THE WHITE HOUSE

WASHINGTON

May 22, 1997

MEMORANDUM TO THE PRESIDENT

FROM: **GENE SPERLING**

SUBJECT: **Tax Cut Proposals for Budget**

Your economic team is meeting with you in the morning to go over options for going forward on the tax package. There are several processes, strategic and substantive issues we need to discuss with you in order for us to move forward.

1. Developing a Package: All of your advisors agree that we need to develop our sense of an overall $135 billion gross tax package. One reason for developing our tax package is that it allows us to work with Democrats to increase a commitment for our education tax package, by showing them that we can put together a package that could include their priorities. Currently, Republicans are telling Democrats that they could support other Democratic education tax cuts -- if they are paid for **within** our $35 billion tax cut. By putting together a package, we can show people like Breaux and Rangel that if they are committed to your higher education tax cuts, we could fit their priorities -- e.g., Kidsave, Rangel's initiatives, -- outside of the $35 billion.

2. Working with Democrats and Republicans: While part of the goal is putting together a set of ideas to get "buy-in" from the Democrats that unifies them, both Bob Rubin and John Hilley believe that the best way to proceed is to shop a $135 billion package with both Democrats and Republicans so that we are continuing to work in a bipartisan process. Therefore, while we would seek to unify Democrats with our $135 billion package, we would shop it and get input from all sides, as opposed to having a "Democratic package" that at this moment might alienate Republicans from working with us. As John states, this would be similar to our posture in March when we took the same one page budget summary and sought input and comments from both Democrats and Republicans.

Bob Rubin and his staff are already been involved in serious consultations. On Wednesday, Bob spoke with Archer for 30 minutes and met with Roth for over 45 minutes, while also speaking with Moynihan and Rangel and other House Ways and Means Democrats. Archer and Roth agreed with Bob to have their staffs meet with Treasury staff next so that they could review our $135 billion set of ideas for discussion.

3. Two Votes Strategy: Erskine cautions that all decisions should be considered against the backdrop of what best ensures that we preserve our two vote strategy.

4. Education Package: One of the main issues we need to decide is what alterations we need to make in our education proposals in order to garner adequate support from Democrats and the education community. Everyone agrees that we need to make the Hope Scholarship more progressive and in some way drop the B- requirement. Yet, in order to afford these changes, we need to decide whether and how to shave the Hope Scholarship or the $10,000 deduction. Attached is a decision memo that goes through the pros and cons of such choices.

5. New Education Ideas: Another decision is what additional ideas we may wish to consider, particularly from Charlie Rangel outside of the $35 billion.

6. Child Tax Credit/Kidsave: A major issue is whether to amend our child tax credit, to a "Kidsave" proposal, and whether we want to add refundability, or change the age or income limits. The current Treasury set of ideas does include a refundable Kidsave proposal.

7. Capital Gains Design: We must decide what capital gains proposal we want to present. This clearly involves not only where we want to end up on capital gains, but strategic questions of where we should start. Currently, the Treasury set of ideas includes a 50% exclusion, a Bumpers expansion, your home capital gains, and the Daschle estate tax cut.
One of the ideas you had mentioned was to include provisions with strong appeal to the small business and high technology community.

8. AMT Reform: Treasury believes there is strong policy rationale for AMT reform. In the current proposal, this is started in 2003. This allows more middle income tax relief to be included in the first five years, yet it fills the last five years with a sensible tax reform instead of an exploding capital gains tax cut. Is this something you are interested in proposing?

9. Additional Ideas: At your request, Treasury has also included a short description of a modified home office deduction and an increased health care deduction for the self-employed.

Attached are the following:

- **One Page Treasury Chart:** Following a meeting in Erskine's office, we agreed on a preliminary package to present you. The chart shows Treasury's estimates of what costs of the different proposals would be.

- **Treasury Background Paper:** Memo from Don Lubick that explains several of the provisions in the chart.

- **Education Tax Cut Pro/Con Memo:** This is a pro/con memo on the different options for reforming our tax proposals using ideas presented from both Secretary Riley, Treasury Department and other members of your economic team.

Illustrative Baseline Tax Package: Very Preliminary Treasury Estimates (except where noted)
Dollar amounts in millions, May 23, 1997

	1997	1998	1999	2000	2001	2002	1998-02	1998-07
Education package								
HOPE scholarship, $1,200; Tuition Deduction, $10,000 \1	-78	-4,242	-6,561	-8,461	-9,371	-10,198	-38,833	-94,560
Rangel K-12 school finance tax provision (not scored)								
Make Section 127 Permanent	-82	-645	-670	-730	-796	-833	-3,674	-8,443
Middle-Class Tax Relief and Saving Provisions								
Refundable Kidsave Credit \2	-568	-10,612	-10,930	-14,338	-17,889	-17,960	-71,729	-161,423
Individual AMT reform, start in 2003 \3	0	0	0	0	0	0	0	-37,472
Capital Gains and Estate Tax Relief								
50% CapGn Exclusion and 20% AMT	-702	-1,470	1,493	-1,643	-1,621	-1,549	-4,790	-11,009
Super-Bumpers Plug Number \4	0	-50	-150	-300	-400	-500	-1,400	-5,500
President's Home Sales Provisions \4	-60	-239	-222	-205	-187	-168	-1,021	-1,600
Daschle Estate Tax Proposals (JCT)	0	-440	-540	-640	-740	-840	-3,200	-10,200
Urban Initiatives								
Distressed Areas Initiatives (JCT) \5	-25	-172	-370	-464	-483	-487	-1,976	-4,063
Welfare-to-Work (JCT)	0	-41	-75	-95	-77	-41	-329	-353
Other Tax Incentives (JCT) \6	0	-57	-156	-285	-344	-420	-1,262	-9,422
One-year Extensions of Expiring Provisions (JCT)	-405	-958	-682	-398	-259	-127	-2,424	-2,459
Gross Tax Cut	-1,920	-18,926	-18,863	-27,559	-32,167	-33,123	-130,638	-346,504
Revenue Offsets	883	7,747	9,067	10,225	10,668	10,955	48,662	103,945
Total Net Cut	-1,037	-11,179	-9,796	-17,334	-21,499	-22,168	-81,976	-242,559

(Not including Rangel school construction program, expected to cost $3 billion through 2002 and $7 billion through 2007)

\1 The proposal drops the B- rule and Pell offset to HOPE.
\2 A refundable child credit for children under 13 with an optional $500 nondeductible IRA for education or retirement for each child credit allowed. The credit is $150 in 1997, $300 in 1998 and 1999, $500 in 2000 and indexed thereafter.
\3 Assumes the enactment of the Administration's child credit proposal. Among other things, it eliminates several inappropriate AMT preference items (most importantly, personal exemptions and the standard deduction), allows personal credits to offset AMT liability, and indexes the A
\4 Stacked after the 50% exclusion.
\5 Expand Empowerment Zones and Enterprise Communities, Brownfields, and CDFI.
\6 Equitable tolling, Puerto Rico Tax Credit, FSC software, and DC incentives.

May 22, 1997

MEMORANDUM FOR SECRETARY ROBERT E. RUBIN
DEPUTY SECRETARY SUMMERS

FROM: **DONALD C. LUBICK** DCL
ACTING ASSISTANT SECRETARY (TAX POLICY)

SUBJECT: Possible Tax Package

The attached table presents an illustrative budget package that fits within the recent budget agreement under very preliminary Treasury scoring. The package includes a number of features that will appeal to Congressional Democrats and some Republicans and reflects our current judgment about the outlines of a sound and politically popular package.

This memo highlights decisions that need to be considered if tax package recommendations are to be made publicly. The memo concludes with brief descriptions of several tax ideas appealing to small business that the President has asked about.

Education

- o The current education package contains a $1,200 HOPE credit, a $10,000 tuition deduction, drops the B- grade requirement and no longer offsets the HOPE credit by Pell grants and other federal aid that a student receives. This package costs $3.8 billion more than the $35 billion for education that is allocated within the budget agreement.

Alternatives

- o The Education Department has suggested an alternative with a $1,500 HOPE credit, with no B- and no Pell grant offset with a $10,000 tuition deduction that is either capped at $1,500 of tax reduction (so, for example, a family in the 28 percent bracket could deduct no more than $5,357) or converted into a credit equaling 15 percent of all higher education expenses, up to $10,000. In addition, the second year of the HOPE credit could only be received by students who have completed their full freshman year of school. We believe this package will cost roughly the same amount as the first package.

- o Either the amount of the tuition deduction, HOPE credit or both must be scaled back to meet the $35 billion revenue target, particularly under JCT scoring. In addition, many potential allies strongly urge us to alter or drop the B- requirement and eliminate the Pell grant offset.

Additional features of the education package

- With money outside the $35 billion, we propose to make permanent the exclusion of employer-provided educational assistance from taxable income (Section 127). This is a cause that has been championed by Senator Moynihan and others in the House and the Senate.

Additional Education Proposals that Could be Considered to Attract Support of Key Members of Congress

- School Construction: We have designed a tax proposal to aid school construction (and other activities) in poor neighborhoods, as urged by Congressman Rangel among others. The States and the District of Columbia would be permitted to allocate a fixed annual amount of tax credits (based on population), much as they do currently with low-income housing tax credits. The States could allocate the credits for projects in public schools located in empowerment zones, enterprise communities or that have a high percentage of low-income students. The schools could use the credits to help pay for construction and renovation projects by giving them as partial payment to developers who perform the construction work or by selling them. Each school would be allocated credits equal to a specified portion of construction costs with the balance to be covered by the State or the school districts.

- Expansion of the Work Opportunity Tax Credit: In addition to extending the credit for at least one year, it would be expanded so that employers hiring graduates of schools that have a high percentage of low-income students within one year of their graduation would be eligible to receive the work opportunity tax credit.

- Exemption for Withdrawals from State Prepaid Tuition Plans: Families that invest in plans that allow them to prepay college tuition not only would receive tax deferral on the annual increase in value of their investment as provided under current law but also an exemption from tax when the funds are applied to the child's tuition. The exemption would apply to plans like Florida's and Virginia's that allow parents to pay in full in advance for tuition, but not to some other states' plans that operate like mutual funds.

- Position on Deductibility of Student Loan Interest: We prefer our tuition credit and tuition deduction, which do not favor borrowing over saving to pay for college, to a student loan interest deduction, which does favor borrowing. A student loan interest deduction would provide relief, however, to many middle-income students and is administrable. Such a proposal is popular with certain Senators (e.g., Moseley-Braun) and thus may be included in a Congressional budget package.

Middle Class Tax Relief and Saving Provisions

- The baseline package contains a refundable "Kidsave" credit based on the child credit in your FY98 Budget. Kidsave proposals combine a child tax credit with a tax-preferred saving vehicle that can be used for the child's education and for retirement (of the taxpayer). Kidsave is popular with many moderate Senators, particularly Breaux and Kerry. The particular version shown in the baseline package is refundable, which would help draw a striking contrast between the distributional effect of likely Congressional taxes packages and ours.

<u>Alternatives</u>

- An alternative would drop refundability and instead extend the child credit in your FY98 budget to children under 18 (the Budget proposal gives a credit for children under 13).

- Kidsave proposals cleverly combine an education saving mechanism with the child credit (our version would make contributions to the education saving account optional). An alternative would be to have separate child credit and IRA proposals, as was done in the FY98 Budget. IRAs, particularly backloaded IRAs, are very costly in years beyond 2002. Adding our IRA Budget proposals would cost about $15 billion through 2002 under JCT scoring.

