficits.

On the other side, there are six common arguments for a stimulus:

1. It will bolster consumer confidence: This is probably the most important argument. Although consumer confidence increased following the election, this increase was based on the assumption that you would take action to accelerate short-term economic growth. Failure to act could damage consumer confidence, given continuing concerns about job loss. It's also worth noting that many forecasting firms predicting continued economic expansion in 1993 have already assumed that you will adopt a stimulus package of $20 to $30 billion.

2. It will help close the gap between actual and potential output: Due to lack of demand, the economy is now operating roughly 4 percent short of its potential to produce without inflationary pressure. Since potential output of the U.S. economy grows at least 2 percent per year, there is room for the economy to grow 12-14 percent over the next four years. Summers and Altman conclude that "the rate at which the current output gap is closed will be the dominant determinant of economic performance over the next several years". This gap is adding $60 billion to the deficit, reducing private sector investment by $50 billion, and costing 2 million jobs. Fiscal stimulus could help close this gap.

3. The risk of inflation is low: There is little risk that inflation will be rekindled, given the gap between actual and potential output. Recent GNP growth has been driven by increases in productivity (employees working longer hours), as opposed to job growth. This has put downward pressure on wages and prices.

4. The risk of a "false start" is real: To date, the economy has had two false starts. The possibility of another is small (20 percent) -- but economists believe it is serious enough to prepare a stimulus package as an insurance policy against it. Consumer confidence could fall after the election, as it did after Desert Storm. U.S. exporters could be hit hard by slowdowns in Europe, Japan, and Latin America. Continuing layoffs by large corporations could continue to hold down job and income growth.

5. It will create jobs: Perhaps the major question -- and the one that we posed at the Economic Conference -- is whether the economy is strong enough to stimulate sustainable private sector job growth. As you have often noted, there has been little job growth, even as the unemployment rate has dropped and we have experienced one strong quarter of GDP growth. While the November employment data did show 105,000 new jobs, over 40,000 of them were temporary election workers and only 45,000 were private sector jobs. Without strong job creation, there is no engine to increase incomes, savings, and demand.

Indeed, when one examines job growth, the last 19 months have been by far the weakest of any similar 19 months coming out of the bottom of any post-war recession. As Robert Solow showed in his presentation at the Economic Conference, this recovery has produced only one-seventh of the job growth of past recoveries. If this had been an average postwar economic recovery, the economy would have generated 3.6 million jobs, and the unemployment rate would be below 5 percent. The outlook for job growth is further clouded by announcements of major layoffs at companies such as IBM, which will reduce employment by 25,000 next year. While output has grown for the past six quarters, employment has not. As a consequence, the unemployment rate now is higher than it was at the likely trough of the recession, in the first quarter of 1991.

Katz and Cutler describe five stages to labor market activity in a typical recovery. First, firms stop laying off workers. We generally see this as a reduction in the number of new unemployment insurance claims. Second, firms begin to expand production, but they do this by working the existing labor force more intensively. This is manifested in more rapid productivity growth and increased overtime hours or the length of the average work week. Third, firms start to hire new workers, but typically for temporary work. This generally reflects hesitancy on the part of firms to commit to large expansions of the work force. Fourth, temporary jobs are turned into permanent jobs and firms hire new permanent workers. At this stage, however, many discouraged workers who were out of the labor force reenter the labor force and are counted as unemployed. Thus, the unemployment rate may not fall even as employment expands. Fifth, the unemployment rate falls because of expansions in employment without large changes in the labor force.

In the past several months, they find some evidence that we have moved into the first few stages, but we have yet to see sustained hiring of permanent workers. On the bright side, they find layoff activity has fallen -- though this was prior to the recent IBM announcement. Productivity has increased rapidly in the third quarter, about 3 percent on an annual basis and average weekly hours have increased slightly in the past two months.

In the most likely economic scenario, growth will average 2.5 to 3.2 percent in 1993, and unemployment will decline to 6.8 to 7.0 percent, from its current level of 7.2 percent. Summers and Altman believe that "as a rough rule of thumb, $20 billion of extra deficit spending during 1993 is likely to reduce the unemployment rate by early 1994 by 0.2 percent."

6. A Bias For Action on Jobs and the Economy: It may be that there will be no one clear view as to whether the current economic recovery is self-sustaining. In this case, we have to ask whether we should err on the "activist" or the "do nothing" side. One can argue that George Bush lost this election because he practiced four years of prudent, wait-and-see economics. With inflation low, the risks that a modest stimulus package will have a negative effect seem slight. By doing nothing, we are implicitly stating that we are satisfied with low job growth, and that we do not see ourselves as an active force in determining whether or not there will be a strong recovery. By doing nothing, we cannot take credit if the economy recovers, and we will be blamed if the economy deteriorates. If we are in a period of uncertainty, we might decide that we should err on the side of action and job creation, rather than on the side of caution and wait-and-see.

3. STIMULUS AND POLITICAL LINKAGES:

If the threshold decision is made that a stimulus package would be economically beneficial, there are two main linkage issues and one main procedural issue that must be resolved.

One linkage issue concerns the financial markets as well as public perception. If we announce only a deficit-increasing stimulus plan, bond markets might react negatively, driving long-term interest rates up. Some felt this happened during the campaign when a rumor that a stimulus plan was being considered appeared in the Los Angeles Times. On the other hand, some felt that this effect on the bond market was exaggerated and due to the undefined nature of the rumor. The markets may have already built-in an expectation that a modest stimulus package might be used. Indeed, most forecasters have built in a modest ($20 billion) stimulus into their models. Thus, one could argue that a stand-alone stimulus plan would not cause concerns in financial markets because they are already expecting it.

The problem with this logic is that financial markets also expect that a short-term stimulus plan will be linked to a long-term deficit reduction package. In this case, the lack of linkage between a short-term plan and a long-term deficit reduction plan would send the disturbing signal that the new Administration is not serious about deficit reduction.

This linkage between a short-term stimulus package and long-term deficit reduction may not have to be formal legislative linkage. In other words, since the issue is one of perception, the linkage can be done through making clear that the two items are part and parcel of the same economic program. This would be a serious but manageable policy and communications challenge. Perhaps one of the most common suggestions is to announce -- either through a speech or series of speeches -- such strong intent to cut the deficit, that the linkage is perceived by the public as well as the financial markets. The key to this linkage is a combination of specificity and courage. If a newly elected President proposes a specific short-term package, but also announces that he has a specific long-term plan to make some very difficult choices, the linkage will be real and the public confidence and financial market confidence issue may be solved.

The advantage of this "perception linkage" is that the tough long-term fights that may be contained in a the fiscal year 1994 package would not bog down a 1993 supplemental agreement needed to get the economy out of a slow period.

The second linkage issue is a legislative linkage issue. Some believe that the short-term stimulus and the long-term package must be linked legislatively. This linkage is compelled by what some see as a "sugar and tough medicine" rationale. They believe that if Congress is allowed to vote on a short-term stimulus package alone, you will be in a sense giving people the sugar for free, and later asking them to take the tough medicine with no sweeteners. To give a specific example: if our long-term plan called for an investment tax credit combined with some loophole closing for corporations, it would be easier to get the tough medicine passed if it was combined with the tax credit, than if you had already passed the investment tax credit and were looking for a vote solely on the corporate loopholes two months later.

Others support a legislative linkage on the grounds that there is a greater chance of passage of both packages if both rely on the reconciliation process.

The problem is that there is an inherent tension in this legislative linkage issue that seems nearly unsolvable. The entire rationale for doing a short-term stimulus package in a 1993 supplemental appropriations is that there is an urgent need to affect the economy before the new fiscal year starts on October 1, 1993. The longer a stimulus plan is held up, the more it loses its rationale. If a stimulus package is not passed until August 1993, at the very best, it can only take affect two months before the FY94 budget does. Thus, if we are attempting to meet our stimulus goal, our aim would be to pass it as soon as possible. However, our goals for the FY1994 budget are to have a "no-business-as- usual" budget with both strong new investments and tough choices on the deficit. History teaches us that the bolder our long-term package, the longer it will take pass. <u>In recent memory, there has never been a tough reconciliation package -- with real sacrifice -- that has been passed before the August recess. Only Reagan beat this</u>

date, and his was a package of tax cuts, not of shared sacrifice.

Thus, if we link legislatively the short-term and the long-term package, we may fail to meet one of our full objectives for either of these goals. The proposed bold long-term plan will ensure that we will delay the passage of the short-term package until it can do little good for the economy prior to October 1, 1993. On the other hand, if we were to pass both the short-term and the long-term package soon enough for the stimulus package to have some effect, the long-term package would have to be so un controversial that it would not meet our longer-term goals.

It does not seem that there are any procedural maneuvers that can diminish this inherent tension. Even if one tried to restructure the 1993 budget resolution to pass the long-term and short-term package within the reconciliation process, the same dilemma would persist: the bolder the long-term package, the more it would hold up -- and thus render ineffective -- the short-term package.

Therefore, if we are to move forward with the short-term stimulus package, we may have to do it separately. In considering the design of the stimulus package, we could consider options that do not necessarily carry over into FY1994, so that the extension of these options would still be available to sweeten the deal.

Thus, there seem to be two or three general paths one can take in determining whether or not to do a stimulus.

1. Choose not to do a stimulus package on the grounds that the economy is improving on its own and that it makes more economic sense to proceed with the long-term plan. To avoid leaving an "economic action gap," however, President Clinton will still be able to come forth immediately with a bold statement of his long-term economic agenda. While he would not be proposing a stimulus, the swiftness with which he proposed his plan to the nation would more than fill the expectation that he would take immediate action on the economy. He could also announce that he has an economic stimulus plan "ready to go" if the economy to weaken unexpectedly. This would make it clear that he is not engaged in George Bush's "wait and see" economics.

2. Send to the Hill an economic stimulus package immediately upon taking office. If the legislative stimulus package must be separated from the long-term package, it makes both economic and political sense to put it forth as quickly as possible. To address the perceptual linkage issue, the stimulus should be announced together (or within a day or two) of a speech that lays out some of the long-term deficit reduction steps.

3. Link stimulus with the passage of some tough medicine: It may be possible to consider packaging together some stimulus for the remainder of fiscal year 1993 with one or two tough deficit options that would take affect after the stimulus period was over.

4. COMPOSITION OF THE SHORT-TERM PACKAGE:

There is no magic combination of options for a short-term stimulus package. It is clear, however, that the package should be guided by four fundamental criteria:

1. Promote only long-term investments: We must avoid options that boost consumption. By developing a stimulus package that involves quicker implementation of long-term investment options (net investment tax credit) instead of short-term consumption options (across-the-board tax cut), we can help generate an "investment-led recovery." As we are choosing long-term investments for our stimulus package, we should also ensure that they have the highest rates of return possible.

2. Look for immediate economic impacts: Obviously, if the goal is to stimulate the economy immediately, we must pick investments with the shortest possible lags.

3. Do not sacrifice long-term goals: We should not rush or alter long-term goals just to meet the stimulus timetable. Where a program reform is significant, it may take time to properly design the change, and the degree of the change may be controversial and thus bog down the process. Therefore, it may be wiser to look for expansions of current programs that fit our long-term agendas unless there are new long-term programs (like the investment tax credit) that we are ready to put in place in January.[1]

4. **Look for new appropriations over new authorization:** All the stimulus options outlined above involve existing authorized programs that are not fully funded as opposed to programs that would require new authorizing language. Increased funding for authorized programs could occur through an supplemental appropriations bill that would go directly from the committees to a floor vote. The entire process (from the Administration's request to final passage) could occur in a few weeks. In contrast, programs that would involve new authorizations would take as long as several months due to the need for hearings, mark-up and drafting in the various authorizing committees. Once passed, these newly authorized programs would still need to go through the appropriations process.

5. SIZE OF THE STIMULUS PACKAGE:

Advocates of fiscal stimulus have proposed packages of between $20 and $60 billion. Many of those calling for stimulus have been less than clear as to whether they want "$30 billion" (or some other number) on an annualized basis, or how much they would actually want to see spent between the passage of the stimulus package and the end of the fiscal year on October 1, 1993. While Professors Solow and Tobin argue for a large stimulus, Bob Rubin, Laura Tyson, Larry Summers and most of the economists advising us believe that we should support a more modest stimulus in the $20-$25 billion range. Given that our transition team has found that most forecasters are already assuming that there will be a modest stimulus package of this size, it is unlikely to cause any harm, and may help accelerate economic growth.

Tobin and others argue that a $60 billion stimulus is only 1% of a $6 trillion economy, and that a stimulus of this magnitude is needed to move the economy toward full capacity. Furthermore, he feels that our nation's standards for growth are too low. He claims that this demand-push would also help long-term growth by spurring investment in new plant and equipment. Those arguing for a more modest stimulus contend that such a large stimulus package is risky. First of all, it may be difficult to spend so much money prudently in such a

[1] Another possible criteria is to look for initiatives that involve previously appropriated funds. These, in essence, are deficit neutral options over 2-5 years, in which local governments are given the option of getting an advance (or interest-free loan) on money going to them anyway in future years. In some ways, this seems ideal: state and local governments have the option to accelerate spending now when demand and thus revenues are down. Hopefully, a stronger economy in the outyears will help them generate the revenues they need to be make up for any shortfall. What is less clear is whether this ideal stimulus option works in reality, or whether state and local governments are not enthusiastic about taking a cut in federal funding in FY95 or FY96 in order to enjoy a greater stimulus now.

short period of time. Second, if we overestimate the degree to which the economy has excess capacity, a stimulus could lead to higher inflation.