<u>Additional features of the Middle-Class tax relief package</u>

- The large tax cuts agreed to in the second five years of the package provide an excellent opportunity to reform the individual Alternative Minimum Tax in a sound tax policy way and better distributed to the middle class. Currently only 600,000 taxpayers are affected by the AMT. By 2007, however, as many as 9 million taxpayers may be affected by the AMT, many of whom will be ordinary taxpayers since even the personal exemptions, standard deduction and state and local taxes are treated as preference items. The AMT will also start to claw back HOPE credits and the child credit. Fixing the AMT is important for the long-run health of the income tax, but is very expensive since the costs of doing so increase sharply beyond 2002. We propose to tackle this problem when the AMT problem becomes important, namely after 2002.

Small Business and Capital Gains Tax Relief

- The baseline package contains a 50 percent exclusion for long-term capital gains (so the maximum tax rate is 20 percent); a small business/venture capital proposal for capital gains relief, supported particularly by the biotech and computer industry; and the home sales provision in your FY98 budget. Note that Treasury and JCT scoring of capital gains has differed substantially in the past.

More Detail on Special Rules for Small Businesses and Small Business Investment Companies

- Individuals' long-term capital gains would be taxed at one half of the statutory rate applicable to ordinary income -- the maximum rate would be reduced from 28 to 19.8 percent. Correspondingly, the maximum rate on the sale of small business stock held for more than five years would be reduced from approximately 14 percent to 9.9 percent (from 21 percent to 15 percent for taxpayers subject to the alternative minimum tax).

  - The size of companies eligible for these special rules would be increased from $50 million of gross assets to $100 million of gross assets and the limitation on the amount of gain that could be excluded (currently $10 million) would be eliminated.

  - This proposal would also adopt some of the changes to the 1993 small business stock provision previously suggested by Senators Daschle, Lieberman and Hatch and by Congressman Matsui (among others). This proposal is particularly favored by venture capital and biotechnology firms.

- Under a separate proposal, a specialized small business investment company (SBIC) would be allowed under special rules to qualify for an exemption from entity-level corporate tax to the extent it distributed its income currently. Alternatively, during a specified period, any SBIC would be permitted to convert tax-free to a partnership. In addition, the rules that provide for exclusion of gain on securities when there is a roll-over to a SBIC would be liberalized for individuals, and would be extended to corporations. These rules would increase the exclusion for capital gains on SBIC stock from 50 to 60 percent, extend the preference for corporate taxpayers, and liberalize certain other rules.

  - These changes have been proposed by Congressman Jefferson who has advocated them as a means of improving capital access for minority-owned businesses.

- This package should receive wide political support, yet is designed to not unduly favor very high-income taxpayers and cause the net tax cut to explode in years beyond 2002.

Estate Tax Relief for Family Farms and Closely-Held Small Businesses

- The baseline package includes the estate tax proposals for special relief to farms and small businesses sponsored by Senator Daschle. They would create an estate tax exemption for the first $900,000 of value in a "qualified family-owned business interest" (in addition to the $600,000 unified credit). The proposal would also increase the amount of estates eligible for the special 4 percent interest rate on deferred payments, as in your FY98 Budget.

Urban initiatives and other Budget items

- The baseline package contains a complete set of FY98 Budget initiatives, including the expansion of EZs and ECs, Brownfields, CDFI and the welfare-to-work tax credit and tax incentives for FSC software, D.C., and Puerto Rico, and the equitable tolling provision. It extends expiring provisions that we do not make permanent, including the R&E tax credit, deduction for contributions of appreciated stock to private foundations, the work opportunity tax credit and the orphan drug tax credit.

Increase Deduction for Self-Employed Health Insurance

- You have asked us to think about increasing the deduction for the purchase of health insurance for the self-employed. The Small Business Job Protection Act of 1996 gradually increases the deduction for self-employed health insurance costs from 30 percent in 1996 to 80 percent in 2006 and thereafter. It has been proposed that the deduction should be increased to 100 percent. The proponents argue that the proposal would provide parity with the employer-provided health insurance deduction, which is 100 percent. However, most employers do not cover 100 percent of their employees' insurance costs. Thus, current law is closer to parity so the proposal to increase the deduction for self-employed health insurance is overly generous. It should also be noted that no tax subsidy is presently provided to encourage employees without employer-provided insurance to purchase their own health insurance. There are approximately nine million employees who purchase their own insurance, as compared to three million self-employed individuals who claim the self-employed health insurance deduction.

Modification to the Home Office Deduction

- You also asked us to think about modifications to the home office deduction. A home office business expense deduction could be allowed where substantial and essential administrative or management activities of the taxpayer's business are conducted on a regular basis in the taxpayer's home, provided the taxpayer has no other location for performing these activities. The current-law limitation that the deduction is available only with respect to that portion of the home that is used exclusively for business purposes, and is so used on a regular basis, would also continue to apply. This proposal has been estimated to cost roughly $650 million through 2002, assuming a January 1, 1997, effective date.

THE WHITE HOUSE

WASHINGTON

May 22, 1997

MEMORANDUM TO THE PRESIDENT

FROM: GENE SPERLING

SUBJECT: Education Tax Package

This memo describes two basic approaches to changing the HOPE Scholarship and $10,000 tuition tax deduction proposals in order to (1) fit within the $35 billion allocation over 5 years, (2) address, to varying degrees, the concerns about possible grade inflation and tuition inflation raised by pundits, and (3) address issues of progressivity raised by key Democrats and education groups. The memo also describes other education tax items that could be included in an Administration tax package *outside* of the $35 billion that was reserved for your credit and deduction.

Inside the $35 billion: HOPE and the Deduction

Treasury's estimate of the revenue loss from your two higher education tax proposals is $36.2 billion, with roughly half the cost associated with each proposal (the credit costs $18.6 billion and the deduction cost $17.6 billion).[1]

Both options 3 and 4 below are attempts to regain costs that would be the result of changes to the grade requirement and Pell offset, as described in 1 and 2.

1. Grade Requirement

The reasons for changing the grade requirement include: (1) administrative concerns raised by colleges, (2) "grade inflation" arguments from pundits, and (3) concerns that the requirement would not be applied equally across families, because middle income families at traditional colleges could still get as valuable a tax benefit through the tuition deduction (which has no grade requirement) even if ineligible for the credit. There are two possible alternatives:

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[1] Joint Tax estimates have been higher -- a total of $40.6 billion, with $28.9 attributable to the credit, and $11.6 attributable to the deduction. The cooperative efforts between Joint Tax and Treasury, agreed to in the budget deal, may reduce this disparity.

1a. Satisfactory Academic Progress. Federal student aid programs currently require that, in order to continue receiving aid, the students must maintain "satisfactory academic progress." This roughly equates to "passing," and is defined and policed by the schools. This option is roughly equivalent to eliminating the grade requirement.

Pro: This is the measure that the colleges prefer, since it is already in use.

Con: This is not a rigorous requirement. We would not be able to argue that we are encouraging students to excel.

1b. Achieving Sophomore status. Under this approach, a student could not receive a second HOPE Scholarship until she had successfully completed one full academic year. (This would incorporate satisfactory academic progress as well).

Pro: A full-time start in college is strongly associated with retention and attaining a degree. This would encourage students to do more than take a few classes, or to continue with their studies beyond a semester or two. It provides an argument that we are not completely backing away from an accountability component within HOPE.

Con: This could be confusing to students and taxpayers who, based on information provided by the school, would have to switch from the credit to the deduction until they fully completed one year, then would switch back to the credit.

Eliminating the grade requirement (option 1a) costs $2.2 billion (assuming no other changes). Option 1b would probably cost slightly less, but has not been estimated.

<u>2. Offset of Federal Grants ("Pell Offset")</u>

In order to stretch the $1,500 credit further into the middle class, your HOPE Scholarship proposal currently makes Pell Grant recipients (and other Federal grant aid recipients) ineligible for the HOPE Scholarship if they receive $1,500 or more in Federal grants. Higher education organizations and Democrats in Congress have argued that this unfairly excludes low-income families from HOPE, leading to a more regressive proposal.[2]

There are two alternatives for the Pell Grant offset:

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[2] Ignoring the full $3,000 that the lowest income students can receive in Pell Grants, they argue that your Budget provides only $300 for the poor students (the Pell Grant *increase*), but $1,500 (HOPE) or even $2,800 (maximum $10,000 deduction at 28% bracket) for higher-income families.

2a. Eliminate offset entirely. A student with a $3,000 Pell Grant could also receive a $1,500 HOPE Scholarship, if the taxpayer paid enough tuition and fees and had tax liability to which to apply the credit. This option costs $3 billion when considered alone.

Pro: Makes the credit more progressive, addressing concerns of key Members of Congress and constituency groups (who have been reluctant to fight for the details of our proposal as currently drafted). Reduces the amount of data that the taxpayer and IRS will need to compute the credit.

Con: Cost which must be absorbed through other changes to the proposals.

2b. Offset grants by 50%. With this approach, a student's eligibility for the HOPE Scholarship would be reduced by half of the Federal grants received. This approach costs $0.9 billion when considered alone.

Pro: Costs less than eliminating the offset entirely.

Con: Excludes the *poorest* students from HOPE (those with maximum Pell Grants). Will not completely satisfy key Democrats and constituency groups. Would still require a "Federal grants" data element to be reported by colleges, and used by taxpayers and the IRS in computing the credit eligibility.

3. Education's approach: $1,500 Credit, Deduction capped at $1,500

The maximum HOPE Scholarship would remain at $1,500. The tax deduction would still apply to up to $5,000 of tuition and fees through 1998 and up to $10,000 thereafter. However, the value of the deduction would be reduced by either capping it at $1,500 or turning it into a 15% credit. With either approach, in the first two years of college, the HOPE Scholarship would never be less valuable than the deduction.

Education argues that this approach would (1) equalize the benefits between the credit and the deduction, addressing a criticism from some Democrats and higher education groups, and (2) maintains the commitment to provide access to the average community college.

The two approaches for achieving these objectives are:

1. Cap value at $1,500. The value of the deduction (tax bracket times applicable tuition and fees) could not exceed $1,500. A family in the 28% tax bracket would reach the cap at tuition and fees of $5,357. For tuition and fees up to that level, the deduction would continue to be more valuable for higher income families than for lower income families, because of their different tax brackets.

Pro: Middle class families in the 28% bracket, with a child at a public university or lower-cost private institution, would continue to get the full benefit of the deduction.

Con: Students at higher-cost private colleges would not benefit as much as under the current proposal.

ii. Set value of deduction at 15% of tuition and fees. The deduction would essentially be turned into a credit valued at 15% of the tuition and fees charged. The value of the deduction would not vary according to the family's tax bracket (except to the extent that a low-income family lacks tax liability to reduce).

Pro: More likely to be embraced by key Democrats and the education groups.

Con: Less helpful to middle-income families at moderate-cost colleges.

Neither of the approaches above would save enough to fully offset the elimination of the grade requirement and the Pell offset. One or both of them might offset a partial elimination of the grade requirement and Pell offset, as described in 1b and 2b.

4. Treasury's approach: $1,200 credit, $10,000 deduction.

The tax deduction would be unchanged: it would apply to up to $5,000 of tuition and fees through 1998 and up to $10,000 thereafter. The HOPE Scholarship would be reduced to a maximum of $1,200.

Pro: One benefit of reducing the HOPE credit is that it reduces any potential tuition inflation at community colleges, because fewer community colleges would have tuition and fees below that level.

Con: Increases the disparity between the value of the credit ($1,200) and the value of the deduction for a higher-income family ($2,800). The credit would not cover average community college tuition (now at $1,500).

This approach also would not save enough to fully offset the elimination of the grade requirement and the Pell offset. One or both of them might offset a partial elimination of the grade requirement and Pell offset, as described in 1b and 2b.

5. Reduce both the deduction and the credit

If you decide to completely eliminate both the grade requirement and the Pell offset (1a and 2a), it may be necessary to explore options that would reduce both the deduction and the credit in order to offset those costs. For example, a $1,200 HOPE Scholarship, and an $8,000 deduction, capped at a value of $1,200 or 15%, might yield the necessary savings.

Education tax items outside the $35 billion

The Administration's tax package could include several education-related tax items outside of the $35 billion allocation. While Chairman Archer's staff clearly want to use some of these other items in place of your HOPE Scholarship and tuition tax deduction, I strongly feel that we must hold firm to our strict interpretation of the letter, which reserves the roughly $35 billion for "postsecondary education, including a deduction and a credit. . . consistent with the objectives put forward in the HOPE scholarship and tuition tax proposals contained in the Administration's FY 1998 budget to assist middle-class parents." If we open up the $35 billion to other items this early in the process, we risk losing the HOPE Scholarship and tuition deduction.

The larger tax package could include:

- **A Rangel elementary-secondary provision.** Rep. Rangel has been helpful on HOPE Scholarships and the tax deduction, and very much wants to see some of his ideas incorporated into the Administration's tax package. Some possible directions are described below. Cost: perhaps $3-5 billion.

- **Student loan interest deduction.** Different proposals have been put forward by Senate Republicans, Senate Democrats, and House Democrats. Strongly supported by the higher education community. Cost ranges from less than $1 billion to $3 billion, depending on design (caps, income ranges, new versus old loans, and whether parents or just students are eligible).

- **Extending Section 127** (tax deduction for employer-paid education assistance). Senate Republicans have proposed making it permanent, while your 1998 Budget extended it through the year 2000. Sen. Moynihan is a strong supporter of this provision.

- **Education savings incentives,** loosely based on the Lieberman-Breaux "KidSave" proposal.

- **Community Service/Income Contingent Loan Forgiveness.** Exclusion from income of loans forgiven by a non-profit entity for community service, or loans forgiven under the Direct Loan Program's income-contingent repayment provisions. Part of your 1998 Budget, costs only $15 million.

- **Work-Study income exclusion.** Senate Republicans have proposed excluding income from the Federal Work-Study program from taxation. This costs $0.4 billion.

- **Pre-paid tuition plans.** Exempt withdrawals from taxation. This costs $0.6 billion.

Rangel's Education Empowerment Zones

Rep. Rangel recently introduced legislation that includes his version of the HOPE Scholarship (refundable), as well as his own proposal aimed at helping public elementary and secondary schools in poor areas. Rangel's legislation includes (1) a tax credit to subsidize bonds for construction, renovation, teacher training, and curriculum development for "academies" based on school-business partnerships in empowerment zones and empowerment communities or high-poverty schools in other areas, and (2) an expansion of the Work Opportunity Tax Credit to benefit employers who hire graduates within six months of leaving an academy.

There are a number of problems with the design of these proposals. However, we do feel that there are some useful concepts in the legislation, and that we can work with Mr. Rangel on one or more of the following approaches:

School Construction in EZ/ECs: A tax benefit to help reduce the cost of borrowing or other financing of school construction or renovation in high-poverty areas. This could include some of Rep. Rangel's conditions for business contributions and involvement, though that would be an awkward design.

Charter School Construction in EZ/ECs: A tax benefit to help reduce the cost of borrowing or other financing for the construction or renovation of public charter schools in high-poverty areas.

School-Business Partnerships in EZ/ECs: A tax benefit for contributions of money, equipment, or time associated with a partnership between a business and a school in a high-poverty area.

WOTC expansion to EZ/EC graduates: Like Mr. Rangel's proposal, expand the Work Opportunity Tax Credit to graduates of schools in EZ/ECs, or to schools that meet certain criteria (such as the Rangel "academies").

WOTC expansion for high school apprenticeships: expand the Work Opportunity Tax Credit to businesses that hire participants in school-business partnerships *while they are in school.*

THE WHITE HOUSE
6-5-97
WASHINGTON

May 25, 1997

MR. PRESIDENT:

Gene wanted you to see this memo tonight--it is a follow-up from your Friday morning tax cut meeting.

Phil Caplan

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Sperling
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THE PRESIDENT HAS SEEN
6-5-97

THE WHITE HOUSE

WASHINGTON

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May 25, 1997

Sperling memo 6-5-97
re: Tax Package

MEMORANDUM TO THE PRESIDENT

FROM: GENE SPERLING

SUBJECT: Tax Package

At the close of the meeting on tax issues Friday morning, we said we would provide you with memos on the form of the capital gains tax cut and the education package. Those memos are attached, along with a memo that Secretary Riley sent to me.

Capital Gains

On capital gains, most of your advisors, including me, believe that the best approach may be to lead with a 40% exclusion of capital gains, as well as an expansion of the Bumpers capital gains relief for the sale of small business stock. Some Democrats will not be satisfied with this approach because it does not have a populist component. But its advantage, as Summers notes, is that it allows you to start with a broad-based capital gains cut that still gives us room to bargain. Bob Rubin, Larry Summers, Ron Klain, John Hilley, Frank Raines and myself all concur that it is best to start with a broad-based cut that leaves you some room to bargain. A 40% exclusion is one, but not the only approach, that would meet that standard.

You will note on the capital gains memo that there are two options listed that actually raise revenues over both the five and ten-year period. These options set specific rate schedules -- as opposed to broad rate exemptions -- which lead to less generous capital gains tax cuts to those in the 31% and 28% brackets. For example, while a 50% exclusion would mean someone in the 31% bracket pays 15.5% and someone in the 28% bracket pays 14%, under the specific rate schedule listed here, both would pay the higher rate of 20%.

Capital gains tax cuts that have significant tax relief for people in the highest marginal rates and only smaller tax rate reduction for those in 28% and 31% brackets tend to raise revenues for the following reasons:

When there is a significant capital gains tax reduction, there is a scoring assumption that upper income taxpayers will realize significant capital gains that they would not have otherwise realized within a five or ten-year window. Therefore, even though tax rates are being reduced, revenues increase because of the increased amount of capital gains realizations occurring within the five and ten-year period. Hence, over a five to ten-year window, significant capital gains tax cuts on those at the 39.6% bracket will tend to raise revenue.

On the other hand, there is a scoring assumption that capital gains tax cuts on those in the 31% and 28% brackets reduce rates on many realizations that would have happened anyway during the five to ten year budget window. Therefore, significant reductions on capital gains rates on those in the 31% and 28% brackets tend to cost revenues. Consequently, options that have significant rate cuts for those in the 39.6% bracket while only smaller tax cuts for those in 31% and 28% brackets can have the cumulative impact of raising revenues within the budget cycle.

My personal view, and one that is shared by many of your economic advisors, is that a capital gains cut that raised revenues would be very poorly received particularly among Democrats and commentators.

Education

On education, the choices are to reduce the credit, reduce the value of the deduction, or to phase both of them in slowly. The cost estimates are preliminary, so any option you choose may need to be adjusted somewhat in order to not exceed the $35 billion allocation. As you will see from Riley's memo, he feels strongly that the credit should be maintained at $1500 (he presents an option similar to Treasury's third option).

While I think there is significant substantive merit to Secretary Riley's option, in light of the criteria you have expressed for laying out an education tax package, myself , Frank Raines, John Hilley, and Ron Klain would all support a proposal that would keep both your $10,000 deduction and $1,500 credit and save costs by simply phasing them in. The Treasury option that meets that standard is option four which phases in both the HOPE Scholarship and $10,000 deduction so that they are at their full amount, $1500 and $10,000, by the fourth year of your budget plan -- Fiscal Year 2001.

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

May 25, 1997

MEMORANDUM FOR THE PRESIDENT

FROM: LAWRENCE SUMMERS
DEPUTY TREASURY SECRETARY

SUBJECT: Education Packages

This memo presents Treasury estimates of several possible combinations of the HOPE scholarship and tuition deduction as well as several other education proposals. The packages illustrate the tradeoffs necessary to fit the HOPE scholarship and tuition deduction into the $35 billion agreement. These tradeoffs are necessary in order to offset the increased costs of the package that would result from dropping the B- requirement (as requested by the education lobby) and the Pell grant offset (as requested by Congressional Democrats). Dropping these two items is estimated to cost approximately $5.3 billion through 2002.

Each of the options set forth below would eliminate the Pell grant offset and the B-restriction. Each option would fully phase in the complete education package by 2003, so the tuition deduction would be $10,000 and the HOPE Scholarship would be $1,500. The effective date of the options has been moved back to January 1, 1998, which saves roughly $2.5 billion. Please note that the Joint Tax Committee may score these proposals as being more expensive than shown in the table.

Education Packages: Preliminary Treasury Estimates, (Dollar amounts in billions)

	1998-2002	1998-2007
HOPE Scholarship, $1,200; Tuition Deduction, $10,000[1]	35.2	92.8
HOPE Scholarship, $1,000; Tuition Deduction, $10,000[2]	34.1	91.7
HOPE Scholarship, $1,500; Tuition Deduction @15% credit[3]	34.9	92.5
Phased in HOPE Scholarship; Phased in Tuition Deduction[4]	35.0	92.6

[1]The tuition deduction starts at $5,000 through 1999, and increases to $10,000 thereafter.

[2]The tuition deduction starts at $10,000 in 1998.

[3]This variation converts the tuition deduction into a 15 percent credit on expenses up to $10,000 ($5,000 in 1998).

[4]The tuition deduction starts at $5,000 through 2000, and increases to $10,000 thereafter. The HOPE credit starts at $1,200 through 2000, and increases to $1,500 thereafter.

o The crucial design choice that needs your guidance is whether the HOPE scholarship, the tuition deduction, or both should be trimmed to fit the education into the $35 billion agreement.

___ Trim the HOPE credit (As in package #1 above) ___ Trim the deduction (as in package #3 above) ___ Phase in both (as in package #4 above)

- There are additional possible variations of the packages. Elimination of the Pell offset could be phased in, though this would not save a lot since completely eliminating the Pell offset costs roughly $3 billion through 2002. The income phaseout ranges could also be altered (the credit and deduction phase out for joint filers with incomes between $80,000 and $100,000 and single filers with income between $50,000 and $70,000).

Additional Features of the Education Packages

o With money outside the $35 billion, we propose to make permanent the exclusion of employer-provided educational assistance from taxable income (Section 127). This is a cause that has been championed by Senator Moynihan and others in the House and the Senate. Doing so will cost roughly $3.7 billion through 2002.

o A student loan interest deduction would provide relief to many middle-income students and is politically popular. Adopting the student loan interest deduction in the Republican Leadership education bill (S.1) would cost $1.8 billion under Treasury scoring (and $0.7 billion under Joint Tax scoring).