6. DESIGNING A PACKAGE:

The stimulus options memo from Summers and Altman provides an impressive menu of options to choose from that meet the above criteria. While they provide an wide array of options, it may be best for us to present them within three central long-term themes:

- **Spurring long-term private sector investment for large and small businesses.**

- **Rebuilding America, through increased infrastructure spending and housing construction.**

- **Investing in our youth, by immediately expanding some investments in successful programs for children and young workers.**

Presenting a possible stimulus package in these three categories has several advantages. First, we avoid the perception of a lengthy laundry list by sending a clear message that is easy for us to communicate, and easier to build support for. Second, by presenting a three-part message, we highlight our key areas of our investment agenda and make clear that the short-term agenda is entirely consistent with our long-term plan; and that we are pursuing an "investment-led recovery."

One shift in emphasis that we should consider from the campaign to the actual package concerns investment in people versus investment in infrastructure. During the campaign we stressed infrastructure as central to the stimulus package, especially as this signified job creation to people in a very tangible way. However, during the transition process, many of our advisers have cautioned that most infrastructure projects may not provide a short-term stimulus. Even if some infrastructure projects are "on-the-shelf", it does not follow that they are truly "ready-to-go" in the time period needed to have a major job creation effect. Some infrastructure projects (e.g. repair and maintenance programs) could get out within a few months and have an impact prior to October 1, 1993. Overall, there seems to be a strong feeling that the mayors may have overstated the case for "ready-to-go" projects.

On the other hand, it may be easier to get money out for human investment projects over the next few months. A simple example is the youth summer jobs program. If the program is passed in time to add 200,000 summer youth jobs, that program -- by definition -- spurs demand and job creation prior to October 1, 1993. It also strengthens our long-term vision of investing in disadvantaged young people.

While there could be considerable variation on how one would design a stimulus package, the following is illustrative. It would aim to pay-out $20 billion, not annualized, but between its passage and the start of the new fiscal year.

1. Incentives for long-term private sector investment for large and small businesses: (1993 Cost: $8 billion)

1. Pass a permanent marginal investment tax credit ($7 billion);
2. Extend the R&D tax credit ($1 billion);
3. Venture capital/seed capital incentives; and
4. Credit access for small companies (immediate reform of banking regulation).

2. Rebuilding America, through increased infrastructure and housing construction: ($8 billion)

1. Repair and maintenance initiative ($6 billion);
2. Low-Income Housing Tax Credit ($1 billion); and
3. Enterprise Zones ($1 billion).

3. Investing in our Youth by immediately expanding some investments in successful programs for children and young workers. ($2 billion):

1. Summer Youth Jobs Program ($0.5 billion); and
2. Childrens' Initiative (Immunization/Head Start/Summer Demonstration Projects, Chapter 1) ($1.5 billion)

** **Unemployment Extension**: ($2.8 billion) While it does not fit neatly into one of the three investment areas mentioned above, it would probably be wise to include in the stimulus package the $2.8 billion that would be needed for extension of unemployment benefits.

Brief Summary of the Proposed Stimulus Components:

1. Marginal Investment Tax Credit: As is the case with many of the stimulus proposals, the decision about an ITC program should be based on its efficacy, its ease of introduction and a variety of political considerations. The credit's ability to encourage capital investment and ultimately increase productivity and employment is widely accepted. From Meyer Associates and DRI we have received estimates that a marginal investment tax credit can create 250,000-500,000 jobs in the first year alone. A serious concern with the credit is that some feel it locks

in tax advantages for companies that have not made large capital investments over the past several years and therefore have lower bases against which the credit would be calculated. Companies that have made large investments would have higher bases, so fewer of their investments would qualify for the credit. It is probably true, however, that most companies in the same industry would have similar investment patterns, so very few competitors would have an advantage on this basis.

The ITC will require careful drafting to address leasing programs, start-up companies that have no base, and acquisitions and dispositions. Any measure almost certainly would have to include retroactivity to prevent the postponement of investment while the program is being debated. Rostenkowski and Bentsen have already promised such retroactivity. The political arguments against the program will probably come from consumer advocates who will argue against the credit's efficacy in creating jobs and the fairness of granting businesses another tax break.

It should be noted, however, that the marginal investment tax credit is especially advantageous to start-up businesses. For a new business, all of its equipment purchases are above their "historic" base, and thus eligible for the tax credit. The marginal ITC is a strong incentive for new start-up businesses.

<u>2. Extend the R&D Tax Credit</u>: One of the most discouraging and irresponsible policies of recent Administrations was the failure to make the R&D tax credit and the low-income housing credit permanent. This failure meant that companies and community groups could not make the long-term plans essential to sustained growth and development. An immediate action to make these temporary programs permanent would not only provide valuable stimulus and incentives, but also demonstrate your commitment to long-term investment and research.

<u>3. Credit Access for Small Business</u>: With continuing layoffs at IBM and GM it is fairly clear that the small business sector will have to continue to be the engine of job creation. A strong signal is needed to reassure small business owners that the Administration both understands their importance to the economy and the role that the government needs to play in improving their access to credit.

A public expression that you understand the effect of the credit crunch on small business and will take all prudent steps to ameliorate the situation is an important first step. This expression should be quickly followed by the appointment of officials to fill vacant bank regulatory positions and an expression of your insistence that these officials work in concert to improve the situation. The section on stimulus options outlines specific measures that deserve consideration, as do the memos in the banking section. The real estate industry, which provides nearly 75% of all local tax revenues will be especially eager to hear your willingness to review bank lending strictures, since banks have purchased enormous amounts of Treasury notes in the past year with funds that might have been loaned to businesses.

4. Tax Incentives for Entrepreneurs: The Clinton-Gore position paper on small business essentially endorses Senator Bumpers' "Enterprise Capital Formation Act", which includes incentives for venture and seed capital. These incentives are estimated to cost $1 billion over the next five years. The Clinton-Gore Administration could signal its recognition of the importance of entrepreneurial firms by including incentives for venture and seed capital in its stimulus package.

Proposed incentives would provide an exclusion for capital gains on capital stock of two types of qualified companies: (1) venture capital -- companies with aggregate capitalization of less than $100 million; and (2) seed capital -- companies with aggregate capitalization of less than $5 million. Venture capital investments enjoy a 50 percent exclusion if held for five years or more. Seed capital investments enjoy the same 50 percent exclusion for a five year holding period, and an additional 10 percent exclusion per year for years 6 through 10. Other provisions would (1) allow investors to sell existing holdings and roll the proceeds tax-free into qualifying investments; and (2) allow tax-exempt investors such as pension funds to pass the capital gains exclusion through to the pension holders.

These proposals have a great deal of support in the entrepreneurial community. There is some concern that the revenue estimates are misleading because losses will occur outside of the "five year window" of the Joint Committee on Taxation. On the other hand, there is no way to predict how much these incentives could increase revenue by increasing economic growth and job creation.

4. Repair and Maintenance Initiative: Infrastructure spending has several attractive qualities. These investments create high-wage jobs, leverage local funds, increase long-term productivity and often have real environmental advantages. Not all of them, however, can begin immediately. Furthermore, increased funding may result in real debate over allocation. The most effective mechanism would be based on increased funding for ISTEA, with a requirement that the funds be spent on maintenance, capital purchases (buses, equipment, etc) and transit operating expenses (which might save transit jobs). Other possible uses include rail programs for track improvement, funds for airport improvement, and wastewater and drinking water projects. As outlined in the stimulus memo, the goal needs to be quick, efficient and strategic spending that provides long-term benefit. For example, the State Revolving Fund program could be amended to allow funds to be used for high-priority projects. This would address real environmental goals and the imperative to spend funds quickly.

5. Low-income Housing Credit: Like the R&D Tax Credit, the Low-Income Housing Credit is still not permanent and authority for the Credit expired in June due to the President's veto of HR 11. Early action to make the credit permanent would reassure community organizations that they could plan future developments and keep open the lines of credit and cooperation that they have developed with their corporate backers. The program creates good jobs and affordable housing and is one of a handful of programs that really allows corporations to invest in disadvantaged communities.

6. <u>Summer Jobs for Youth</u>: Each summer the Department of Labor distributes funds to local mayors through an existing allocation formula. These funds leverage corporate contributions and provide the basis for thousands of summer jobs. Given that each $1,200 in Federal funds creates an additional job, an increase in funding of $250 million would result in over 200,000 new jobs starting in June. In addition to the stimulative effect, the program sends a clear signal that disadvantaged youth, community redevelopment and job training are important priorities.

7. <u>Urban Park and Recreation Program (UPPAR)</u>: Like the Summer Jobs program, UPPAR puts thousands of youth to work improving their communities and learning valuable work skills. UPPAR has several real advantages as a stimulus option: new projects can begin within a few months of appropriations, the projects restore badly needed urban open spaces, and they employ disadvantaged youth. Most of these projects are more capital intensive than the Summer Jobs program so they would also benefit local suppliers and contractors.

8. <u>Child Immunization</u>: As much as any other issue, the Republican legacy of cutting funds for immunization programs symbolized their irresponsible attitude toward programs that have proven cost: benefit ratios. Immunization programs not only save $10 for every $1 spent, but they also serve disadvantaged communities that are in most need of preventive care. As a stimulus measure, the funds can be spent quickly to hire new staff and medicine with a complete understanding that the funds will have extremely positive long-term effects. Appropriation of $100 million in FY93 could be almost immediately spent on hiring 3,000-5,000 outreach workers who would help ensure that children who visit WIC centers, nonprofit poverty health sites and day care programs have access to immunizations. One suggestion is to have an Immunization Day, to galvanize support and workers for this effort.

9. <u>Head Start</u>: This incredibly successful program has gained almost universal support in Congress, which should extend to any effort to secure additional funding in FY93. The stimulative effect of new funding is fairly clear: job creation for teachers, drivers and administrators. One option is to use new funds for a Summer Head Start to experiment with making Head Start year-round program. Alternatively, funds could be spent on less comprehensive pilot projects that explored programs for children age 0-3, and day-long programs. All of these programs currently exist, so the stimulus can take effect quickly because they only need to be extended -- either more hours a day or over the summer. The major equity issue, however, is whether it makes sense to spend more money on kids already receiving Head Start when only one-third of eligible children are currently covered. However, if one interprets these supplemental funds as funds for further experimentation with one of the nation's most successful programs, it could be productive.

PART II: LONGTERM INVESTMENT -- FY1994 PACKAGE

The main purpose of this section is to give you some sense of the major trade-offs you will have to consider in putting together a Fiscal Year 1994 budget.

In Putting People First, you called for an average of $50 billion of new investment per year, plus an additional $15 billion for a middle-class tax cut. All of these investments were financed by raising taxes on the wealthiest Americans, cutting defense, attacking bureaucratic waste, and closing corporate loopholes.

We also stated that we could do this while cutting the deficit in half within four years. While our projections assumed a modest growth dividend, our ability to reduce the deficit in half was due to the fact that we paid for all of our new investment, and that the January CBO budget deficit baseline was projected to decline without policy changes.

We now face several challenges in meeting all of the Putting People First goals:

As we discussed previously, some of our management savings may not be scored by CBO unless we give more detailed descriptions of the cuts. There is also no agreement on how much money can be raised by closing transfer price abuses by foreign companies. This means that we must generate another $20 billion more a year in specific revenue increases or spending cuts to pay for the full-funding levels of all of our Putting People First initiatives. We can deal with this problem with modest cutbacks in our programs, or additional spending cuts we are prepared to support. Some of these cuts were discussed towards the end of the campaign.

In Putting People First, the universal health care proposal was financed through proposed and expected savings. It seems that the only way to identify those public sector health savings is to call for the specific cuts listed in the CBO deficit options book.

The major obstacle for the Clinton-Gore Administration in achieving the Putting People First agenda is the deterioration of the CBO baseline due to economic and technical changes and the delay in dealing with the costs of the S&L's. The baseline is now essentially flat, and simply paying for the new spending as we did in Putting People First still falls $100 billion short by FY1997.

In considering new deficit options, it is critical to understand that there is little new under the sun. Many bright people on the Hill have spent a great deal of time over the last several years searching for the least painful ways to cut the deficit. As we learned during the campaign -- and as those on the transition team saw during the transition -- there is a strong consensus on the Hill as to what are the most appropriate deficit options. Despite this consensus, these options have not been exercised because of the associated political difficulties. The line one hears most often is that "if it was easy, we would have already done it." Thus, there is no shortage of meritorious cuts that many people agree on: there is just a shortage of such deficit options one can do without substantial political costs.

1. PUTTING TOGETHER A PACKAGE: CORE AND EXTRA-CORE BUDGET

In considering your budget choices, a useful place to start is with what I refer to as a Core Budget. The key trade-offs outlined in the Core Budget are clear. You can promote a substantial, (albeit scaled-back) investment and deficit reduction agenda, without calling for highly controversial options. The Core Budget allows you to:

- Meet nearly all of your investment initiatives, although in a somewhat more modest form;
- Significantly reduce the deficit;
- Keep your pledge to cut middle-class taxes;
- Avoid any increase in taxes on the middle class; and
- Avoid any cuts on social security for the middle class.