- The proposal to deduct student loan interest would provide a $2,500 above-the-line deduction, phased out at $45,000 to $65,000 for single filers and $65,000 to $85,000 for joint filers.

o We are developing proposals to aid school construction (and other activities) in poor neighborhoods, as urged by Congressman Rangel and others.

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

May 23, 1997

MEMORANDUM FOR THE PRESIDENT

FROM: **LAWRENCE SUMMERS**
DEPUTY TREASURY SECRETARY

SUBJECT: Capital Gains Relief Package

This memo provides several options for broad-based capital gains tax relief. Our recommended option is a 40 percent exclusion for capital gains (with the AMT rate on capital gains reduced to 20 percent). This leaves room for negotiating a slightly higher exclusion, but holding firm against capital gains indexing. We would also recommend that a capital gains relief package include expansion of the Bumpers targeted capital gains relief presently provided to holdings of small business stock (as described more fully below), and our budget proposal to exclude up to $500,000 of capital gains from the sale of principal residences for married couples filing jointly ($250,000 for other taxpayers). We intend to provide you next week with a memo regarding capital gains indexing, which will detail the problems that would result from allowing indexing.

<u>Broad-based capital gains tax relief</u>

The following table provides the cost estimates for various broad-based capital gains options that we have considered:

Preliminary Treasury Estimates, (Dollar amounts in billions)[1]		
	1998-2002	1998-2007
40% capital gains exclusion (w/ 20% AMT rate)	-$2.7	-$15.2
40% capital gains exclusion (w/o AMT preference)	-$10.6	-$34.0
50% capital gains exclusion (w/o AMT preference)	-$18.3	-$55.3
50% capital gains exclusion, plus indexing starting 1/1/97	-$32.3	-$96.9
Separate rate schedule: 10.5% for 15% bracket taxpayers, 20% for other taxpayers; 20% AMT rate	+$13.4	+$15.3
Separate rate schedule: 7.5% for 15% bracket taxpayers, 20% for other taxpayers; 20% AMT rate	+$8.2	+$3.7

[1] All of the estimates shown include the cost of the proposed exclusion for sales of principal residences, which costs $1.4 billion through 2002 and $2.3 billion through 2007. However, they do not include the proposed expansion of the Bumpers targeted capital gains provision.

o **Replace the current maximum rate on capital gains with a percentage exclusion.** This provides the same proportional reduction in the rate on capital gains for taxpayers in all tax rate brackets. Thus, in contrast to current law (which provides a maximum capital gains rate of 28 percent benefitting only higher income taxpayers), the proposal would provide capital gains relief for low and middle income taxpayers. A 50 percent exclusion would lower the top rate on capital gains from 28 percent to 19.8 percent. Several current Republican bills include a 50 percent exclusion for capital gains. For AMT purposes, capital gains would be subject to a special 20 percent rate, rather than the regular AMT rates of 26 or 28 percent. This ensures that the top capital gains rate is 20 percent for both regular tax and AMT purposes.

o **Separate rate schedule applicable to capital gains.** An alternative means of providing rate relief would be to tax capital gains under a separate rate schedule. For example, a special rate schedule could be established with a rate of 7.5 percent for taxpayers in the 15 percent bracket and a rate of 20 percent for taxpayers in higher tax brackets. A special AMT rate of 20 percent would apply.

Thus, in contrast to a percentage exclusion, taxpayers in tax brackets ranging from 28 percent to 39.6 percent would be subject to the same special capital gains rate. This causes a separate rate schedule of this type to be much less expensive than a percentage exclusion because the greatest benefits are given to high bracket taxpayers who are more likely to have induced realizations from the proposal. Conversely, less revenue is spent on lower bracket taxpayers who are less likely to change their realization pattern as a result of the proposal. Obviously, this type of separate rate schedule is more regressive than an across-the-board exclusion.

<u>Expand Bumpers targeted capital gains relief for the sale of small business stock.</u>

In 1993, targeted capital gains relief was added under section 1202, largely at the behest of Senator Bumpers, for sales of small business stock. Section 1202 presently provides a 50 percent exclusion for capital gains from the sale of qualified small business stock held for more than 5 years. If additional targeted capital gains relief is desired, Section 1202 could be expanded by: (1) eliminating the $10 million limitation on eligible gain, and (2) increasing the size of qualified businesses from $50 million of gross assets to $100 million of gross assets. Also, if a broad-based capital gains exclusion were adopted, we would recommend that the exclusion under section 1202 be increased correspondingly to 75 percent, i.e., the maximum rate under section 1202 would be reduced to 9.9 percent (15 percent for taxpayers subject to the AMT). Certain technical changes would also be made.

These changes are similar to proposed changes to section 1202 made by Senators Daschle, Lieberman and Hatch and by Congressman Matsui (among others).

UNITED STATES DEPARTMENT OF EDUCATION

THE SECRETARY

May 23, 1997

MEMORANDUM FOR GENE SPERLING

FROM: SECRETARY RICHARD RILEY

RE: Recommended compromise higher education tax package

I describe below a compromise $35 billion higher education tax package that would eliminate the B- requirement and eliminate entirely the HOPE offset for Pell and other federal grants while keeping the maximum HOPE tax credit at $1,500 -- the average community college tuition. It pays for these changes by making the tax credit and tuition deduction effective January 1, 1998 rather than June 1, 1997, and by capping the value of the tax deduction at 15% of tuition, up to a maximum of $1,500. I strongly favor this approach over one that would reduce the size of the HOPE tax credit for the following reasons:

The compromise package described below which maintains the $1,500 tax credit would:

- Make the average community college free.
- Still provide significant benefits to families in the 28% tax bracket (over $60,000 AGI) because families with more than one child could take the tax credit for each child in their first or second year of college at the same time that they take the tax deduction for their other children or for themselves (i.e. the credit is per person while the $10,000 tuition deduction is per family). In addition, we would help families in the 28% bracket by reinstating the student loan interest deduction, paid for outside the $35 billion.
- Make the package more progressive, ensuring that the balanced budget plan is more progressive, and even more so when viewed in combination with the 1993 Economic Plan.
- Simplify the proposal by equalizing the maximum value of the credit and the deduction.

Reducing the HOPE tax credit to $1,200 and maintaining the tuition deduction as is would:

- Make it very difficult to say that the tax credit would make the average community college free because the average community college tuition is $1,500. *Over half the States* now have estimated average community college tuitions above $1,200.
- Make it difficult to argue with others against lowering the credit further because the level would no longer be tied to the average community college tuition.
- Leave us highly vulnerable to Congress amending our proposal to cap the deduction at $1,500 and using the savings for a different Congressional proposal. Congressional Minority, the higher education community, and pundits have criticized our deduction as regressive. *Thus, we could very well end up with a tax credit below $1,500 and a reduced tuition deduction.* And once we propose lowering the tax credit, it is very unlikely that we could raise it back up to $1,500.

Recommended Compromise Package: **5-year cost: $35 billion**

1. **HOPE Tax Credit: Require satisfactory progress rather than at least a B-**

   This package would eliminate the B- requirement for eligibility for a second HOPE tax credit, but would continue to require responsibility by applying the "satisfactory progress" requirements now used for eligibility for student aid programs. These rules require that students maintain at least a C average or meet other standards set by the institution. This change would increase costs by $2.2 billion over 5 years.

2. **HOPE Tax Credit: Eliminate the offset for Pell and other federal grants**

   Our FY98 Budget proposal deducts the value of any Pell or other federal grant from the value of the HOPE tax credit. To provide more assistance to lower income students, this compromise package would eliminate the offset completely, as both Rep. Rangel's bill and the Senate Minority bill propose. This costs an additional $3 billion over 5 years.

3. **Tax Deduction: Cap the benefit at $1,500**

   To offset the cost of the above changes, this package would reduce the maximum benefit of our proposed tax deduction from $2,800 to $1,500 by limiting the value of the deduction to 15% of tuition and fees, up to a maximum of $1,500. This would respond to criticism that the deduction is regressive while maintaining its sensitivity to tuition amounts. The higher education community and Hill Democrats would strongly supported this change, and it would save $4.0 billion over 5 years. To provide additional assistance to families in the 28% bracket who would benefit less than under our original proposal, I recommend reinstating tax deductibility of interest on student or parent higher education loans, paid for outside the $35 billion reserved for the tax credit and tuition deduction.

4. **Make the tax credit and deduction effective for studies begun after January 1, 1998 instead of after June 1, 1997**

   Our FY98 Budget proposed making the tax credit and tuition deduction effective for studies begun after June 1, 1997. However, at this point, it would be very difficult, if not impossible, for the IRS, Education Department, and higher education institutions to implement the change for tax year 1997. Therefore, this package would make these changes effective for studies begun after January 1, 1998 (tax year 1998), which preliminary Education Department analysis suggests might save $2.3 billion over 5 years.

This package would also commit to reinstating the deductibility of interest on any student or parent higher education loan (Senate Minority version which has the higher phased out range benefiting those in the 28% bracket), extending Section 127, establishing a 10% tax credit for small businesses that provide education and training, and allowing tax-free forgiveness of student loans for those engaged in community service, but would pay for these proposals outside the $35 billion reserved for the HOPE tax credit and $10,000 tax deduction.

Compromise Higher Education Tax Package

		5-year cost ($ billions)
Proposal in FY98 Budget:		**$36.1**
Possible Compromise Package:		
1.	Substitute satisfactory progress requirement for the B- requirement	+$2.2
2.	Eliminate HOPE offset for Pell and other federal grants	+$3.0
3.	Cap the value of the tax deduction at 15% of tuition, up to $1,500	-$4.0
4.	Make the tax credit and tuition deduction available for studies begun after January 1, 1998	est. -$2.3 (Treasury estimate not yet available)
	Net change:	-$1.1
Total Cost:		**$35 billion**

Outside of the $35 billion reserved for the HOPE tax credit and tuition deduction, this compromise package would reinstate the student loan interest deduction (Senate Minority version which has the higher phase-out range benefiting those in the 28% bracket), extend Section 127, establish a small business tax credit for education and training, and allow tax-free loan forgiveness for people engaged in community service.

June 10, 1997

MEMORANDUM FOR GENE SPERLING

FROM: **Bob Shireman**

SUBJECT: **Opposition letters to Archer plan**

Attached are new letters opposing the Archer approach to higher education tax cuts. They include:

Association of Community College Trustees
American Association of Community Colleges
The College Board
United States Student Association
U.S. Public Interest Research Group Higher Education Project

These are in addition to the AASCU letter that was released today.

The Vice President is giving some math and science teaching awards in the morning, **and may include a couple of paragraphs about the building opposition to the Archer plan.** I will be working with them later tonight on possible language. They would then distribute copies of these new letters as well as the endorsement packet.

Secretary Rubin is not able to fit an event into his schedule tomorrow, so there will not be a Riley-Rubin press conference with the groups.

Jake is working with Education to make sure that the press feels the drumbeat of organizations expressing concern about the Archer approach.

FOR IMMEDIATE RELEASE
Contact: Noah Brown
202/775-4667

COMMUNITY COLLEGE STUDENTS LOSE HOPE UNDER ARCHER TAX PLAN

Washington, DC (June 9) -- House Ways & Means Committee Chairman Bill Archer today unveiled his plan to provide $85 billion in net tax cuts as part of the budget reconciliation bill to be considered by Congress this summer. The plan's education components depart significantly from President Clinton's proposals and cuts in half the value of the tuition credit for students attending community colleges. The plan also would raise taxes on working Americans who need access to postsecondary education to remain employable.