Beyond the Core Budget: While the Core Budget does make clear how much can be achieved without harsh measures, it also makes clear two other stark realities. One, to even achieve the Core Budget you will have to push through many smaller cuts and fees that previous Administrations have found too politically difficult. Two, you will have to consider the toughest deficit options if you wish to go beyond the Core Budget to accomplish: (1) greater public investment; (2) a 50 percent reduction in the deficit over four years; and (3) universal health in your first term. The Core Budget contains generous funding for several health-related initiatives such as AIDS and women's health issues, but it does not include the funding necessary to move towards universal care.

2. ELEMENTS OF THE CORE BUDGET:

Even the Core Budget outlined below will call for a degree of sacrifice unprecedented in recent times. We should not underestimate the opposition the Clinton-Gore Administration would face to nearly all of these proposals. Listed below are 25 deficit reduction options that will stir substantial opposition from well-organized interest groups. It would be a bold step to call for all of them. The good news is that none of these measures are, in themselves, capable of stirring the same type of opposition as middle class taxes or cuts in Social Security that affect average Americans. Furthermore, the core budget meets your values. It is progressive; it is pro-investment; and it puts an end to "something for nothing" policies.

Specifically, the core budget still allows for over $50 billion in new investment or tax relief per year (and $10 billion for S&L costs), while bringing the deficit down by $80 billion in Fiscal Year 1997 alone. This will not please those who want to bring the deficit down in half in four years; nor will it please those who want more funding for new programs. As a point of departure, it is important to note how much you can accomplish with a balanced approach.

I. Investments: The Core Budget promotes additional efforts for nearly every major new initiative you called for in the campaign. In many cases, the costs are less than was proposed. To some degree, the decrease in costs may reflect the difficulty in starting up new programs. In other cases, it may reflect a decision to simply move at a slower pace in implementing a bold program. While you may wish to build up many of these initiatives beyond their proposed funding in the Core Budget, it should still be recognized how many new initiatives you would be promoting:

	FY 1997 (bn)
AIDS, Women's Health and Public Health Initiatives (1)	7.64
Infrastructure	9.70
Natural Resources Infrastructure	0.15
Environmental Technology (2)	0.79
Defense Conversion	3.70
Expand EITC (3)	4.20
Expanded JOBS	3.80
Child Support	0.50
Head Start	4.00
HIPPY	0.20
WIC	1.08
Children's Tax Allowance	9.72
Youth Apprenticeship	0.53
Chapter 1 Supplemental	0.58
Dislocated Worker Assistance Act	0.50
100,000 New Cops/Police Corps	1.25
Byrne Grants/Community Policing	0.90
SAFE Schools	0.10
Community Development Banks	0.19
Enterprise Zones	0.99
Perm. Extension of Low-Income Housing Tax Credit	0.30
Perm. Extension of the Mortgage Revenue Bond Program	0.20
R&D Tax Credit (4)	1.80
Technology (5)	5.40
ITC (Permanent, Incremental 10%) (6)	5.00[2]

[2] NOTES

1. Moderate cost proposal (there was no low cost proposal)
2. '96 numbers were used for '97 (no '97 numbers provided in options memo)
3. Low options for stimulus: $15 billion over 2 years ('93, '94)
   high options: $50 billion over five years
4. Low revenue estimates are the same as high estimates (all that is available)
5. This will not add to the deficit if funds are transferred from defense R&D
6. Levels for each year determined by averaging multi-year total estimate.

2. Deficit Reduction: Reducing the deficit in half in four years would require $150 billion in deficit reduction in FY 1997 alone. The Core Budget outlined below pays for all new initiatives and still reduces the deficit by $80 billion in FY1997. Reducing the deficit to around $220 billion in 1997 would stabilize the debt::GDP ratio. It also meets the standard that Summers lists as a reasonable amount of deficit reduction, although this is the minimum he believes is acceptable. Although this may not satisfy everyone, it would be a significant step, particularly if it could be shown that the deficit would be cut in half over six years.

3. Middle Class Tax Cut: The Core Budget keeps a middle class tax cut, but rather than rising to $17 billion a year and covering both singles and families, this tax cut would be targeted to provide an average of $300 more per child 10 years and under for middle class and low income families, and cost roughly $8 billion. For the millions of two-worker families, the cost of child care is great and the value of the child tax exemption has only a fraction of the value it had a couple of decades ago.

4. No Middle Class Tax Increases: The Core Budget takes a nearly absolutist approach to avoiding taxes on the middle class. Therefore it does not include "sin" taxes -- other than indexing them -- or any type of energy tax. This is not meant to pass judgment on any of these proposals. However, it seems important to know what can be done while meeting this standard because of the likely political firestorm that could erupt if taxes were raised.
Certainly, while "sin" taxes are listed in Level 2 deficit cuts, it may be the case that they are more popular than other deficit measures called for. Nonetheless, since they do have an impact -- usually regressive -- on the middle class and poor, these proposals should be weighed carefully before being adopted.

5. No Social Security Tax Cuts: While the Core Budget does include some Medicare cuts to providers, and does subject earnings above $80,000 to 85% taxation, the Core Budget does not contemplate cutting costs or raising taxes on the middle class when it comes to Social Security. Even the proposal to subject all Social Security above the thresholds to 85% income tax only raises $7.7 billion by 1997 and by that time will affect 26% of all recipients. Thus, deficit reduction from Social Security only comes with shared sacrifice from a wide number of people.

3. ADDITIONAL PRINCIPLES TO CONSIDER--PROGRESSIVE EXPENDITURE CUTS:

There currently exists a strong public perception that entitlements are out of control and that they must be cut. During the campaign, we stressed that the majority of those increases were directly attributable to rising health care costs.

To build public support for necessary cuts, we need to expand the perception of "entitlements" to include tax expenditures that are unnecessary or go to those who are relatively well-off. Indeed, a tax expenditure operates just like an entitlement. Several of the items proposed for cuts in the Core Budget -- and included in almost all of the papers that we have been given -- involve cuts in tax expenditures that benefit relatively wealthy Americans.

Average Americans should not be taxed more to ensure that high income Americans can benefit from these subsidies. These include: meals and entertainment deductions; mortgage deductions for $300,000 plus houses; deductions for lucrative pension benefits, and deductions for "Cadillac" health care plans. Limiting -- not eliminating -- the degree that these tax expenditures can benefit well-off Americans can save a total of $20-$45 billion a year. For example, limiting the health care deduction at a core amount can raise as much as $26 billion a year. Cutting these tax expenditures is not a tax hike, it is an entitlement cut on giveaways to well-off Americans. We should be building support for this highly defensible policy.

4. NOTES ON THE CORE BUDGET OPTIONS:

In devising a Core Budget, there are several major areas where the design and implementation of certain proposals can have substantial revenue effects.

1. Tax Increase on the Well-Off: There are several different options for raising taxes on the top 1% that approximate our proposal in Putting People First. In the Core Budget, the option chosen is the one that was vetoed in the March 1992 Growth package. That proposal would add a fourth rate that would raise taxes on income from 31% to 36% for singles with income above $115,000 and couples above $140,000. This is estimated by Rostenkowski to raise $12.9 billion in 1997, while an estimate we received during the campaign from the Joint Tax Committee had the number at $14.3. As this is based on taxable income, this is quite close to our proposal. Taxation of income for singles above $115,000 is probably close to the $150,000 in AGI we mentioned during the campaign, while taxing couples at $140,000 amounts to an average of $180,000 AGI -- quite close to the $200,000 we spoke of. Rostenkowski provides a series of other options close to this, yet most come in this range.

2. Middle Class Tax Cut: A major consideration is the $17 billion per year we allocate in Putting People First. During the campaign, we had the Joint Tax Committee -- through a confidential Congressional request -- develop a revenue estimate for our proposal. The $17 billion proposal would allow single couples making under $60,000 taxable income and $80,000 AGI to take an extra $300 per child (13 years and under), and allow singles to take an additional $150. As an alternative to either proceeding with our full Putting People First proposal or not pressing for a middle class tax cut at all, we could call for a refundable child credit averaging $300 for families making under $60,000 for each child under 10 years old.

3. Infrastructure: During the campaign, you called for $80 billion over four years for a "Rebuild America Fund" -- but this included many of the proposals which are being funded in the defense conversion and technology initiatives. In FY1997, the Core Budget calls for over $12 billion for infrastructure and defense conversion. This level saves $8 billion a year off Putting People First, while still making much-needed investments in our nation's infrastructure. It would provide full funding for ISTEA (Intermodal Surface Transportation Efficiency Act of 1991), as well as provide funding for substantial investments in airports, wastewater treatment, and drinking water. The "full funding" option ($71.6 billion over FY93-FY97) would underwrite an additional $18 billion of investment in highways, mass transit, and intelligent-vehicle highway systems; and $7.7 billion in rail, including high-speed systems.

4. **Human Investment Proposals:** The Domestic Policy book illustrates the capacity to make progress in your priority areas while saving funds from Putting People First. Head Start and WIC receive approximately the full-funding promised during the campaign. National Service, however, is proposed at $2 billion a year in FY 1997 (100,000 participants) as opposed to the $8 billion (500,000 students) we talked about during the campaign. Furthermore, the apprenticeship program was priced at $1.85 billion (FY93 - FY98), as opposed to the $10 billion promised during the campaign. Finally, EITC and welfare reform are proposed at almost $8 billion in new funding. Again, while this a very sizable increase, several scholars and experts believe that we need significantly more to ensure that everyone who wants to work, can work and do so out of poverty. The reason for pointing out these costs is to note that bolder funding for any or all of these proposals would probably require the more painful Second and Third Level deficit reduction options.

5. **Defense Cuts:** Some have suggested that it would be possible to cut $30 to $40 billion from the defense budget in FY97. The number generated by the Defense transition team for FY97 is $18 billion, however. Given the wide range of estimates as to what is feasible, you may wish to explore this further with your Secretary of Defense.

CORE BUDGET: REVENUES AND CUTS	Amount in FY'97 (US$ Billion)	Source
CURRENT PROJECTED BASELINE	$299	
NEW INVESTMENTS	60.41	
SAVINGS	144.66	
CONTRIBUTIONS TO DEFICIT REDUCTION	84.25	
CUMULATIVE INTEREST SAVINGS	7.00	
CORE PROJECTED DEFICIT	203.75	
REVENUES:		
Add 36% rate $115K/$140K taxable income	12.90	House Ways & Means
Increase Individual AMT from 24% to 28%	8.00	House Ways & Means
Make Pease permanent	4.50	House Ways & Means
Make PEP permanent	1.20	House Ways & Means
H.R. 11 (revenue raisers only)	2.2	House Ways & Means
Index all "sin" taxes for inflation	1.30	Transition Budget Team Estimate
Foreign Tax Avoidance	3.00	Estimate
Millionaires surtax	1.60	House Ways and Means
Lift $130,000 Medicare Wage Cap	7.00	CBO
FEES:		
Impose royalty payment on communications user of radio spectrum	2.00	CBO
Auction licenses to use the radio spectrum	0.80	CBO/House Budget Comm.
Establish user fees for air traffic control services	1.70	CBO
Establish charges for airport takeoff and landing slots	0.30	CBO
Extend Patent and Trademark Fee	0.10	CBO/House Budget Comm.

PMA debt	0.50	CBO
Fee for examination of state-charted banks	0.3	CBO
Impose User Fees on Inland Waterway System	0.40	CBO
Grazing fees	0.03	CBO/House Budget Comm.
Eliminate CSRS Morrill-Nelson	0.03	CBO/House Budget Comm.
Eliminate Wool and Mohair Price Support Program	0.20	CBO
Eliminate honey program	0.02	CBO
Eliminate the ship operating subsidy	0.20	CBO/House Budget Comm.
Coast Guard - 100% cost recovery	0.80	CBO/House Budget Comm.
Restrict Agency Match on thrift plan contributions to 50%	1.7	CBO/House Budget Comm.
Abolish the Interstate Commerce Commission	0.03	CBO
Eliminate 3 small education programs	0.10	CBO
Cancel Moon to Mars mission	0.10	CBO
TAX EXPENDITURES:		
Limit meals & entertainment deduction to 50%	3.50	CBO
Limit all home mortgages deduction to $300,000	4.20	CBO
Limit Deductions for Second Homes	0.4	CBO
Pension to 120,000 to $60,000	5.00	CBO
Replace 936 possess tax w/Wage Credit	3.00	CBO
CUTS:		
Defense	18.00	Defense Transition
Decrease pension contri. limits from 120K to 60K	5.0	CBO
End lump sum payments of federal retirement benefits	2.80	CBO

Management savings	10.00	Ira Magaziner estimate
Limit Ag Subsidies, $100K Non-farm income	0.15	1993 Bush Budget
Amortize Insurance	2.50	1990 Budget Negotiations
Cut highway demonstrations in half	0.80	CBO/House Budget Comm.
Restructure Federal Debt	4.0	CBO/House Budget Comm.
Eliminate Special HUD Grants	0.13	CBO
Reduce overhead on federally-sponsored university research	0.80	CBO
Streamline operation of Farm Agencies Offices	0.14	CBO
Reduce subsidies provided by Rural Electrification Administration	0.20	CBO/House Budget Comm.
Reduce spending on consultants	2.00	1/2 Transition Estimate
ENTITLEMENTS:		
Expenditure target of 8% for inpatient services	4.00	House Ways & Means
Reduce update by 2%	4.70	House Ways & Means
Medicare premium for income > $100,000	4.5	CBO
Expand Social Security tax to all new state/local employees	2.70	CBO
Limit Federal subsidy to 25% of SMI program	1.00	CBO
Costs for $100K single and 125K couple: single fee supervisory anesthesia	0.25	CBO
Adjust DME reimbursements to reflect market forces	0.14	CBO
Payment of lab services, lower cap from 88% to 76% of the median	1.30	CBO
3% Target Prices (CBO)	5.95	CBO

Expand State/Local Gov. Medicare Coverage	1.6	
Raise Medicare B; $100,000+	4.5	
Subject Soc. Sec 85% for $100,000+	1.5	
Raise share of acreage ineligible for deficiency payments	0.89	Domestic Policy
SECOND LEVEL:		
Increase cigarette tax to 48 cents Alcohol beverages to 416.00 per proof gallon	8.7	CBO
Capital Gains carryover	2.0	CBO
Oil Import tax/w energy credit	(12.3-4.0=) 8.3	CBO
Health exclusion	26.00	CBO
Inside build up	2.60	Domestic Policy
Amortize some advertising costs	2.60	CBO
Tax 85% of Social Security benefits at the current income thresholds	6.90	CBO
Tax on water pollutants	5.0	CBO
Fixed oil import fee	14.8	CBO
Limit Tax Deduc. to Core Benefit Package	26.0	CBO
3% Hospital Revenue Tax	15.0	CBO
3% Insurance Premium Surcharge	11.0	CBO
Defense	10(?)	Varying estimates
THIRD LEVEL:		
Carbon tax (@ $30/ton)	39.2	CBO
Gasoline tax ($.35/gallon)	30.80	CBO
85% no thresholds	25.8	CBO
Social Security COLAS	22.0	

Include Capital Gains in Last Return of Deceased	5.3	CBO
Limit Tax Deductions at 15%	79.4	CBO

4. WHAT THE CORE BUDGET LACKS:

As mentioned above, there are three basic reasons why you might wish to go beyond the Core Budget and consider some of the more painful Second and Third Level deficit options. One is to expand some of the major investment initiatives -- such as welfare reform or national service. This is the least problematic of the reasons since major expansions of such programs could take place at a cost of $5 billion.

The second would be to fully implement universal coverage. According to the Health Care group, the costs of fully implementing universal coverage would be $74 billion by FY97. Finally, to cut the deficit in half would require another $75 billion in deficit reduction. Thus, in the absence of unexpected economic growth, one would need to find an additional $150 billion in FY97 to go beyond the Core Budget, cut the deficit in half, and finance universal health care. While this may seem like a herculean task, there are certainly plausible options to achieve either of these goals.

1. **Universal Care:** As full coverage moves some people previously on Medicaid to the private sector, savings of $12 billion will leave a $62 billion gap. Health care cuts and heath care revenue raisers may be more politically palatable if they are tied to access.

Core Budget:

Combined Medicare Provider Cuts	'11.4
Lift $130,000 Wage Cap	7.0

Level 2 Cuts:

Sin Taxes	8.7
Limit Deductibility to $185/$335 Core	26.0
TOTAL:	52.4

By using $18.4 billion currently in the Core Budget, while raising sin taxes and limiting the deductibility of health insurance, one can get very close to paying for universal health care for FY1997.

Also, it is quite possible that the support for the two Level 2 options would increase dramatically if they were clearly dedicated to universal health care. Unions often object to the limitation of deductibility, as they tend to bargain generous health packages for their members above this core health package. In exchange for universal health care, many, including unions, might find this reform tolerable. Likewise, taxes on alcohol and cigarettes are often criticized for being regressive. However, there is a strong "externality" argument concerning each of these substances that justifies additional taxation. This economic externality argument is that these products impose additional costs on society in the form of extra health care costs for cancer and injuries from automobile accidents that are not represented in the costs charged by the producer. Taxing cigarettes and alcohol to pay for the health costs they impose on society makes good economic and common sense. These revenues would pay for a service -- universal heath care -- that would be most beneficial to working poor and middle class Americans fearful of losing their job and their health insurance.

2. Cutting the Deficit in Half: The Core Budget provides substantial deficit reduction -- even if $18 billion is dedicated to universal health care. Some may argue that we must cut the deficit deeper to ensure that real interest rates are low enough to stimulate private sector investment and reduce the national debt service. Even if we get the deficit down to $220 billion, we will still have the lowest savings rate in the industrialized world and far lower than at any time between 1960-1980. Nonetheless, these is no question that the only way to achieve such additional reductions are through dramatic Level 2 and Level 3 cuts.

Even some deficit hawks have called for a longer 7 to 10 year plan for reducing the deficit. Some may feel that as long as the Clinton-Gore Administration stays on a serious path, the failure to cut the deficit in half in exactly four years is not significant. Politically, it may be acceptable to show that you are on a path that will cut the deficit in half, but that due to poor economic performance (the weakest recovery in a half century) it would be wise to take one or two more years to ensure that too much demand is not taken out of the economy. Most likely, if you are displaying significant courage and making serious progress on reducing the deficit, it is unlikely that failure to bring the deficit in half will be that consequential.

Therefore, the main issue should be establishing confidence in the financial community, and determining how much deficit reduction is necessary for the health of the economy, compared to the long-term social return of using those resources for key investments. One basic reason for aiming for more deficit reduction is that deficits are generally higher than predicted. Therefore, one needs to aim for cutting the deficit substantially more, simply to ensure that we indeed reach the more modest goal of stabilizing Debt/GDP.

Another reason for going beyond the Core Budget in deficit reduction is that any bold move on a Level 2 or Level 3 Deficit option must be taken in the first 100 days of a first term, when the honeymoon is at its height. From this point of view, we will look back with regret at any cautious incrementalism later. This view, of course, must be balanced against the other goals of the Administration, such as health care, and it must be measured against the goals and promises set out during the campaign.

CONCLUSION

The purpose of setting out a Core Budget is to help crystalize the trade-offs that must be considered between conflicting budgetary and investment goals. It is easy for anyone to state the case for bold investments, low deficits and more health care in the abstract. However, the task at hand is to recognize, confront and decide the explicit trade-offs necessary to make a compelling budget. The Core Budget identifies what can and can't be done without significantly controversial deficit choices in the hope that this focuses the reader on how much he or she is willing to sacrifice for more investment, more health care or more deficit reduction, and thus serves as a useful vehicle for developing the first Clinton-Gore budget.

SUMMARY OF REVENUE OPTIONS
(In $ Billions)

	1994	1995	1996	1997	TOTAL	1998
Taxes -- Business Taxes/Deductions:						
Reduce Foreign Tax Avoidance	--	--	--	3.00		--
Repeal Deferral of Controlled Foreign Corp. Income	0.60	0.80	0.30	0.10	1.80	0.10
End Overseas Plant Incentives	0.60	0.80	0.30	0.10	1.80	0.10
Limit CEO Deductions	0.30	0.40	0.40	0.40	1.50	0.40
Limit Meals/Entertainment Deduction to 50%	1.60	3.40	3.40	3.50	11.90	3.60
Taxes -- Capital Gains:						
Tax Capital Gains Unrealized by Heirs	--	--	--	2.00		--
Stepped Up Basis for Capital Gains	0.00	0.00	1.40	1.70	3.10	2.00
Taxes -- Deductions/Exemptions/Credits:						
Limit Deductions for 2nd Homes and Debt to $100K	0.20	0.30	0.40	0.40	1.30	0.40
A: Limit all Home Mortgage Deductions to $300K	1.00	2.60	3.20	3.70	10.50	4.20
B: Limit Mortgage Int. Deductions $12K/$20K Return	1.50	4.20	5.00	6.00	16.70	6.80
Make Permanent Limit on Itemized Deductions	0.00	0.00	2.90	4.50	7.40	5.00
A: Make PEP permanent	0.00	0.00	0.00	1.20	1.20	1.30
B: Make PEP Permanent	0.00	0.00	0.00	3.00	3.00	--
Make Pease Permanent	0.00	0.00	2.00	4.50	6.50	4.60

SUMMARY OF REVENUE OPTIONS (In $ Billions)	1994	1995	1996	1997	TOTAL	1998
Repeal Deduction for Lobbying	0.10	0.10	0.10	0.10	0.40	0.10
End Exemption for Employer Paid Life Insurance	--	--	--	4.00		--
Replace Possessions Credit	0.20	0.40	0.50	0.50	1.60	0.60
A: Reduce Employer-Provided Parking Subsidies	4.00	4.00	4.00	4.00	16.00	4.00
B: Eliminate Employer-Provided Parking Subsidies	14.00	14.00	14.00	14.00	56.00	14.00
Taxes -- Estate Taxes:						
Estate Tax Carryover	--	--	--	2.00		--
Taxes -- Health Care Related:						
Health Care-Impose Tax Cap	9.90	16.10	19.00	22.20	67.20	25.80
Repeal $125K HI Cap	2.60	5.60	6.00	6.50	20.70	7.10
Taxes -- HR. 11						
H.R. 11 (revenue raisers only)	7.00	5.40	5.60	12.10	30.10	6.30
Taxes -- Personal Income:						
A: Add 36%, $115K/$140K, Millionaires Surtax	4.50	12.50	12.00	12.50	41.50	12.50
B: Add 36%, $115K/$140K, Millionaires Surtax	--	--	--	21.00		--
Increase Individual AMT to 28%	1.10	5.40	5.30	6.10	17.90	9.20
Elimination of Exclusion for Income Earned Abroad	--	--	--	1.70		--

SUMMARY OF REVENUE OPTIONS						
(In $ Billions)						
	1994	1995	1996	1997	TOTAL	1998
Taxes -- Sin:						
Increase Cigarette Tax to $.48/Pack	2.90	3.90	3.80	3.80	14.40	3.70
Increase All Alcohol Taxes to $16/Proof Gallon	3.90	4.90	4.90	4.90	18.60	5.00
Index All Sin Taxes for Inflation	0.20	0.60	0.90	1.30	3.00	1.60
Taxes -- Social Security						
Increase SS Benefits Included in AGI	5.60	6.20	6.90	7.70	26.40	--
A: Tax 85% of SS/RR Benefits, Current Inc. Thresholds	2.70	5.60	6.20	6.90	21.40	7.70
B: Tax 85% of SS/RR benefits w/index	3.20	5.00	5.00	5.00	18.20	5.00
Expand SS Tax to All New State/Local Employees	0.30	1.10	1.90	2.70	6.00	3.50
Taxes & Fees -- Consumption/Environmental:						
A: Full Value Added Tax w/Progressive Credit	0.00	47.00	70.00	73.00	190.00	77.00
B: 5% Value Added Tax	47.00	70.00	73.00	77.00	267.00	--
Excise Tax of $150/Ton on SOx	0.00	2.00	2.70	2.70	7.40	2.60
Excise Tax of $250/Ton on NOx	0.00	1.60	2.10	2.10	5.80	2.10
Excise Tax on $250/Ton on VOCs	0.00	1.90	2.60	2.60	7.10	2.60
Excise Tax of $150/Ton on Particulate Matter	0.00	0.60	0.80	0.80	2.20	0.80

SUMMARY OF REVENUE OPTIONS (In $ Billions)	1994	1995	1996	1997	TOTAL	1998
A: Increase Polluter Fines	1.80	2.50	2.90	2.90	10.10	2.90
B: Polluters Fines/Taxes	13.30	17.70	17.70	17.60	66.30	17.60
A: Increase Motor Fuels Taxes by $.10/gallon	12.50	22.30	32.00	41.00	107.80	50.00
B: Gas Tax ($.07/gallon)	7.50	7.60	7.60	7.70	30.40	7.80
C: Gas Tax ($.35/gallon)	7.50	15.20	22.80	30.80	76.30	39.00
D: Extend $.025 Gas Tax (expires in FY96)	--	--	--	2.50		--
A: Ozone Depleting Substances Tax (HCFC)	0.08	0.11	0.13	0.15	0.47	0.18
B: Ozone Depleting Subst. Tax (HCFC+Methyl Bromide)	0.22	0.28	0.32	0.35	1.17	0.40
A: Tax on Water Pollutants	1.50	2.00	2.00	2.00	7.50	2.00
B: Tax on Water Pollutants	3.70	5.00	5.00	5.00	18.70	5.00
Tax on Ag. Chemicals that Pollute	0.70	1.00	1.00	1.00	3.70	1.00
Broad Based Tax on Lead (HR 2922)	0.70	1.00	0.90	0.80	3.40	--
Fixed Oil Import Fee	8.80	10.80	11.30	11.80	42.70	12.30
Excise Tax 3% on Imported Petr. and Refined Products	1.50	1.60	1.70	--	4.80	--
Floor Price for Domestic Oil Production	1.00	1.00	1.00	1.00	4.00	--
A: Carbon Tax ($5/ton)	7.50	7.60	7.60	7.70	30.40	7.80
B: Carbon Tax ($25/ton)	7.50	15.20	22.80	30.80	76.30	39.80