Archer's plan provides $22 billion for the President's Hope Scholarship tax credit over five years. The credit would match 50 percent of higher education out-of-pocket expenses (tuition and books) up to $3,000 to families earning less than $80,000 per year, and to individuals earning less than $40,000 per year. This contrasts sharply with the Administration's tax credit plan to provide a tax credit of up to $1,500 to cover educational expenses for the first two years of college.

Students attending community colleges, where annual tuition averages less than $1,500, lose under Archer's version of the tuition tax credit. This is due to the way in which the amount of the credit would be calculated. For example, if a student attends a community college and pays $1,500 for tuition, they would be eligible for a $750 tax credit under Archer's plan – half the amount available under the President's Hope Scholarship proposal. The net effect of Archer's plan is to shift the credit's benefit to students with financial means and to those attending costlier four-year colleges and universities.

Archer's plan also raises taxes on working people seeking to upgrade their skills and/or qualify for new jobs. Under the plan, the tax exclusion for employer-provided tuition assistance would expire after this year. Beginning next year, individuals receiving tuition assistance from the employers would see their paychecks reduced by additional tax withholding.

ACCT opposes Archer's changes to the Hope Scholarship tax credit and is alarmed that Employee Education Assistance would not continue beyond the current year. The plan fails to provide real access and opportunity to Americans without the financial means to attend college and creates a tax impediment for those seeking to successfully join today's high-skills workplace.

ACCT represents the more than 6,000 publicly elected and appointed governing officials of community, junior, and technical colleges across the United States and Canada.

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Association of Community College Trustees, 1740 "N" Street, NW, Washington, DC 20036

The College Board
1233 20th Street, N.W., Suite 600, Washington, D.C. 20036-2304
Telephone: (202) 822-5900; Facsimile: (202) 822-5920

hington Office

June 10, 1997

College Board Response to Ways and Means Committee Chair Archer's Education Tax Proposals

Throughout recent discussions on tuition tax proposals, the College Board has advocated judicious use of the tax code for educational purposes and recommended adjustments to ensure that any tax credit or deduction be equitable for all families. In that regard, the College Board is pleased to note that the proposals announced by the chairman of the House Ways and Means Committee this week support savings for higher education through penalty-free withdrawals from IRAs accounts for postsecondary education.

In its totality, however, the package falls far short of advancing the College Board's priority of targeting the tax code for specific educational purposes and making any changes equitable for all families. For example, we are concerned that the package does not include:

- deductibility of interest on student loans;
- tax-free treatment of need-based grants, fellowships, scholarships, and federal College Work Study earnings; and
- permanent (in contrast to a one-year) extension of section 127 of the tax code for both undergraduate and graduate students, a modest incentive for private sector investment in the continuing education of adults.

We are also greatly concerned about other aspects of the chairman's package. By limiting the credit to 50 percent of up to $3,000 of "out-of-pocket" tuition expenses required for college attendance, the chairman's version of the Hope Scholarship further reduces the tax benefit for many low-income students. Like the Administration's Hope Scholarship, the chairman's tax credit would also be non-refundable, that is, students and families without any tax liability would not receive the benefit.

In addition, the chairman's proposed $10,000 tuition deduction, focused only on state- and private-sponsored pre-paid tuition programs, would primarily benefit middle- and upper-middle income taxpayers. These provisions of the chairman's package also have the potential to complicate the financing of higher education by encouraging multiple state variations of the pre-paid tuition concept, not to mention the proliferation of private for-profit models.

The College Board is pleased that the Administration last week modified its original tuition tax proposals, shifting more funding to the needier students, providing student loan interest deduction, and allowing tax relief for employer-provided education assistance. We are concerned that the committee did not include these modifications in its recently released plan.

* * *

The College Board is a national association of over 3,200 schools and colleges dedicated to advancing equity and excellence for all students.

Statement of the American Association of Community Colleges on Chairman Archer's Mark Relating to Revenue Reconciliation Provisions

The American Association of Community Colleges (AACC) is pleased that the Chairman's mark includes a tax credit to help pay for the first two years of postsecondary education. However, AACC is deeply concerned about its present configuration. As announced, the credit would cover 50 percent of up to $3,000 of out-of-pocket tuition expenses and books required for attendance. This structure would limit the benefit the tax credit will have for community college students, most of whom are enrolled at institutions whose tuition is well below the level at which they could receive the maximum tax credit. We strongly believe that community college students should be eligible for the same level of support through a tax credit as students enrolled at more expensive institutions of higher education.

We are also troubled that the Chairman's mark does not permanently extend Section 127 of the Internal Revenue Code. Limiting the extension to a six-moth period for undergraduate programs will hamper the ability of America's workers to gain access to the education programs they need to maintain and upgrade their skills.

June 10, 1997

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UNITED STATES STUDENT ASSOCIATION

50 YEARS CLOSER TO FREEDOM

FOR IMMEDIATE RELEASE
June 10, 1997

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********PRESS RELEASE********

Students Express Strong Disappointment With Chairman Archer's Education Tax Proposals

WASHINGTON, D.C.--Students around the country are registering their disappointment with Chairman Archer's plan for education tax initiatives. Chairman Archer's package will do nothing to expand access to education. Instead of addressing student concerns about the administration's education tax proposals, the plan shifts benefits away from even middle income families and funnels aid to those with greater resources.

Students believe that education tax initiatives must include measures to broaden educational opportunity. We know that without additional help thousands of young people will be forced to forego a college education. We support the President's efforts to ensure that at least $35 billion of any overall tax package be targeted to higher education, and we urge Congress to ensure that the neediest families, as well as those with middle and upper-middle incomes, qualify for education-related tax benefits.

Chairman Archer's plan will provide additional aid to those families least in need and no help to low-income students and families who often find the financial barriers to college insurmountable.

Students are particularly concerned that the modifications to the HOPE Scholarship move the tax subsidies further toward the upper income rather than toward those with the greatest need, that the $10,000 deduction proposals will only help the wealthiest families, and that there are no provisions for student loan forgiveness, a student loan interest deduction, permanent extension of employer-provided education assistance, or non-taxability of work-study and need-based scholarships and fellowships.

50TH ANNIVERSARY
1947•1997

U.S. Public Interest Research Group

National Association of State PIRGs

News Release

For Immediate Release:
June 10, 1997

For More Information:
Ivan Frishberg, (202) 546-9707

Statement from PIRG's Higher Education Project regarding House Ways and Means Committee Proposal on Higher Education tax cuts.

A college education is the best investment we can make in America's future. Rather than fully opening up that investment to all Americans students, Chairman Archer's Mark represents a missed opportunity to expand access to higher education.

U.S. PIRG has commended both the President and the Leadership in Congress for the commitment to higher education that was made in the balanced budget deal. However, we have persistent concerns that the $35 billion investment in higher education is delivered in a way that truly delivers hope to all students, including those working families with incomes too low to create significant tax liability.

Compared to the President's proposals, Chairman Archer's proposal does even less to deliver assistance to those who need it the most, when it could have done more. We encourage Chairman Archer to listen a little closer to the concerns of students, and work towards a greater and more real hope for America's college students.

Congress and the Administration should work together to construct a tax package that includes a hope scholarship that goes to the millions of American students who don't have tax liability, and that includes proposals that ease the burden of student debt: tax exempt loan forgiveness and a student loan interest deduction.

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U.S. PIRG is the national lobbying office of the state Public Interest Research Groups. U.S. PIRG is a non-profit environmental and consumer watchdog group with citizen and student members in over 35 states, and with chapters at over 100 college campuses.

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

June 26, 1997

SECRETARY OF THE TREASURY

MEMORANDUM FOR THE PRESIDENT

FROM: Robert Rubin RER
Gene Sperling

SUBJECT: An Offer on Your Tax Package

Your budget team met in Erskine's office today to finalize our recommendations for our tax package to be offered on Monday. The following memo summarizes issues and highlights choices that need to be made concerning the package. The side-by-side following the options memo compares the features and five-year costs of the competing Administration, House and Senate choices.

Post-Secondary Education

- o **Option 1** provides a two-year HOPE scholarship of $1,000 and 50 percent of additional expenses up to $1000 starting in 1998. It provides a 20 percent credit on allowable out-of-pocket education expenses of $5,000 through 2000 and $10,000 thereafter. The package is more generous than the House and Senate packages.
  - This costs roughly $34.5 billion through 2002 and $90.6 through 2007 under Treasury's scoring. We expect JCT scoring to be at least $5 billion higher in the first five years.

- o **Option 2** would give a four year HOPE scholarship of $1,000 for students attending at least half time in a degree or certificate program, and 20 percent of additional expenses up to $1000 starting in 1998. Students not eligible for the HOPE scholarship could get a credit for 20 percent of additional expenses up to $1000 starting in 1998. This package will cost in the neighborhood of $35 billion under Treasury's scoring.

- o **Option 3** mirrors the proposals offered by the House and Senate Democrats. It gives a HOPE Scholarship of $1000 and 50 percent of additional expenses up to $200 through 1999, $400 in 2000 and $1,000 thereafter. Students must be attending at least half time in the first two years of a degree or certificate program. If a student is not eligible for the HOPE scholarship, we would give a 20 percent tuition credit on expenses up to $4,000 through 1999, $7,500 in 2000 and $10,000 thereafter.
  - This option costs $32.3 ($37.4) billion through 2002 and $88.6 ($87.3) through

2007 under Treasury (JCT) scoring.

Your advisers are in general agreement that Option 1 makes the most sense at this time. It stays close to the original proposal in your Budget and allows you to stress how the proposal best advances your goal of making the 13th and 14th grades universal, plus it has a strong lifelong learning component. Furthermore, by including the notion of 50 percent of the second $1,000, it addresses the tuition inflation argument and shows us being responsive to suggestions by Daschle and Senate Democrats.

Many of your advisers believe that in the end, we may wish to fall back to a single, simpler four-year option -- such as Option 2. Most of your advisers would rather lead with Option 1 and use a version of Option 2 (perhaps with a more generous lifelong learning provision) as a fall-back. Frank Raines, however, would favor moving to this option sooner rather than later as a means of showing our immediate willingness to offer a compromise suggestion on our tax priority.

___ prefer Option 1 ___ prefer Option 2 ___ prefer Option 3

General Capital Gains Relief

- o **Option 1** would provide a 30 percent exclusion. This holds the top rate at 28 percent, but gives a rate cut to all taxpayers in the 36 percent bracket and lower. Taxpayers in the 28 percent and 15 percent brackets get as much relief as they do under the 20/10 separate rate schedule. The proposal would include the President's home sale provision.

  - Costs $8.2 billion through 2002 and $17.5 billion through 2007 (Treasury scoring). We expect the JCT to score this as costing several billion less through 2002.

- o **Option 2** would provide a separate rate schedule approach (using rates of 24/12), retain 28 percent rate for collectibles, depreciation recapture at 26 percent, AMT adjustment to tax gains at 24 percent, President's home sale provision.

  - Treasury estimates that this proposal would raise $3.6 billion through 2002 and $4.6 billion through 2007. We expect the JCT to score this as losing roughly $2 billion through 2002 and roughly $20 billion through 2007.

- o **Option 3** is the proposal that came out of the Finance Committee, which had a separate rate schedule of 20/10, depreciation recapture at 24 percent and the President's home sales provision. An AMT feature will need to be addressed.

  - JCT estimates that the Senate Finance proposal would lose $3.3 billion through 2002 and $23.9 through 2007.