SUMMARY OF REVENUE OPTIONS (In $ Billions)	1994	1995	1996	1997	TOTAL	1998
A: BTU Tax ($.10/mmBtu)	7.50	7.60	7.60	7.70	30.40	7.80
B: BTU Tax ($.5/mmBtu)	7.50	15.20	22.80	30.80	76.30	39.80
Fees -- User :						
Raise Fees for Uranium Enrichment	0.20	0.20	0.20	0.20	0.80	0.20
Raise Rates for Federal Hydro-electric Power	0.00	0.30	0.30	0.20	0.80	0.20
Impose User Fees on the Inland Waterway System	0.40	0.40	0.40	0.40	1.60	0.40
Impose a Royalty Payment on Users of Radio Spectrum	1.50	1.60	1.80	1.90	6.80	2.00
Auction Licenses to Use the Radio Spectrum	0.00	0.00	1.70	1.80	3.50	0.00
Charge for Examination of State-Chartered Banks	0.20	0.30	0.30	0.30	1.10	0.30
Establish User Fees for Air Traffic Control Services	0.70	1.50	1.60	1.70	5.50	1.70
Establish Charges for Airport Takeoff and Landing Slots	0.30	0.30	0.30	0.30	1.20	0.30
Raise Coast Guard Fees	0.70	0.70	0.80	0.80	3.00	0.80
Charge a Fee for SMI Claims Not Billed Electronically	0.20	0.30	0.20	0.20	0.90	0.10
Weather Service Fees	0.01	0.01	0.01	0.01	0.02	--
Prisoner Use Fee	0.05	0.05	0.05	0.05	0.19	--

SUMMARY OF REVENUE OPTIONS
(In $ Billions)

	1994	1995	1996	1997	TOTAL	1998
BATF User Fee	0.01	0.01	0.01	0.01	0.02	--
Extend Patent and Trademark Fees	--	--	--	0.10		--
Extend Custom's User Fees	--	--	--	0.80		--
Grazing Fees	0.02	0.03	0.03	0.03	0.11	--
Health Care Reform:						
Limit Tax Deduc. to Core Benefit Package	10.00	17.00	21.00	26.00	74.00	33.00
3% Hospital Revenue Tax	11.00	12.00	14.00	15.00	52.00	17.00
3% Insurance Premium Surcharge	9.00	10.00	10.00	11.00	40.00	12.00
Medicare:						
IME to 3%	1.60	1.90	2.10	2.30	7.90	2.50
Establish Prospect. Paymt. for Hospital Outpatient	--	--	--	0.80		--
Home Health Co-Insurance	1.90	2.50	2.70	3.00	10.10	3.30
Income Related Premium (125K/150K)	0.30	1.20	1.20	2.40	5.10	4.30
Elim. Wage Cap for Medicare Hosp. Fund Payroll Tax	3.00	6.00	7.00	7.00	23.00	8.00
Medicare Premium for Income >$100,000	1.20	1.20	2.50	4.50	9.40	--

SUMMARY OF REVENUE OPTIONS						
(In $ Billions)						
	1994	1995	1996	1997	TOTAL	1998
Tax Both Portion of Medicare for Inc>Threshold	4.70	5.60	6.70	8.00	25.00	--
Increase Medicare-B Premium for Income Over $125K	0.60	1.00	1.00	1.80	4.40	2.70
Tax Medicare HI + 75% SMI benefits	1.80	4.70	5.60	6.70	18.80	8.00
Expand Medicare to State &Local Employees	1.20	1.70	1.70	1.60	6.20	1.60
Expenditure Target 8% for Inpatient Services	--	--	--	4.00		--
Occupancy Penalty for Capital Payments	--	--	--	0.80		--
Apply Relative Values to Overhead	--	--	--	0.30		--
Reduce Payments for Laboratory Services	--	--	--	0.50		--
Reduce Grad. Medical Ed. for Specialists in Oversupply	--	--	--	0.30		--
Limit Variation by Hospital in GME Payments	--	--	--	0.10		--
Penalty for Paper Claims	--	--	--	0.10		--
Pension Contribution Limits:						
Decrease Pension Contrib. Limits from 120k to 60k	--	--	--	5.00		--

Note: "A", "B", and "C" indicate various versions of a policy option, or differing revenue estimates for the same policy option

SUMMARY OF COSTS							
(In $ Billions)							
LOW COST	**1993**	**1994**	**1995**	**1996**	**1997**	**TOTAL**	**1998**
Health Care:	**0.00**	**5.30**	**6.05**	**6.85**	**23.84**	**42.03**	**47.86**
National Health Care Reform	0.00	0.00	0.00	0.00	16.00	16.00	39.00
Long-Term Care and Personal Assistance Services	0.00	0.10	0.10	0.10	0.20	0.50	0.20
AIDS, Women's Health and Pub. Health Initiatives (1)	0.00	5.20	5.95	6.75	7.64	25.53	8.66
Rebuild America:	**10.70**	**12.40**	**12.00**	**11.90**	**13.40**	**60.40**	**5.10**
Highways, Bridges and Mass Transit	4.30	4.00	3.40	3.00	4.50	19.20	0.00
High Speed and Other Rail (2)	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Airports and Aviation (3)	1.00	0.50	0.40	0.30	0.20	2.40	0.10
Waste Water Treatment (3) (4)	2.00	3.00	3.00	3.00	3.00	14.00	3.00
Drinking Water Supply (3) (5)	2.00	2.00	2.00	2.00	2.00	10.00	2.00
Defense Firms	0.20	0.50	0.70	0.80	1.00	3.20	0.00
Defense Workers	0.20	0.40	0.50	0.80	0.70	2.60	0.00
Local Communities	1.00	2.00	2.00	2.00	2.00	9.00	0.00
Environment and Energy:	**0.16**	**0.15**	**0.13**	**0.15**	**0.15**	**0.74**	**0.00**
Natural Resources Infrastructure	0.00	0.10	0.13	0.15	0.15	0.53	0.00
Energy Conservation (6)	0.15	0.00	0.00	0.00	0.00	0.15	0.00
Federal Energy Efficiency Fund	0.01	0.05	0.00	0.00	0.00	0.06	0.00
Environmental Technology: (13)	**0.37**	**0.65**	**0.79**	**0.79**	**0.79**	**3.38**	**0.00**
R&D (NSF & Env. Tech. Centers)	0.25	0.36	0.47	0.58	0.58	2.24	0.00
Stimulate Commercializaion of Env. Tech. (3)	0.05	0.14	0.15	0.16	0.16	0.66	0.00
Convert Fed. Cars to Nat. Gas and Electric	0.04	0.05	0.05	0.05	0.05	0.22	0.00
Eliminate Purchase of CFC Cooling Units (3)	0.02	0.08	0.08	0.00	0.00	0.18	0.00
Convert Fuel Oil Fed. Bldgs. to Natural Gas (3)	0.01	0.03	0.05	0.00	0.00	0.09	0.00

SUMMARY OF COSTS (In $ Billions)							
LOW COST	**1993**	**1994**	**1995**	**1996**	**1997**	**TOTAL**	**1998**
Finance: (3)	**70.00**	**10.00**	**10.00**	**10.00**	**10.00**	**110.00**	**0.00**
RTC S&L Insurance Fund	60.00	0.00	0.00	0.00	0.00	60.00	0.00
Infrastructure Bank	10.00	10.00	10.00	10.00	10.00	50.00	0.00
Defense Program Increases:	**0.00**	**1.05**	**1.55**	**1.80**	**2.40**	**6.80**	**2.65**
National Service:	**0.00**	**0.35**	**1.10**	**1.80**	**2.10**	**5.35**	**2.40**
Welfare Reform:	**0.70**	**1.80**	**3.80**	**7.00**	**8.50**	**21.80**	**10.40**
Expand EITC (7)	0.70	1.00	2.00	4.00	4.20	11.90	4.40
Expanded JOBS	0.00	0.60	1.50	2.60	3.80	8.50	4.00
Child Support	0.00	0.20	0.30	0.40	0.50	1.40	2.00
Children & Families:	**0.00**	**6.53**	**13.76**	**15.19**	**16.58**	**52.06**	**17.67**
Family Preservation Services	0.00	0.10	0.22	0.30	0.32	0.94	0.34
Tax Deduction for Adoption	0.00	0.02	0.02	0.02	0.02	0.08	0.02
Grants for Licensing and Monitoring	0.00	0.03	0.03	0.03	0.03	0.10	0.03
Head Start	0.00	1.00	2.00	3.00	4.00	10.00	5.00
HIPPY	0.00	0.20	0.20	0.20	0.20	0.80	0.20
WIC	0.00	0.36	0.57	0.78	1.08	2.79	1.11
Dependent Care Tax Credit	0.00	0.05	1.12	1.14	1.20	3.51	1.25
Children's Tax Allowance	0.00	4.77	9.60	9.72	9.72	33.81	9.72
Teenage Pregnancy Prevention Strategy	0.00	0.01	0.01	0.01	0.01	0.03	0.01

SUMMARY OF COSTS (In $ Billions)							
LOW COST	1993	1994	1995	1996	1997	TOTAL	1998
Education & Training:	0.28	1.34	2.12	2.60	3.11	9.45	3.62
National Education Goals Panel	0.03	0.03	0.04	0.04	0.04	0.18	0.04
State and Local Reform Grants	0.00	0.05	0.10	0.15	0.20	0.50	0.20
Urban Reform	0.00	0.13	0.13	0.13	0.13	0.50	0.13
Youth Apprenticeship	0.00	0.08	0.18	0.33	0.53	1.10	0.75
Chapter 1 Supplemental	0.25	0.52	0.54	0.56	0.58	2.45	0.61
Office of Ed. Research and Improvement (Reauth.)	0.00	0.01	0.01	0.01	0.00	0.04	0.00
Quality Workforce Development Act	0.00	0.03	0.63	0.89	1.14	2.67	1.40
Dislocated Worker Assistance Act	0.00	0.50	0.50	0.50	0.50	2.00	0.50
Crime Strategy:	0.21	2.64	2.34	2.79	2.84	10.82	2.89
100,000 New Cops/Police Corps	0.15	0.91	0.75	1.20	1.25	4.26	1.30
Byrne Grnts/Community Policing	0.06	0.90	0.90	0.90	0.90	3.66	0.90
Brady Bill	0.00	0.10	0.00	0.00	0.00	0.10	0.00
Criminal Justice Drug Testing/Treatment	0.00	0.10	0.10	0.10	0.10	0.40	0.10
Medications Development Program	0.00	0.02	0.02	0.02	0.02	0.10	0.02
Drug Treatment Research	0.00	0.15	0.15	0.15	0.15	0.60	0.15
SAFE Schools	0.00	0.10	0.10	0.10	0.10	0.40	0.10
Gang Prevention Grants	0.00	0.10	0.10	0.10	0.10	0.40	0.10
Domestic Violence/Rape Grants	0.00	0.15	0.12	0.12	0.12	0.51	0.12
White Collar Crime	0.00	0.05	0.05	0.05	0.05	0.20	0.05
Law Enforcement Family Support	0.00	0.01	0.00	0.00	0.00	0.01	0.00
Rural Crime Initiative	0.00	0.05	0.05	0.05	0.05	0.20	0.05

SUMMARY OF COSTS							
(In $ Billions)							
LOW COST	**1993**	**1994**	**1995**	**1996**	**1997**	**TOTAL**	**1998**
Community Empowerment:	**0.78**	**1.33**	**1.76**	**2.01**	**2.27**	**8.15**	**2.50**
Community Development Banks	0.00	0.13	0.15	0.17	0.19	0.64	0.21
Enterprise Zones	0.28	0.40	0.56	0.77	0.99	3.00	1.18
Perm. Extension of Low-Income Housing Tax Cred.	0.30	0.30	0.30	0.30	0.30	1.50	0.30
Perm Extension of the Mortgage Revenue Bond Prog.	0.20	0.20	0.20	0.20	0.20	1.00	0.20
Homelessness Rehab. Grant Program	0.00	0.05	0.05	0.05	0.05	0.20	0.05
Moving to New Opportunities	0.00	0.25	0.50	0.52	0.54	1.81	0.56
Technology/Mfg./Small Business:	**0.12**	**2.72**	**5.08**	**7.10**	**7.32**	**22.34**	**2.23**
R&D Tax Credit (3)	0.00	0.80	1.40	1.60	1.80	5.60	2.10
SBA Loans	0.12	0.05	0.00	0.00	0.00	0.17	0.00
Export Promotion	0	0.07	0.08	0.10	0.12	0.37	0.13
Technology (8)	0.00	1.80	3.60	5.40	5.40	16.20	0.00
Tax Incentives:	**10.00**	**10.00**	**10.00**	**10.00**	**10.00**	**50.00**	**0.00**
ITC (Permanent, Incremental 10%) (9)	10.00	10.00	10.00	10.00	10.00	50.00	0.00
TOTAL -- LOW COSTS	**93.33**	**61.55**	**76.51**	**86.83**	**127.12**	**445.34**	**145.17**

SUMMARY OF COSTS							
(In $ Billions)							
HIGH COST	**1993**	**1994**	**1995**	**1996**	**1997**	**TOTAL**	**1998**
Health Care:	**0.00**	**19.06**	**38.43**	**69.95**	**94.60**	**222.03**	**116.50**
National Health Care Reform	0.00	10.00	28.00	44.00	61.00	143.00	71.00
Long-Term Care and Personal Assistance Services	0.00	0.00	0.00	14.00	20.00	34.00	30.00
AIDS, Women's Health and Public Health Initiatives	0.00	9.06	10.43	11.95	13.60	45.03	15.50
Rebuild America	**17.38**	**23.78**	**23.28**	**27.08**	**29.48**	**121.00**	**7.55**
Highways, Bridges and Mass Transit	6.30	8.00	7.40	7.00	8.50	37.20	0.00
High Speed and Other Rail (10)	1.28	0.78	0.78	2.68	2.58	8.10	2.45
Airports and Aviation	1.00	0.50	0.40	0.30	0.20	2.40	0.10
Waste Water Treatment (11)	2.00	3.00	3.00	3.00	3.00	14.00	3.00
Drinking Water Supply (12)	2.00	2.00	2.00	2.00	2.00	10.00	2.00
Defense Firms	2.20	3.50	3.70	5.80	7.00	22.20	0.00
Defense Workers	1.50	4.00	4.00	4.30	4.20	18.00	0.00
Local Communities	1.10	2.00	2.00	2.00	2.00	9.10	0.00
Environment and Energy:	**0.85**	**1.00**	**1.25**	**1.40**	**1.40**	**5.90**	**0.65**
Natural Resources Infrastructure	0.68	0.70	0.75	0.75	0.75	3.63	0.00
Energy Conservation	0.15	0.20	0.30	0.35	0.35	1.35	0.35
Federal Energy Efficiency Fund	0.03	0.10	0.20	0.30	0.30	0.93	0.30
Environmental Technology: (13)	**0.68**	**1.60**	**1.85**	**1.84**	**1.84**	**7.82**	**0.00**
R&D (NSF, Tech. Centers, and interagency program)	0.25	0.46	0.67	0.78	0.78	2.94	0.00
Stimulate Commercializaion of Env. Tech.	0.05	0.14	0.15	0.16	0.16	0.66	0.00
Convert Fed. Cars to Nat. Gas and Electric	0.35	0.90	0.90	0.90	0.90	3.95	0.00
Eliminate Purchase of CFC Cooling Units	0.02	0.08	0.08	0.00	0.00	0.18	0.00
Convert Fuel Oil Fed. Bldgs. to Natural Gas	0.01	0.03	0.05	0.00	0.00	0.09	0.00

SUMMARY OF COSTS							
(In $ Billions)							
HIGH COST	**1993**	**1994**	**1995**	**1996**	**1997**	**TOTAL**	**1998**
Finance:	**70.00**	**10.00**	**10.00**	**10.00**	**10.00**	**110.00**	**0.00**
RTC S&L Insurance Fund	60.00	0.00	0.00	0.00	0.00	60.00	0.00
Infrastructure Bank	10.00	10.00	10.00	10.00	10.00	50.00	0.00
Defense Program Increases	**0.00**	**1.05**	**1.55**	**1.80**	**2.40**	**6.80**	**2.65**
National Service:	**0.00**	**0.35**	**1.10**	**1.80**	**2.10**	**5.35**	**2.40**
Welfare Reform:	**0.70**	**1.80**	**3.80**	**7.00**	**8.50**	**21.80**	**10.40**
Expand EITC (7)	0.70	1.00	2.00	4.00	4.20	11.90	4.40
Expanded JOBS	0.00	0.60	1.50	2.60	3.80	8.50	4.00
Child Support	0.00	0.20	0.30	0.40	0.50	1.40	2.00
Children & Families:	**0.00**	**6.53**	**13.76**	**15.19**	**16.58**	**52.06**	**17.67**
Family Preservation Services	0.00	0.10	0.22	0.30	0.32	0.94	0.34
Tax Deduction for Adoption	0.00	0.02	0.02	0.02	0.02	0.08	0.02
Grants for Licensing and Monitoring	0.00	0.03	0.03	0.03	0.03	0.10	0.03
Head Start	0.00	1.00	2.00	3.00	4.00	10.00	5.00
HIPPY	0.00	0.20	0.20	0.20	0.20	0.80	0.20
WIC	0.00	0.36	0.57	0.78	1.08	2.79	1.11
Dependent Care Tax Credit	0.00	0.05	1.12	1.14	1.20	3.51	1.25
Children's Tax Allowance	0.00	4.77	9.60	9.72	9.72	33.81	9.72
Teenage Pregnancy Prevention Strategy	0.00	0.01	0.01	0.01	0.01	0.03	0.01

SUMMARY OF COSTS							
(In $ Billions)							
HIGH COST	**1993**	**1994**	**1995**	**1996**	**1997**	**TOTAL**	**1998**
Education & Training:	**0.28**	**1.34**	**2.12**	**2.60**	**3.11**	**9.45**	**3.62**
National Education Goals Panel	0.03	0.03	0.04	0.04	0.04	0.18	0.04
State and Local Reform Grants	0.00	0.05	0.10	0.15	0.20	0.50	0.20
Urban Reform	0.00	0.13	0.13	0.13	0.13	0.50	0.13
Youth Apprenticeship	0.00	0.08	0.18	0.33	0.53	1.10	0.75
Chapter 1 Supplemental	0.25	0.52	0.54	0.56	0.58	2.45	0.61
Office of Ed. Research and Improvement (Reauth.)	0.00	0.01	0.01	0.01	0.00	0.04	0.00
Quality Workforce Development Act	0.00	0.03	0.63	0.89	1.14	2.67	1.40
Dislocated Worker Assistance Act	0.00	0.50	0.50	0.50	0.50	2.00	0.50
Crime Strategy:	**0.21**	**2.64**	**2.34**	**2.79**	**2.84**	**10.82**	**2.89**
100,000 New Cops/Police Corps	0.15	0.91	0.75	1.20	1.25	4.26	1.30
Byrne Grnts/Community Policing	0.06	0.90	0.90	0.90	0.90	3.66	0.90
Brady Bill	0.00	0.10	0.00	0.00	0.00	0.10	0.00
Criminal Justice Drug Testing/Treatment	0.00	0.10	0.10	0.10	0.10	0.40	0.10
Medications Development Program	0.00	0.02	0.02	0.02	0.02	0.10	0.02
Drug Treatment Research	0.00	0.15	0.15	0.15	0.15	0.60	0.15
SAFE Schools	0.00	0.10	0.10	0.10	0.10	0.40	0.10
Gang Prevention Grants	0.00	0.10	0.10	0.10	0.10	0.40	0.10
Domestic Violence/Rape Grants	0.00	0.15	0.12	0.12	0.12	0.51	0.12
White Collar Crime	0.00	0.05	0.05	0.05	0.05	0.20	0.05
Law Enforcement Family Support	0.00	0.01	0.00	0.00	0.00	0.01	0.00
Rural Crime Initiative	0.00	0.05	0.05	0.05	0.05	0.20	0.05

SUMMARY OF COSTS							
(In $ Billions)							
HIGH COST	**1993**	**1994**	**1995**	**1996**	**1997**	**TOTAL**	**1998**
Community Empowerment:	**0.78**	**1.33**	**1.76**	**2.01**	**2.27**	**8.15**	**2.50**
Community Development Banks	0.00	0.13	0.15	0.17	0.19	0.64	0.21
Enterprise Zones	0.28	0.40	0.56	0.77	0.99	3.00	1.18
Perm. Extension of Low-Income Housing Tax Cred.	0.30	0.30	0.30	0.30	0.30	1.50	0.30
Perm Extension of the Mortgage Revenue Bond Prog.	0.20	0.20	0.20	0.20	0.20	1.00	0.20
Homelessness Rehab. Grant Program	0.00	0.05	0.05	0.05	0.05	0.20	0.05
Moving to New Opportunities	0.00	0.25	0.50	0.52	0.54	1.81	0.56
Technology/Mfg./Small Business:	**0.20**	**4.23**	**7.52**	**10.73**	**10.94**	**33.61**	**2.10**
R&D Tax Credit	0.00	0.80	1.40	1.60	1.80	5.60	2.10
SBA Loans	0.20	0.32	0.00	0.00	0.00	0.52	0.00
Export Promotion	0	0.10	0.12	0.13	0.14	0.49	0.00
Technology (8)	0.00	3.00	6.00	9.00	9.00	27.00	0.00
Tax Incentives:	**10.00**	**10.00**	**10.00**	**10.00**	**10.00**	**50.00**	**0.00**
ITC (Permanent, Incremental 10%) (9)	10.00	10.00	10.00	10.00	10.00	50.00	0.00
TOTAL HIGH COST	**101.09**	**84.70**	**118.75**	**164.18**	**196.06**	**664.78**	**168.93**

Assumptions:

1. moderate cost proposal (there was no low cost proposal)
2. "Env., Energy, and Natural Resources Options" memo suggests $150 million in '93, increasing to $400 million in '97
3. low revenue estimates are the same as high esimates (all that is available)
4. "Env., Energy, and Natural Resources Options" memo suggests $2.7 billion in '93 and '94 for sewage and wastewater treatment plants
5. "Env., Energy, and Natural Resources Options" memo suggests $2 billion/year starting in '94 for drinking water projects
6. as a part of a stimulus package
7. low options for stimulus: $15 billion over 2 years ('93, '94)
   high options: $50 billion over five years
8. this will not add to the deficit if funds are transferred from defense R&D
9. levels for each year determined by averaging multi-year total estimate
10. "Env., Energy, and Natural Resources Options" memo suggests $45 million in '93, increasing to $950 million in '97
11. "Env., Energy, and Natural Resources Options" memo suggests $4 bill./year startin in '93 for sewage and wastewater treatment plants
12. "Env., Energy, and Natural Resources Options" memo suggests $2 billion/year starting in '93 for drinking water projects
13. '96 numbers were used for '97 (no '97 numbers provided in options memo)

OPPORTUNITIES FOR COST SAVINGS (1)							
(In $ Billions)							
	1993	1994	1995	1996	1997	TOTAL	1998
Administrative:							
3% admin savings (begin. in 1995)	0.00	0.00	2.00	5.00	6.50	13.50	8.50
Freeze consultants (begin. in 1995)	0.00	0.00	0.20	0.20	0.20	0.60	0.20
Eliminate 100,000 Federal Employees	0.00	0.00	2.00	4.30	4.50	10.80	4.50
Reduce Spending on Consultants, Overhead	0.00	1.50	3.00	4.50	6.10	15.10	6.40
Cut White House Budget 25%	0.01	0.01	0.01	0.02	0.02	0.07	0.02
Elimination of Unnecessary Commissions	0.03	0.05	0.05	0.06	0.06	0.25	0.06
Enhanced Recission	3.00	6.00	6.00	6.00	6.00	27.00	6.00
Agriculture:							
Restrict eligibility and reduce the payment limitation	0.00	0.10	0.20	0.20	0.20	0.70	--
Eliminate Honey Program	0.00	0.00	0.00	0.02	0.02	0.04	--
Eliminate wool/mohair price support program	0.00	0.19	0.19	0.20	0.20	0.78	--
Lower prices to farmers in USDA commodity progs.	0.44	1.55	2.15	3.20	5.95	13.29	--
Raise share of acreage ineligible for deficiency pymts.	0.41	0.96	0.91	0.81	0.89	3.98	--
Streamline operation of Farm Agencies offices	0.03	0.07	0.12	0.14	0.14	0.49	--
Reduce subsidies provided by Rural Elec. Admin	0.03	0.07	0.13	0.17	0.20	0.60	--
Replace Crop Ins. Prog. w/ disaster assist program	--	--	--	--	1.00	--	--
Eliminate market promotion program	0.01	0.01	0.01	0.01	0.01	0.05	0.01
AID:							
Consolidate the Overseas Broadcasting System	0.00	0.10	0.20	0.30	0.30	0.90	0.30
Reduce Security Assistance	0.04	0.15	0.33	0.54	0.55	1.61	--
Debt:							
Reduce Interest by Shortening Maturities	0.00	1.70	3.40	5.10	6.80	17.00	8.30

OPPORTUNITIES FOR COST SAVINGS (1)							
(In $ Billions)							
	1993	1994	1995	1996	1997	TOTAL	1998
Defense Cuts Packages							
Aspin A	0.00	10.60	24.30	38.70	51.60	125.20	46.80
Aspin B	--	7.60	18.30	29.70	39.60	95.20	34.80
Specific Defense Savings (2):							
Force Structure Cut	0.00	1.70	2.90	5.60	9.20	19.40	9.20
Overhead Reduction	2.40	0.90	2.10	2.15	4.30	11.85	3.05
A: SDI Reduction	1.60	1.20	2.20	2.20	2.20	9.40	3.00
B: SDI Reduction	1.60	2.00	3.10	3.20	3.70	13.60	5.50
A: Acquisition Cut	0.00	0.65	0.65	1.05	1.25	3.60	0.65
B: Acquisition Cut	0.00	1.90	2.75	2.05	2.75	9.45	1.05
A: National and Tactical Intelligence Cut	2.60	1.00	0.70	0.70	0.60	5.60	--
B: National and Tactical Intelligence Cut	2.60	1.50	1.20	1.20	1.10	7.60	--
A: Pay Raise Adjustment	0.00	2.00	2.70	2.80	2.80	10.30	2.90
B: Pay Raise Adjustment	0.00	2.00	4.40	6.40	7.30	20.10	7.70
Reform DOD inventory system	0.00	5.70	0.00	0.00	0.00	5.70	--
Education:							
Eliminate Funding to School Districts for Impact Aid B	0.00	0.10	0.10	0.20	0.20	0.60	0.20
Replace Stafford and SLS Loans with Direct Loans	0.00	1.40	1.40	1.50	1.50	5.80	1.60