Your advisers recommend Option 1. This proposal provides a broad based capital gains tax cut to all but the people at the very top of the income scale. The Republicans will not like it because it does not provide relief to the roughly half percent of taxpayers who are in the 39.6 percent bracket, but it will put them in an awkward message situation, help with our distribution, and most importantly, give us room to move in exchange for coming our way on the higher education tax cut and the "stacking" on EITC.

___ prefer Option 1 ___ prefer Option 2 ___ prefer Option 3

Child Credit

The child credit is the piece that moves to fit the rest of the package.

- o **Option 1** would do the following. First, the child credit would be stacked before the EITC, ensuring that working families who pay income taxes receive the benefit of the child credit. Moreover, the child credit would be partially refundable to the extent the employee share of payroll taxes exceeds their EITC. Thus, the child credit will offset income taxes and payroll taxes, to the extent the latter exceeds the EITC. Second, we will cover children under 17, as is the case in the Congressional packages. Third, we would keep the optional Kidsave feature that allows parents to contribute up to the amount of the credit plus $500 to a nondeductible, backloaded IRA-type savings vehicle. Earnings would be distributed tax free for the child's education and possibly child related events, or for the parent's retirement. Fourth, the income phaseouts will be as in the FY98 budget ($60,000 to $75,000) through 2002 and higher thereafter. Fifth, the credit will be phased in (starting at $300 in 1998 and phasing up to $500) to fit the $85 billion budget agreement.

- o **Option 2** would drop refundability, stack the child credit before the EITC and include the optional Kidsave feature. The proposal should first phase-in at a level comparable to the Republican proposal (no credit in 1997, $400 in 1998 and $500 thereafter). It should then cover children under 17 (though we could cover 17 year olds) and then use whatever money is remaining to increase the income limits beyond the $60,000-$75,000 range in the FY98 Budget (we will increase the income limits after 2002).

- o **Option 3** incorporates a more generous Kidsave feature. It would give a child credit of $500 for families that do not contribute to a Kidsave account, and a $600 child credit to families that contribute at least $600 to the Kidsave account. This proposal would need to be somewhat less generous in some dimension than Option 2 in order to finance the saving subsidy.

Your advisers recommend Option 1. The major issue of the discussion was to what extent out proposal should be refundable. Focusing strictly on stacking would allow us a cleaner message because it would keep the debate on the young police officer you discussed at the press conference. On the other hand, going with refundability would allow us to stay close to our Democrats, plus leave room to move later.

All of us agree that we did not want to allow the Republicans to be able to frame the message as Democrats for welfare payments at the expense of Republicans for tax credits for teens in middle class families. We reached consensus around a proposal that would give the tax credit to teenagers, and have partial refundability -- but only to the degree that people paid payroll and income taxes beyond what they get in their EITC. In this way, we take away the Republican message on teenagers, keep some element of refundability, but keep our message that this is a tax cut only for people who owe federal payroll and income taxes. While this may not be as strong on refundability as some Democrats will like, it has partial refundability, keeps our message advantage, and can be described as taking characteristics from both the Rangel and Daschle packages. In order to afford all this, however, we have to phase in the $500 credit -- but that is consistent with your original child credit proposal.

___ prefer Option 1 ___ prefer Option 2 ___ prefer Option 3

Airport and Airways Trust Fund

- **Option 1** would follow the President's FY 1998 budget by extending the airline ticket tax through 2007 and wait for the National Civil Aviation Review Commission to propose a more long-term solution to meet the FAA's long-term needs with user fees.

- **Option 2** would adopt changes from the Finance Committee mark, which raise an additional $2.9 billion through 2002 and $8 billion through 2007. While no airline supports increased fees, low-cost carriers prefer the Senate approach versus the "head tax" provisions proposed in the House.

Your advisers recommend that you choose Option 1, which sticks with what was in your budget and keeps you out of this fight.

___ prefer Option 1 ___ prefer Option 2

Tobacco Taxes

- **Option 1** would impose a 20 cents/pack increase in the tobacco excise tax as included in the Finance Committee package, but dedicate the revenue to a trust fund for children's and health expenditures. Under this option tobacco taxes would not displace other raisers needed to finance the tax cuts that are sought.

- **Option 2** would impose a 20 cent/pack increase in the tobacco tax and use it to fund other measures.

o **Option 3** would not include a tobacco tax increase.

Your advisers recommend Option 1. We believe we should include a tobacco tax increase but insist that it go to help advance your goals for children. We will discuss with Bruce Reed and others the best tactical strategy for deciding how we should describe what such children's concerns these funds should go to.

___ prefer Option 1 ___ prefer Option 2 ___ prefer Option 3

Comparison of Major Provisions of Competing Tax Packages, June 24, 1997 (Scoring through 2002)			
Item	Suggested Administration Package	Ways and Means Package	Senate Finance Committee Package
Education	<u>HOPE Scholarship</u>: 100 percent of the first $1,000 and 50 percent of additional expenses up to $1000 starting in 1998. <u>Tuition credit</u>: 20 percent credit on allowable out-of-pocket education expenses of $5,000 through 2000 and $10,000 thereafter. ($34.5)	Modified HOPE scholarship --50% of expenses up to $3,000 (phaseout $40,000-50,000 singles/$80,000-100,000 joint). ($22.3) Deduction for undergraduate expenses paid through state-sponsored prepaid tuition program of up to $10,000/yr., $40,000 max. per student. ($0.9)	Modified HOPE scholarship --50% of expenses up to $3,000; 75% of up to $2000 for community colleges and technical school students (phaseout $40,000-50,000 singles/$80,000-100,000 joint). ($20.4) No deduction or credit, other than Modified Hope Scholarship.
School construction	Allocable tax credits for K-12 construction. ($2.5; Rangel spent $1.7)	None	Raise small issuer arbitrage exemption for education facilities. ($.03)
Section 127	Permanent extension of Section 127, for both graduates and undergraduates. ($3.6)	Six month extension of Section 127 for undergraduates. ($0.2)	Permanent extension of Section 127, for both graduates and undergraduates. ($3.5)
Computer technology K-12	Subsidy for Internet access for K-12 schools. ($0.3)	Enhanced deduction for corporate contributions to schools. ($0.2)	Exclude certain teacher training (including technology training) expenses from application of 2% floor on miscellaneous itemized deductions. ($0.1)
Student loans	$2500 above-the-line student loan interest deduction. ($1.1)	None	$2500 above-the-line student loan interest deduction. ($1.1)

$150 million bond cap for private colleges and universities	Repeal bond cap. ($0.3)	Raise by $10 million per year until it reaches $200 million. ($0.13)	Repeal bond cap. ($0.3)
IRA withdrawals	Penalty-free IRA withdrawals for undergraduate, post-secondary vocational, and graduate education expenses. ($0.8)	Penalty-free IRA withdrawals for undergraduate, post-secondary vocational, and graduate education expenses. ($0.8)	Penalty-free IRA withdrawals for undergraduate, post-secondary vocational, and graduate education expenses. ($0.8)
Education saving incentives	Kidsave accounts (i.e. backloaded IRA for educational saving), with $1,000 contribution limit. As in the Senate, education expenses financed by Kidsave withdrawals would reduce allowable expenses for the Hope Scholarship.	Education investment accounts for children under 18 (maximum $5,000 annual contribution, $50,000 aggregate contributions), private prepaid tuition plans; deduction for undergraduate and post-secondary vocational expenses of up to $10,000/yr., $40,000 max. per student. ($7.0)	Contributions of up to $2000 (plus $500 child credit) per year to Education IRA-- tax-free inside buildup and tax-free withdrawals if used for higher education; allow private prepaid tuition plans $2000 (plus $500 child credit) per year; tax-free withdrawals for prepaid State-sponsored programs. ($ 6.2)
Middle-Class Tax Relief	This provision will be adapted to fit the $85 billion net tax cut target. The credit will be stacked before the EITC and partially refundable. It will cover kids under 17, incorporate an optional Kidsave feature, phases out between $60,000 and $75,000 (prior to 2002) and phases in to a $500 credit, starting at $300 in 1998.	$500 ($400 in 1998) child credit, non-refundable, under 17, stacked <u>after</u> the EITC; 50% offset with dependent care credit for married couple making $60,000 or more ($33,000 for other taxpayers), beginning after 2000. ($71.3) Phased out starting at $75,000 for singles and $110,000 for joint	$500 ($250 in 1997 only for children under 13) child credit, for children under 17 (18 after 2002); mandatory Kidsave for children age 13 and above; stacked <u>after</u> half of the EITC. ($83.5) Phased out starting at $75,000 for singles and $110,000 for joint

		Index dependent care tax credit expense limit, $75,000-$100,000 AGI phaseout. ($0.1)	
Alternative Minimum Tax	None	Increase individual AMT exemption amount by $1,000 every other year from 1999 through 2007, index thereafter. ($1.2)	Increase individual AMT exemption amount by $600 (joint) for 2001-2002; $950 (joint) every year thereafter. ($0.35)
Corporate AMT	None. (Exemption from AMT for small corporations -- included as part of Administration Simplification Proposal)	Exemption from AMT for small corporations. ($0.6)	None
	None	Prospective repeal of AMT depreciation. ($11.8)	None
Capital Gains Provisions	30% exclusion; retain 28% for collectibles. $500,000 exclusion for home sales. Includes the President's home sales provisions. ($8.4, Treasury estimate).	Separate 20/10 rate schedule, 26% maximum rate on depreciation recapture, indexing starting in 2001; phase down of top corporate capital gains rate to 30% for assets held at least 8 years. $500,000 exclusion for home sales. (raises $2.7)	Separate 20/10 rate schedule, 24% maximum rate on depreciation recapture, no indexing or corporate capital gains. $500,000 exclusion for home sales. ($3.3)
Small Business Provisions	Variant of Bumpers-Matsui targeted small business relief. ($0.4, Treasury)	None	Slightly expanded version of Administration's proposal. ($0.7)

IRAs	None, but allow penalty-free IRA withdrawals for education and establish new Kidsave accounts	Create backloaded American Dream IRA's, penalty free rollovers from IRA (which raises money), special purpose withdrawals for first time home purchase. ($.03)	Expand income phaseouts for deductible IRAs; expand availability of spousal IRAs; create backloaded IRA Plus accounts; special purpose withdrawals for first time home purchases. ($3.3)
Home Office	Increase availability of home office deduction. ($0.6, Treasury)	Slightly modified version of home office provision ($1.1)	None
Estate Tax	Daschle qualified family owned business estate tax relief. ($2.3, Treasury)	Increase unified credit to $1.0 million by 2007. ($7.5)	Increase unified credit to $1m by 2006 ($3.1). Modified Daschle proposal with $1m exemption for qualified businesses ($3.1). Up to $1m exclusion for conservation easements and other changes ($0.4)
Urban Initiatives	Expansion of EZs and ECs, Brownfields, CDFI and the welfare-to-work tax credit. ($2.3)	Modified welfare-to-work provision ($0.1); no brownfields or EZ/ECs.	Restricted brownfields ($0.25); no welfare-to-work or EZ/ECs.
Other Presidential Initiatives	Equitable tolling, Puerto Rico, FSC software, and DC. ($1.3)	Modified D.C. package ($0.3); no equitable tolling, FSC software, or Puerto Rico	Modified D.C. package ($0.3); FSC software ($0.6); no equitable tolling or Puerto Rico.
Extenders	R&E, contributions of appreciated stock to private foundations, WOTC and orphan drug credit. ($2.8)	1-1/2 year extension of R&E, and contributions of appreciated stock to private foundations; one year extension of modified, two-tier WOTC; and permanent extension of orphan drug credit. ($4.1).	Two-and-a-half year extension of R&E and contributions of appreciated stock to private foundations; modified two-tier WOTC and permanent extension of orphan drug credit. ($6.6)
Independent contractors	None	Liberalized independent contractor rules. ($1.0).	Provision re: classification of securities brokers. (negligible).