OPPORTUNITIES FOR COST SAVINGS (1)							
(In $ Billions)							
	1993	1994	1995	1996	1997	TOTAL	1998
Energy/Environment:							
Stop Acquisitions of Crude Oil for the SPRO	0.00	0.30	0.40	0.40	0.40	1.50	0.50
Elim. below-cost timber sales from national forests	0.02	0.03	0.05	0.06	0.08	0.23	--
Hardrock mining claims	0.00	0.06	0.06	0.06	0.06	0.24	--
Decrease government financing of superfund	0.75	0.19	0.31	0.27	0.28	1.80	--
Improve pricing for commercial uses of public lands	--	--	--	--	0.20	--	--
Index nuclear waste disposal fees for inflation	--	--	--	--	0.10	--	--
DoE raise federal hydro power rates for debt rpymnt	0.00	0.26	0.25	0.24	0.22	0.97	--
Entitlement Cuts							
Eliminate COLAs before age 62	--	0.39	0.96	1.53	2.18	5.06	2.81
Social Security - CPI-2 on COLAs for four years	--	--	--	--	22.00	--	--
SS Freeze COLA for One Year	8.00	11.00	11.00	10.90	10.80	51.70	--
Eliminate lump sum benefits for Federal retirees	--	--	--	2.10	2.80	4.90	3.80
Health Care Costs	--	--	--	--	50.00	--	--
Health -- Medicaid savings							
Tighten estate asset rules	0.00	0.08	0.15	0.25	0.40	0.88	0.45
Rx rebates	0.00	0.00	0.10	0.10	0.20	0.40	0.20
Replace State Admin. Cost Grant w/ 1 Indexed Grant	0.00	0.50	0.80	1.20	1.60	4.10	2.10
Health -- Medicare savings							
Freeze PPS update	0.00	1.60	2.20	2.40	2.60	8.80	2.90
Reform hospital outpatient	0.00	0.20	0.60	0.80	0.90	2.50	1.10
Freeze updates for 5 years	--	--	--	--	1.60	--	--
One-year Part B freeze	0.00	0.40	0.60	0.60	0.80	2.40	0.90

OPPORTUNITIES FOR COST SAVINGS (1)							
(In $ Billions)							
	1993	1994	1995	1996	1997	TOTAL	1998
Reduce updates:							
A: By 2%	--	--	--	--	4.70	--	--
B: By 1% for 5 years	--	--	--	--	1.70	--	--
Increase SMI deductible	0.00	1.00	1.70	2.30	3.00	8.00	3.90
Health -- Medicare/Medicaid offsets	0.00	3.50	4.30	6.50	9.00	23.30	--
HUD:							
Scale Back Low-Income Home Energy Assistance	0.00	0.10	0.20	0.20	0.20	0.70	0.20
Eliminate special HUD grants	0.00	0.06	0.12	0.13	0.13	0.44	--
Miscellaneous:							
Eliminate Consumer Homemaking grants	0.01	0.03	0.04	0.04	0.04	0.15	--
Eliminate law-related grants	0.00	0.01	0.01	0.01	0.01	0.02	--
Continue to delay child care obligations	--	--	--	--	0.30	--	--
Tax credit unions like other thrift institutions	0.20	0.50	0.60	0.60	0.60	2.50	--
Eliminate CSRS Morrill-Nelson	0.00	0.00	0.00	0.00	0.00	0.02	--
Eliminate the ship operating subsidy	0.25	0.24	0.24	0.23	0.19	1.14	--
Reduce the Ocean freight differential	0.04	0.04	0.04	0.04	0.04	0.20	--
Restrict agency match on thrift plan contrib. to 50%	0.47	0.77	1.05	1.40	1.70	5.39	--
Eliminate follow-through	0.00	0.00	0.01	0.01	0.01	0.03	--
Coast guard - 100% cost recovery	0.70	0.70	0.75	0.75	0.80	3.70	--
Science/Space/Technology:							
Reduce Overhead on Federally Sponsored Univ. R&D	0.00	0.10	0.10	0.20	0.20	0.60	0.20
Cancel New Spacecraft Development Projects	0.00	0.10	0.20	0.20	0.20	0.70	0.20
Cancel the Space Station Program	0.00	1.10	1.90	2.20	2.30	7.50	2.40
Cancel Development of Advanced Rocket Motor	0.00	0.30	0.40	0.50	0.50	1.70	0.50

OPPORTUNITIES FOR COST SAVINGS (1)							
(In $ Billions)							
	1993	**1994**	**1995**	**1996**	**1997**	**TOTAL**	**1998**
Abolish the Interstate Commerce Commission	0.02	0.03	0.03	0.03	0.03	0.13	--
Privatize NOAA research fleet	0.05	0.05	0.05	0.05	0.05	0.25	--
Cancel moon to mars	0.05	0.08	0.10	0.10	0.10	0.42	--
Eliminate airport grants-in-aid	--	--	--	--	2.20	--	--
Cut highway demonstrations in half	--	--	--	--	0.80	--	--
Tax:							
Amortize a portion of advertising Costs	3.30	5.90	4.40	2.90	1.70	18.20	--
Turn the possesions tax credit into a wage credit	0.20	0.40	0.50	0.50	0.60	2.20	--
Welfare Reform:							
Caseload Reduction	0.00	0.00	0.40	0.80	2.00	3.20	2.20

Notes:

1. The following list includes several estimates (designated A and B) for similar opportunities when the cost estimates vary significantly.
2. The "A" indicates option 1 and the "B" indicates option 2 -- both from the defense options paper

STIMULUS OPTIONS

Executive Summary
Larry Summers/Roger Altman

This summary provides background on current macroeconomic conditions, the effect that various stimulus measures might have on the economy, and outlines a variety of stimulus options.

Macroeconomics and the Deficit:

1. The most likely scenario for the American economy over the next 12 months is modest growth in the 2.5-3.0 percent range that brings unemployment down just below 7.0 percent by the end of 1993. There is a 30% chance of more rapid growth that brings unemployment down to the 6.5 percent range and a 20% chance of significantly slower growth that does not bring down unemployment at all. Key uncertainties include continuing layoffs, conditions in Europe and Japan, financial strains, and volatile consumer confidence.

2. Past trends suggest that because of the lack of demand the economy is now operating 4 percent below its potential to produce without inflationary pressure. Potential output grows at about 2 percent or slightly faster a year. So there is room for the economy to grow 12-14 percent over the next 4 years. The risk of growth never reaching the 3.5 percent a year range is quite remote. But the risk of more rapid growth being attained but not proving sustainable in 1995 and 1996 because of collisions between fiscal and monetary policy is very real.

3. Short term fiscal stimulus without a deficit increase is impossible. Modest stimulus in the form of accelerated infrastructure spending, human investments, and an incremental ITC would insure the recovery and probably improve consumer confidence. A stimulus program should be approached through phased in a sound long-run program rather than through the development of a separate stimulus package.

4. A minimum credible deficit reduction package would involve stabilizing the debt-GNP ratio by 1997. This would require about $75 billion in policy changes either to reduce expenditures or increase revenues. Credible enactment of a deficit reduction package would spur growth in the short run by reducing long term interest rates, and increase the likelihood of four years of sustained growth. It would also contribute to economic growth by liberating a significant part of the pool of private savings that are now flowing into government debt rather than productive investment. The greater the near-term strength of the economy, the more urgent it is to credibly reduce the deficit. Long term deficit reduction is imperative even if no stimulus package is adopted.

5. Federal investment now comprises about 2 percent of GDP. The Putting People First plan would raise this figure to about 2.7 percent of GDP by 1997, and increase by 50 percent real spending. A 50 percent increase is a potentially attractive goal. It is unlikely that increases in Federal investment spending will have a major impact on macroeconomic performance over a 5 year period even if the investments have a very high rate of return, though the benefits in a number of sectors would be very visible. Increases in public investment would not mitigate the financial risks associated with budget deficits.

Stimulus Options:

There are four sets of options: 1) Tax Options; 2) Spending Options; 3) Non-Fiscal Options; and, 4) Global Coordination. All of the proposals draw on the priorities outlined during the campaign and address the goals of putting people back to work, tax fairness, long-term investment, and commitment to the Nation's disadvantaged communities.

This division does not, however, fully represent the differences and similarities between these proposals. While each of the items within these four sections can stand alone and should be viewed within the context of the type of program they represent, it is equally useful to place them within several other categories.

The first concerns the use of funds. Many of the proposals encourage long-term investment -- either through providing tax incentives to businesses or investors, or through government spending. This category includes Investment Tax Credit proposals, Capital Gains Tax proposals, and possible increases in funding for Infrastructure. Two of the tax proposals, the Middle Class Tax Cut and the Earned Income Tax Credit, address fairness issues that were raised by you during the campaign. Finally, some of the proposals fund social initiatives that have long-term benefits such as Head Start and Child Immunization which will have immediate stimulative benefits, but also are considered investments in productivity and cost-efficiency which will result in significant long-term savings.

Most of these proposals have costs associated with their implementation; some of the options in this memo, however, are cost neutral and may in fact increase revenue. The cost of these options range significantly from very modest programs that address public health issues such as the spread of Tuberculosis in several urban communities to much more expensive proposals like an Investment Tax Credit. Each of the proposals includes a range of cost options that have their own programmatic and political distinctions.

The section on Tax Options presents a range of proposals to meet the goal of stimulating the economy in the short-term while providing the basis for renewed long-term economic growth. Two of the areas, the Investment Tax Credit (ITC) and the range of Incentives for Entrepreneurs, focus on encouraging higher levels of investment; the New Job Tax Credit proposals seek to stimulate job creation; and, the Middle Class Tax cut options and the Earned Income Tax Credit options primarily address issues of tax fairness, but they also encourage increased consumption. Some of these proposals, such as the ITC and Middle Class Tax Relief are quite expensive with four year costs potentially as high as $60 billion. Most of the others have a wide range of cost options that vary with design.

The section on Spending Options outlines a range of proposals that would have an immediate stimulative effect and that would be long-term social investments. Many of the proposals address pressing social problems by allocating additional funding for existing programs that could quickly put these funds to effective use. These investments are structured to provide important short-term stimulus. Most importantly, many of these programs, from Head Start to child immunization, are extraordinarily cost-efficient, saving billions of taxpayer dollars over the long-term for a small up-front investment. In addition to proposals on Head Start and child immunization, the section includes options that address the Nation's infrastructure needs, the affordable housing shortage, the increasing incidence of TB in our nation's cities, the shortage of community health services, and the desperate condition of our urban parks and open spaces. Some of these options involve no new spending -- only administrative changes that would expedite spending of previous appropriations; others, such as the infrastructure proposals, could cost as much as $15 billion over four years.

The section on Non-Fiscal Options addresses problems that have hampered economic recovery and, like aspects of the Spending Options section, should probably be considered regardless of their stimulative effects. It starts with proposals to address the unusual reduction in the supply of credit that has severely limited commercial lending through the imposition of Presidential leadership, and a careful review of regulatory guidelines. The section on Restructuring the National Debt suggests that changes in Treasury policies on financing the national debt might result in savings as high as $15 billion over four years. In addition to these savings, shortening the average maturity of the outstanding debt might push down long-term interest rates which would have an important stimulative benefit.

The final section outlines the damaging effect that slow growth in Japan and Germany have on our economy and makes clear both the importance and difficulty of global coordination.

BUDGET PROCESS ISSUES

Executive Summary

Harrison Wellford, Alan Cohen, Jonathan Sallet

Budget Process

Issues of budget process will inevitably affect the timing and sequence of Congress' consideration of the Clinton-Gore economic plan. Accordingly, it is very important that any legislative strategy be carefully measured against the impact of budget process questions. For example, a series of early deadlines may force the Administration to take action on issues it would prefer not to confront immediately. It is also important, however, that budget process issues not be allowed to take on a life of their own. For that reason, the Administration's very first statements, including the Inaugural Address, should establish the broad framework and goals of the economic plan, even if details need to be filled in later. With a broad framework in place, the budget process questions can be discussed in the appropriate context.

There are seven major budget process issues:

1. Whether the Administration will, on January 21, 1993, adjust the maximum deficit ceilings for FY 94 and FY 95.

2. Whether the Administration is required to submit a FY 94 budget by February 1, 1993.

3. Whether the Administration will seek an additional extension of unemployment benefits prior to the expiration of the current extension on March 7, 1993.

4. Whether the Administration will seek a short-term or long-term extension when the current debt ceiling is reached on or about March 15, 1993.

5. Whether the Administration will submit a fiscal stimulus program separate from its FY 94 budget proposal.

6. Whether the FY 94 budget proposal will, without regard to question 5, be the vehicle by which the Administration proposes its long-term budget deficit reduction strategy, implements its investment goals, and proposes health-care reform.

7. Whether the Administration should voluntarily submit legislative proposals concerning the extension and/or modification of the basic budget process laws.

The attached memorandum has gathered the conventional wisdom from the staff of the most relevant congressional committees concerning the resolutions of these issues. But two beliefs in particular should be noted. First, Hill staff believes firmly that technical budget process issues should not be permitted to distort the Administration's political strategy (Questions 1 and 2). Second, there is also a prevailing belief that the time required to finish work on a comprehensive budget submission will preclude its submission together with a fiscal stimulus program, which is thought to require quick legislative action. This belief has a number of procedural and political consequences. It probably requires, for example, that the extension of a debt ceiling (Question 4) be very short-term, thus permitting another debt ceiling vote before FY 94 begins. More importantly, as a political matter, this view inevitably would require the Administration to move at least two large economic proposals (fiscal stimulus and the FY 94 budget) in its first year.