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

July 2, 1997

SECRETARY OF THE TREASURY

MEMORANDUM FOR THE PRESIDENT

FROM: Robert Rubin

SUBJECT: Defining an Acceptable Tax Bill

There are three main problems with the tax bills that have passed the House and the Senate. The bills do not comply with the budget agreement by failing to include $35 billion of spending over five years that is consistent with your HOPE scholarship and tuition tax proposals. Second, the cost of the bills explode outside the 10-year budget window. Third, both bills provide too little tax relief to middle-class families.

We would like to briefly discuss the following provisions in the Congressional bills

- o The Senate bill spends $22.3 billion on modified HOPE scholarship. The House spends $20.4 billion. Neither bill has a generally available tuition deduction that will assist families with children in their third and fourth year of college or assist lifelong learning.

- o Indexing capital gains (House bill)

- o Reduction in the tax rate on corporate capital gains

- o Phased-in, *defacto* elimination of the corporate AMT

- o A proliferation of tax-preferred saving accounts (like IRAs) that do not have income limits

- o A larger reduction (the 20/10 schedule) in the capital gains tax rate than a 30 percent exclusion

- o Denying the child credit to working families earning roughly $18,000 to $27,500 by requiring them to compute the EITC before taking the child credit ("stacking" problem).

- o Failure to include Brownfields, the expansion of EZs/ECs, CDFI, and the welfare-to-work tax credit.

- o The Senate bill has a variant of Kidsave, the House does not. Should it be optional (as you proposed) or mandatory (as in the Senate bill)?

Distribution

Relative to your tax package, the Congressional bills are sharply skewed to upper income taxpayers. This result is driven by the capital gains provisions, the individual and corporate AMT proposals, the expansion of IRA-like saving accounts for education and other purposes and, to a lesser degree, the higher income phaseouts of the child credit. The distribution tables do not include the estate tax, which would heighten the contrast between the proposals.

Distribution of Alternative Tax Cut Proposals			
Income Quintile	**President Clinton**	**House**	**Senate**
Lowest	1.2%	0.6%	0.4%
Second	10.1	2.5	2.7
Middle	22.2	9.6	10.2
Fourth	34.6	20.0	21.3
Highest	31.5	66.8	65.0
Top 10%	11.7	47.3	42.3
Top 5%	6.5	34.9	28.2
Top 1%	2.6	18.8	12.5
Middle 60%	**66.9**	**32.1**	**34.2**

Costs in the Second Ten Years

The following table shows the year-by-year path of net tax cuts in the competing tax plans.

Net Tax Cuts in House, Senate and President Clinton's Proposals (in billions)										
	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
House	4.4	5.8	26.7	27.2	20.0	27.1	29.7	31.9	36.1	40.9
Senate	-1.5	19.1	22.2	24.9	20.1	24.1	29.0	32.0	36.1	41.1
President	5.0	17.0	17.7	20.6	24.0	27.8	30.5	30.6	32.6	34.1

It is clear that the out-year costs of the Administration plan grow much more slowly than they do under the Congressional plans. There are two ways to see this. First, as the following table makes clear, the Congressional packages contain several provisions whose costs escalate rapidly in the out-years. The costs in the second ten years are driven by the combined effect of provisions like the following:

Costs of Competing Packages: First Five Years, Second Five Years				
	House (in billions)		Senate (in billions)	
	First Five	Second Five	First Five	Second Five
Savings Provisions	$7.5	$28.2	$9.9	$36.8
Capital Gains	+2.7	37.5	2.7	23.6
Individual AMT	1.3	14.1	0.2	13.5
Estate Tax	8.1	20.5	6.5	30.8

- Second, we can make back-of-envelope calculations that give a sense of the tax reductions that would be expected in years 11 through 20 of the budget period. These calculations extrapolate the costs in the final three years of the package through to 2008-2017.

  - Both the House and Senate plans explode, and are likely to cost more than $600 billion in the second ten years (the back-of-envelope calculation is $612 billion for the House plan and $631 billion for the Senate plan). In contrast, the Administration plan is expected to cost around $400 billion (the back-of-envelope calculation is $407 billion).

Comparison of Tax Cuts in the President's Proposal and in the House and Senate Tax Bills

Percentage Distribution

	1997-2002			2003-2007			2007		
	President	House	Senate	President	House	Senate	President	House	Senate
Education	32.4	18.1	16.9	35.2	12.7	14.6	34.3	11.0	12.6
Child Credit	52.1	54.0	53.4	51.3	35.0	37.8	48.9	27.1	30.6
Savings*	1.0	5.7	6.4	2.3	12.4	15.7	2.8	16.0	17.0
Capital Gains	6.3	-2.1	1.8	5.1	16.6	10.1	4.8	19.7	8.9
Individual AMT	0.0	1.0	0.1	0.0	6.2	5.8	0.0	9.4	9.9
Estate Tax	1.7	6.2	4.2	2.4	9.1	13.1	2.8	10.2	17.2
Other Provisions	6.5	17.1	17.2	3.7	7.9	3.0	6.4	6.5	3.8
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Addendum:									
Education and Child Credit	84.5	72.1	70.4	86.5	47.8	52.3	83.3	38.1	43.2
Capital Gains, AMT, Estate	8.1	5.1	6.1	7.5	31.9	28.9	7.6	39.4	36.0

* Includes President's Kidsave proposal, the education investment accounts and expansion of IRAs in the House Bill, educational IRAs and the expansion of IRAs in the Senate Bill, and penalty-free withdrawals from IRAs for educational purposes in all three proposals.

Tax Cuts ($ billions)

	1997-2002			2003-2007			2007		
	President	House	Senate	President	House	Senate	President	House	Senate
Education	43.649	23.551	26.447	72.677	28.84	34.207	15.465	5.977	7.182
Child Credit	70.202	70.41	83.375	105.864	79.36	88.724	22.047	14.779	17.45
Savings	1.316	7.456	9.912	4.73	28.181	36.808	1.249	8.722	9.686
Capital Gains	8.547	-2.688	2.742	10.619	37.543	23.627	2.146	10.741	5.05
Individual AMT	0	1.296	0.215	0	14.061	13.532	0	5.138	5.651
Estate Tax	2.301	8.061	6.54	4.881	20.547	30.827	1.257	5.577	9.832
Other Provisions	8.735	22.31	26.855	7.541	17.987	7.154	2.892	3.565	2.147
Total	134.75	130.396	156.086	206.312	226.519	234.879	45.056	54.499	56.998

CLOSE HOLD
July 3, 1997

MEMORANDUM TO THE PRESIDENT

FROM: **GENE SPERLING**

SUBJECT: **Long-term entitlement reform**

As you know, our original game plan on long-term entitlement reform was first to pass the balanced budget agreement and then to turn our attention to the longer-run challenges. But we no longer have the luxury of waiting until after the budget agreement is implemented: both the House and Senate reconciliation bills set up Medicare commissions. We must therefore decide immediately whether to accept a commission on long-term Medicare reform. We must also decide whether we want to set up a commission on Social Security -- probably separately from the Medicare commission -- within the budget legislation.

The purpose of this memorandum is to explore three related questions and to give you an opportunity to provide us with your guidance on these questions. First, should our long-term entitlement strategy put more priority on initial action on Social Security reform or Medicare reform? Second, even if we believe that our best strategy is to focus initially on Social Security, should we still support a Medicare commission, and, if so, should we try to change the congressional proposals to ensure that the commission neither interferes with our efforts on Social Security nor produces problems for Medicare? Third, should we support the creation of a Social Security commission now, or should we allow ourselves more time to analyze the best way to proceed?

I. Where should we initially focus our efforts on long-term entitlement reform?

A first step in addressing our immediate concerns is that you must decide where to place our initial emphasis in long-term entitlement reform. Senator Lott and other Hill leaders have indicated that they want to tackle long-term Medicare reform first. *But your economic and* *health advisers believe that we should concentrate our initial political capital primarily on Social Security.* The basic argument is that the various options for tackling Social Security are – at least by comparison with Medicare – well-researched and relatively well-understood. Our understanding of how to address the long-term solvency of Medicare is limited. Indeed, your four top health advisers -- Donna Shalala, Chris Jennings, Bruce Vladeck, and Nancy-Ann Min -- believe that the budget agreement embodies most of the obvious steps in reforming Medicare, and that we need much more analysis before considering which additional long-term policies are sensible. Even new proposals such as raising the eligibility age from 65 to 67 and introducing a home health care co-payment will have only a small impact over the long run. Medicare combines Social Security' s demographic challenges with those posed by a health care delivery system characterized by generally rising health costs per beneficiary but much uncertainty over the dynamic evolution of those costs, making effective reform particularly complicated.

Chris Jennings will be submitting a separate memorandum to you explaining why long-term Medicare reform is difficult. Nonetheless, in deciding whether to pursue Social Security reform first, you should remember that such a strategy would be complicated because Senator Lott and other Republican Hill leaders favor addressing Medicare first.

Decision

________ Put initial emphasis on Social Security reform

________ Put initial emphasis on Medicare reform

________ Discuss

II. How should we respond to the Medicare commission proposals?

While you obviously have the option of opposing a Medicare commission in reconciliation, we believe that it is basically a done deal, and our focus should be on how to fix it to fit our needs. If you agree that we should focus our efforts on Social Security first, it is important that a Medicare commission not hinder or undermine that objective. For example, an over-hyped commission on Medicare with key officials from both sides and an early reporting date could divert attention away from Social Security reform. It could also lead to ill-conceived and possibly harmful recommendations for Medicare.

Under both the House and Senate plans, the commission would comprise 15 members (eight Republicans and seven Democrats): six (four Republicans and two Democrats) chosen by the Senate Majority Leader in consultation with the Senate minority leader, six (four Republicans and two Democrats) chosen by the Speaker in consultation with the House minority leader, and three Administration representatives. Under the House bill, you are not granted any discretion in choosing your representatives, who would be the Secretary of Treasury, the Secretary of Labor, and the Secretary of HHS. Thus, under the House bill, the Hill leadership could choose their own representatives, which provides distance from controversial decisions, while you would be forced to put three Cabinet secretaries on the commission. Unlike almost all previous commissions, neither the House nor the Senate proposal would give you the right to choose the chair. The reporting date for the commission would be May 1, 1999 under the House bill and one year after passage of the act -- implying a likely deadline of August 1998 -- under the Senate bill.

You could of course oppose the creation of any Medicare commission. However, your advisers would be concerned that opposition to a Medicare commission may be incorrectly viewed as indicating a lack of interest on our part in tackling entitlement reform. John Hilley believes that the Medicare commission will survive in conference regardless of whether we oppose it.