Conventional wisdom is, of course, no substitute for bold leadership. It may be possible, if the FY 94 budget can be prepared quickly enough and if aggregate figures can be used to kick off the budget process on the Hill, to move a fiscal stimulus package and the FY 94 budget together. This would allow, in essence, all of the key components of the Administration's economic package to be consolidated and would, of course, have the advantage of allowing the Administration to push hard for a single legislative victory.

BUDGET POLICY

Executive Summary

Letitia Chambers, Craig Bury and Cindy Lebow

Budget Theme and Budget Scenarios

The Budget for Fiscal Year 1994 will be the vehicle through which the Clinton/Gore agenda is articulated and delivered to Congress. It is through the Budget that the new administration's vision for the future will be made manifest. The budget will reflect hundreds of decisions that must be made explicit. To guide the decision making process, and to place those decisions in a context that will be meaningful and easily understood by Congress and by the public, a central theme should be established, and the entire Budget should be built around that theme.

The first paper submitted by the Budget Policy Group, Investment for the Future: A Budget Decision Framework, suggests that the unifying theme of the first Clinton/Gore Budget be **Investment for the Future**. Several principles are suggested to guide decision making -- thinking long term, increasing investment and reducing consumption, encouraging private as well as public action, and reducing the deficit. The paper also provides in concise, summary fashion data on the size and sources of the public debt and deficits, discussing both revenue and spending sides of the equation. This discussion provides a context in which to view three illustrative budget scenarios, each of which halves the deficit by 1997, but arrives there by very different paths.

Budget Restructure

Presentation is an important element in developing and offering a budget which provides a coherent theme. The Presidential focus on **Investment for the Future** can drive the Congressional decision making by restructuring the presentation of the federal budget to include a Capital Investment Budget. The second paper prepared by the Budget Policy Group sets forth a three-part budget which includes:

- A **Capital Investment Budget** which reflects **investments for the future** and includes expenditures for programs and activities which have multiple-year life and raise future productivity.
- An **Income Replacement Budget**, which reflects the nation's **past commitments** made to workers and includes Social Security and Medicare, Federal Employee Retirement programs, and the Unemployment Insurance System.
- An **Operating Budget** which contains all other programs and activities and reflects **current consumption** by the federal government.

The proposed budget restructuring has several advantages in addition to changing the focus of decision making. It will end the practice of hiding deficit spending behind surpluses in dedicated trust funds, it will show costs that are hidden by the current budget structure, and it will make explicit the current imbalance between general revenue and consumption in the operating budget. Another advantage of restructuring immediately is that this imbalance can be blamed on past practices and on prior administrations.

While some statutory changes will be needed to fully implement the budget restructure and to adapt the budget process to the new structure, it is possible (and, we believe, desirable) to present the FY 1994 budget without any statutory changes in the restructured format.

The paper on Restructuring the Federal Budget provides both the rationale for restructuring and options for the scope of programs to be contained in the Capital Investment Budget, including options for investment in R&D and human capital, as well as investment in physical capital.

Eliminating "Pork"

An important element in the overall budget strategy is to control budgetary "pork." Enacting expedited rescission authority is a major component of this strategy. The third paper presented by the Budget Policy Group, Eliminating the "Pork": Expedited Rescission Authority, discusses the provisions to be included in rescission legislation and sets out the constitutional and political constraints. It also proposes a definition for pork to be used in "jawboning" the Appropriations Committees and the Congress to secure their cooperation in eliminating "pork" as a part of the deficit reduction strategy.

Proposed Budget Schedule for the FY 1994 Budget

The FY 1994 President's Budget will be transmitted to Congress in the documents prepared by the Office of Management and Budget during the first 30-60 days of the new Administration. More detailed agency submissions will also be prepared during this period and will be presented to the Appropriations Committees shortly after the OMB documents are released.

Decision-making, review, and preparation of the full set of OMB FY 1994 Budget documents will require about three months. This schedule leaves virtually no room for missteps or delays and assumes:

1. The President-elect will make major decisions before Inauguration;

2. Decision-making will be more top-down, with agency heads given only limited opportunity to appeal in this initial budget; and

3. OMB staff and budget data will be available in a virtually unrestricted relationship at the beginning of the year.

The schedule in Proposed Schedule for the FY 1994 Budget, also submitted by the Budget Policy Group, proposes an interim budget document to be made available by February 15 with the full set of OMB FY 1994 Budget documents (including the Budget Appendix) submitted on March 15. This paper includes a complete timeline of the budget decision process.

Budget Process Reform

The federal budget process has evolved into a complex, convoluted multi-track series of technical procedures which constrain bold action on the budget. Reform is needed. In order to break the budget stalemate of the past decade, however, substantive economic policy changes -- not budget process -- should be the first priority. Policy must proceed process reform to avoid becoming bogged down in potentially endless process debates.

The Budget Process Reform paper argues that short-term budget process hurdles must be overcome, but long-term reform should come during FY 1995, after a bold policy framework has been laid before Congress and the American public. This paper provides a more detailed discussion of major reform issues that should be covered in this later major overhaul.

Executive Orders

It is possible that President-Elect Clinton may wish to sign one or more Executive Orders either on Inauguration Day or shortly thereafter. The Executive Order process is governed by Executive Order No. 11030, issued by President Kennedy on June 19, 1962. The clearance process for proposed Executive Orders involves certain requirements for development, routing and approval which should be respected during the Transition period. A memorandum entitled "Guidelines for Consideration of Potential Executive Orders to be Signed by President Clinton on or Shortly After Inauguration Day" outlines this process and suggests that analogous procedures be established within the Transition for review of such proposals by the OMB Director-designate and the Attorney General-designate. This Transition review process may expedite final clearance of a limited number of Executive Orders to be signed by the President on or shortly after Inauguration Day.

Budget Policy Group

Members of the Budget Policy Group, in addition to preparing the papers submitted here, have developed an interactive data base to test budget scenarios and extensive revenue and spending options, which have been provided in separate books. The group also has assisted several other members of the Economic Policy team in developing their submissions, and also has provided assistance and support to the cluster groups and agency liaison teams in securing budgetary information and material to be included in the briefing books for new agency and department heads.

The Budget Policy Group, which is made up of highly experienced senior budget specialists and legal and regulatory experts, includes: Letitia Chambers, Team Leader, Craig Bury, Alan Cohen, Comer Coppie, Robert Greenstein, Jerry Julius, Richard Kogan, Lynn Mahaffie, Congressman Jim Moody, Sue Nelson, Wendell Primus, Ted Ralston, Tom Sliter, Nancy Sutley, Mike Telson, Jon Weintraub, Marina Weiss, David Williams and Sue Woolsey.

The Budget Legal and Regulatory Team, which consists of Cynthia Lebow, John Dill, and Larry Simms, are examining the regulatory review process, and legal and legislative aspects of the budget process. Administrative and Support Staff include: Amy Buzzell, David Kovner, Elise Patton, Kirsten Powers, and Marti Thomas.

DEFICIT REDUCTION OPTIONS

Executive Summary
Ira Magaziner

THE DILEMMA

Fulfilling the campaign promise to cut the deficit in half by FY 1997 will require politically difficult spending cuts and/or tax increases even without any "Putting People First" investment.

Carrying out a substantial investment program as envisioned in "Putting People First" and cutting the deficit in half will require 1) a bold effort at deficit reduction within the first budget cycle, 2) passage of comprehensive health care reform early in the new administration, and 3) fiscal discipline as new investment initiatives are proposed--cost cuts or dedicated taxes to pay for new expenditures.

The only alternative to this prescription is to hope for or find a way to stimulate the economy sufficiently to increase real economic growth to an average of 4-5 percent per year for the next four years--a dubious prospect.

Most staff members on the Hill believe that if President-elect Clinton wishes to propose serious deficit reduction, he must lock it in place in the first budget.

There are political risk to deficit reduction.

1. It would potentially anger most major interest groups unless a call to "shared pain for the greater good" can be sold.

2. It would require a change from campaign rhetoric and positions which did not stress the deficit as a problem.

3. It may fail to win passage.

There are also political positives.

1. It would allow President-elect Clinton to take the "high ground" economically, persuading the business and journalistic communities and the deficit conscious public that he is indeed responsible and a "different kind of Democrat".

2. It would clear the budget slate, so that investment programs can be rolled out without each one being swiped at as "busting the budget".

3. It would preempt the expected Republican attack on President-elect Clinton as a

tax and spend Democrat and attempts to pass a "balanced budget amendment" when the debt ceiling is reached in February or March.

4. It would accelerate the shift to a more investment-oriented budget.

The politics of deficit reduction are not easy. The following principles may make it more feasible.

1. All tax hikes are political "time bombs". Deficit reduction should stress cost cuts.

2. There is a temptation to take refuge in gimmicks, caps, plugs and process changes but the financial community and media increasingly discount these if not accompanied by serious real measures.

3. A broad "across the board" assault on the deficit may be more feasible than a halfway attempt since the pain can be broadly shared.

4. If President-elect Clinton decides to go after the deficit he should:

   o Do it early and make it a precondition for future investment programs.

   o Present it as a way to cleanse the nation from past sins in order to move on to redemption.

   o Start immediately to deal the program and build congressional support.

<u>HOW FAR TO GO</u>

There are a number of ways to define the goal of cutting the deficit in half in our years. When fixing upon a definition, it is important not to appear to be redefining the goal in a "gimmicky" way.

As originally conceived in June, the goal, assuming CBO growth rates, was to cut a 1992 projected deficit of about $350 billion to about $175 billion. "<u>Putting People First</u>" actually listed a $141 billion target, assuming faster than CBO projected growth. "<u>Putting People First</u>" also used a 1996 target instead of a more realistic 1997 one.

The actual 1992 deficit turned out to be $290 billion (albeit with gimmicks which pushed significant billions into 1993). Halving this means a deficit of $145 billion by 1997.

The latest CBO projections for the 1997 deficit are between $290 and $299 billion.

Halving this is also in the $145 billion range.

Another way to look at the goal, and one which is entirely defensible economically, is to cut the deficit in half as a percentage of GDP. The deficit to GDP ratio in 1992 was roughly five percent. Reducing it to 2.5 percent (an economically rational deficit ratio) would mean a deficit of about $190 billion by 1997.

If President-elect Clinton submits a serious deficit reduction plan based on CBO growth projections, with no gimmicks, which accounts for his investment initiatives and which credibly reduces the deficit to 2.5 percent of GDP by 1997, he will be economically responsible and would probably pass the political test of being fiscally responsible.

Redefining the goal in this way will succeed even better if an 8-10 year plan is put on the table which takes advantage of longer term savings for health care. The longer term plan could also find benefits from future retiree pension reforms (lengthening years of service requirements prospectively) and for accelerating the age eligibility changes now planned for Social Security.

A BALANCED APPROACH TO DEFICIT REDUCTION

Deficit reduction should be balanced. When Congressional staff speak of a balanced approach to deficit reduction, they usually mean a package which spreads the pain to everyone. This should include:

1. Defense cuts which go below the Clinton "Putting People First" plan -- perhaps to Aspen B -- $246 billion in 1997.

2. Some action on Social Security -- even if only a relatively small one. Because touching Social Security is politically risky, including it in the package lets people know you're serious, and makes other cuts easier.

3. Some action on federal retirement programs.

4. A reduction -- even if modest -- in agricultural price supports.

5. A willingness to cut a series of the "cat and dog" items which are protected by regional or powerful lobbying interests.

6. A willingness to take on some of the tax expenditures which are protected by powerful lobbies.

7. Serious tax increases on the wealthy and sin or pollution taxes.

8. A serious health care plan.

This memo proposes a few packages as scenarios. Leon Panetta and Alice Rivlin will undoubtedly be able to present a more varied set of detailed options.

Deficit Reduction Scenarios

Exhibit 1 shows that "Putting People First" cuts the deficit only to $222 billion at best. This does not leave room for any investments nor does it meet deficit reduction commitments.

Any serious deficit reduction must include defense cuts (which go at least $20 billion beyond the Clinton campaign plan) and serious health care cost cuts (in the $50 billion range by 1997).

In addition, a series of other coast cuts and revenue raisers are necessary to make the package work. Exhibit 2 gives a modest reduction scenario that allows $88 billion of investment in 1997 (including the cost of phasing in universal health insurance) and still cuts the deficit to $190 billion -- roughly 2 1/2 percent of projected GDP.

Exhibit 3 show a more aggressive deficit reduction path which allows almost $100 billion of investment in 1997 (including the cost of phasing in universal health insurance) while cutting the deficit below $145 billion.

The appendices to this memo provide other options which can be used and Letitia's group has a reference book of further cuts.

Both scenarios suggest roughly 2/3 cost cuts and 1/3 tax increases. Most observers feel, and I concur, that at least 2/3 of the plan should involve cost cuts both as sound economic policy and also to avoid political labelling as a "taxing Democrat."

There is no major new tax in either package except for the upper income PPF tax described in the campaign, "sin taxes" and possible pollution taxes in the more aggressive scenario.

I believe it would be a mistake to push for a gas tax of a progressive VAT in the first package. Both of these would become the media centerpiece of the whole proposal and would brand it as a "middle class tax" proposal.

Serious deficit reduction is feasible. It should be done soon to clear the way for the Clinton investment agenda.