Instead of opposing a Medicare commission, we could try to ensure that any such commission is not over-hyped, forced to follow a face-track decision-making process leading to an up-or-down vote on a package, or in other ways crowds out your ability to put your initial focus on Social Security. There is enough uncertainty over the substance of Medicare reform, even among your top health advisers, that an intelligent analysis of the issues by a commission could prove extremely beneficial. A commission comprising serious, top-flight people could thus advance the cause of Medicare reform by illuminating possible options, much like the Gramlich commission did for Social Security. To ensure that a Medicare commission is beneficial and does not detract from Social Security reform, we would recommend several changes to the congressional proposals:

- **Membership.** We should not be required to name top Administration officials to the commission, which would preferably also not include Senators and Representatives. If its membership includes top policy-makers, the commission may be constrained by possibly premature policy statements and would seem unlikely to engage in the type of wide-ranging analysis most beneficial on the Medicare front. A commission comprising outside specialists and academics seems more auspicious. As mentioned above, the House version currently appoints to the commission the Secretaries of Treasury, Health and Human Services, and Labor, but grants flexibility to the congressional leadership over appointments. We could fight to remove the Cabinet members from the commission and provide you with full discretion over your appointments.

- **Party balance.** We should also insist on a truly bipartisan commission, with equal numbers of Republicans and Democrats. The current proposals would have eight Republicans and seven Democrats.

- **Chair.** The chair of the commission could set the tone for the entire exercise. Unlike almost all previous commissions, the congressional proposals do not allow you to appoint the chair of the commission. We could insist that you appoint the chair. As a fall-back, we could ask that the chair be chosen mutually.

- **Consensus voting rules.** We could insist on super-majority (3/5 or 2/3) voting for any of the commission's recommendations -- making it more likely that a diversity of views would be represented in the commission's work. Unfortunately, even super-majority voting may not be able to prevent bad outcomes, given the most likely makeup of the commission. (A super-majority could likely be achieved even if only two of the four congressionally-appointed minority members vote with the majority.)

- **Reporting deadline.** The House proposal includes a May 1, 1999 deadline. The Senate proposal sets a deadline of one year after passage of the act -- implying a likely deadline of August 1998. An August 1998 deadline is likely to be too soon to permit the commission to conduct a careful analysis. And the May 1999 deadline would allow us time to make proposals on Social Security before the Medicare commission reports.

- **Analysis.** The House proposal requires the commission to use CBO rather than HCFA estimates. HCFA has produced the numbers for previous commissions, and HCFA should produce them here as well.

<u>Decision</u>

_________ Support changes to Medicare commission proposals outlined above

_________ Do not support changes to proposals outlined above

_________ Discuss

III. Should we support a Social Security commission within the budget legislation?

As noted above, your advisers believe that we should initially focus our long-term entitlement efforts on Social Security. Although it will not be easy to obtain, true Social Security reform would ease the burden from expected increases in the elderly dependency ratio over the next several decades, and would represent a substantial and lasting achievement of your second term. Regardless of the process, *the Administration would need to spend much of next year -- perhaps starting as early as this fall -- educating the American public and reaching out across the political spectrum to build support for reform.* Historically, a short-term crisis has been necessary for change. (Scholars argue, for example, that the success of the 1983 Greenspan commission was due in large part to the imminent exhaustion of the Trust Fund.) We do not face such a short-term crisis now, making it more difficult to motivate reform. Your challenge would be to motivate the nation to sensibly address and protect one of our most successful programs -- so we could avoid dealing with it in a more disruptive crisis environment later. Public understanding of these issues -- though still inadequate -- is far greater than it has been before. And early action would permit time to implement changes gradually -- and slowly phased-in changes may be more feasible than sudden ones.

The immediate question before us is whether creating a bipartisan Social Security commission in reconciliation will help our chances for achieving long-term reform. Some think the best way to proceed on Social Security is to include a commission in the budget legislation. Others think that we should take more time before pushing for a commission, so that we can more carefully consider our options. Then if we decide that we want a commission later, we could always create one by executive order (as with the Greenspan commission in the early 1980's) or by a separate statute.

Option 1: Try to negotiate a bipartisan Social Security commission in the budget legislation

Under the first option, we would engage the Republicans immediately to create a bipartisan Social Security commission within the omnibus budget legislation. The goal would be to make the commission credible and specific: It would be charged with issuing its recommendations within a relatively short time period, perhaps by next summer.

- Under one approach, the commission's membership could include all key policy players from the beginning. This approach would facilitate rapid implementation of proposals.

- An alternative approach would have the commission represent a broader array of relevant groups: older Americans, younger Americans, the unions, corporate leaders, etc. The commission's proceedings would then be used as part of our public education effort.

Following the commission's report, we could hold a smaller high-level negotiating process or look to another process -- perhaps including announcing our own proposals -- to implement reform.

While a commission was undertaking its work, an inter-agency team within the Administration would put together our own proposals. The Administration would then work with the commission and the Hill to reach consensus on an acceptable package that would carry bipartisan support, and to translate the commission's proposals into legislation.

Option 2: Do not create a Social Security commission within the budget legislation -- instead act later, either with or without a commission

The alternative is not to create a commission within the budget legislation, but rather to engage with the Republicans later -- either with or without a commission. The basic logic is that we should not create a bipartisan process before we have fully developed our own strategy for Social Security reform and considered what bipartisan processes would best advance that strategy.

For example, our strategy could involve holding our own series of public education events, while reaching out to prominent Republicans like Bob Dole or Warren Rudman. It could include a series of regional public hearings. And it could include a commission created by executive order, or one created by statute. There are many possibilities, and with more time we could think through which ones are most promising. After we reached internal consensus on the right approach, we would be able to present a coherent, unified front and would be more likely to achieve success. And after we evaluate our options, it may turn out that we do not even need a commission: Frank Raines points out that President Carter was able to reform the Social Security system without one.

Pros and cons of including a Social Security commission in the budget legislation

<u>Pros</u>

- It dissipates some of the focus away from a Medicare commission, maintaining momentum behind Social Security reform.
- You would clearly signal your commitment to Social Security reform.
- Secretary Rubin and John Hilley feel that we have a short window of opportunity to engage in a bipartisan process, and that opportunity could be lost if we wait to analyze

our options further.

Cons

- It may not make sense to create a commission before we have carefully explored the best strategy for achieving reform.

  -- Moving now would not allow us time to consider our options and to consult with the Republican and Democratic leadership, Senator Moynihan, the AARP, and others on how best to proceed.

- Given that Senator Lott and other Hill leaders want to focus initially on Medicare, we may not even succeed in getting a Social Security commission into the budget legislation.

- Some are not sure that a commission is beneficial or necessary for effecting reform.

Decision

_________ Create Social Security commission within budget legislation

_________ Do not create Social Security commission within budget legislation to allow more time to consider strategy

_________ Discuss

Action

We will be convening an NEC inter-agency process with your budget team, HHS, DPC, and others appropriate to consider both the strategy and substance of Medicare and Social Security reforms. I will talk with Erskine about how best to design a process for ensuring that we maintain the appropriate degree of confidentiality while still benefitting from the insights of relevant agencies and officials.

If you want to create a Social Security commission within the budget legislation, we will hold an expedited process to present you with options on how that commission should be structured.

THE WHITE HOUSE

WASHINGTON

July 3, 1997

MEMORANDUM FOR THE PRESIDENT

FROM: **GENE SPERLING**
RUSSELL HORWITZ

RE: ***Wall Street Journal* Poll and Other Articles of Interest**

We have attached some recent articles which we think you will find interesting.

Wall Street Journal/NBC News Survey: First, included in last Friday's *Wall Street Journal* is a separate section titled the "American Opinion" which presents the findings of the most recent *Wall Street Journal*/NBC News survey.

The questions concerning the economy found the following:

- Three out of five Americans expressed satisfaction with the economy and even more expressed satisfaction with their own financial situation. "This optimism cuts across nearly every age, regional, educational, occupational and racial fault line."

- Almost three in 10 respondents (28%) said you deserved most of the credit for the economic upswing – far more than anyone else. Increased worker productivity received 17%, the Federal Reserve received 14%, American corporations received 13% and Congress garnered 8%.

- 59% of the public says their families are better off than they were four years earlier -- an historic high and ten points higher than last October.

- A 53% to 42% majority expects its kids' generation will enjoy a higher standard of living than they do. The opposite view draw a similar majority just 18 months ago.

- While there is a clear feeling among the respondents that there won't be a recession within the next year, many felt that there would be one within the next five.

- Still, while many Americans seem to recognize the health of the economy, over 80% of the respondents believe that it disproportionately benefits top wage earners and more needs to be done to close the gap between the rich and poor.

- While 60% of the respondents believe that the economy "could perform even better if we made deeper cuts in taxes, 52% said cutting taxes wouldn't make much difference and could even hurt the economy.

- Nearly six in 10 Americans agree with Democrats that the federal government should do more to help the poor, as with education and training programs.

Al Hunt Column: We have also attached Al Hunt's article from Thursday titled "This Republican Tax-Cut Dog Won't Hunt." While generally critical of both the Republican plan and ours, he does hit the Republicans hard for not extending the child tax credit to the working poor. Hunt uses the example of the police officer in Georgia with two kids who makes $23,000, and still pays over $1100 in payroll and federal excise taxes even after the EITC rebate -- but still wouldn't quality for the child tax credit under the Republican plan.

Hunt makes the telling point that under the House GOP tax measure, Bill Gates would benefit from capital gains and estate tax reductions, but a $23,000-a-year rookie cop would receive no tax credit for his kids.

Bob Herbert Column: Bob Herbert's column in Monday's New York Times "Topsy-Turvey Tax Cut" makes the similar point. Using the real life example of the McCumbers family (two children) of West Virginia who make just over $20,000, Herbert slams the Congress for excluding it to millions of families: *"To exclude the McCumberses and millions of other working-class families from a child tax credit plan while giving the credit to well-do-do families, some with annual incomes higher than $100,000, is absurd."* I believe examples such as these resonate and hurt the GOP where they are so clearly vulnerable on this issue.

Washington Post Editorial on EITC: Lastly, we've included a Post editorial from last Sunday entitled, "Tax Fraud." It defends the EITC as an "underappreciated provision" and faults the Republicans in stacking it against the child tax credit.

Who Gets Credit: Clinton Receives Big Pat on Back For the Economy

A year or so ago, President Clinton would complain—privately but vehemently—that unlike Ronald Reagan he didn't get sufficient credit for an improving economy.

By November, that obviously had changed; the voters gave him more than sufficient recognition. And in this month's Wall Street Journal/NBC News poll, the president gets the highest grades for the bullish economy. Almost three in 10 respondents say he deserves most of the credit for the economic upswing, far more than anyone else receives.

"More than anything else—the Fed, business, labor or Congress—Clinton gets credit for how well the economy is performing," says Fred Yang, vice president of the Peter Hart polling firm. "Increasingly this is seen as a Clinton economy."

Moreover, when asked point-blank whether first Bill Clinton and then Ronald Reagan deserve credit for an improving economy under their watch, the responses are almost identical: More than four in 10 say both presidents should get a great deal or fair amount of credit, while about half say neither should get much credit. Of course, Clinton and Reagan partisans differ sharply over which president produced the best economy. This gets into arcane arguments over which is the fairest period to measure.

One reasonably neutral method is to compare the entire eight-year Reagan term with the four-and-a-half years of the Clinton presidency. Under Mr. Reagan, almost 16 million new jobs were added, or an average of about two million a year. Under Mr. Clinton, a little more than 12 million jobs have been added, or somewhat less than three million a year.

When both men took office, the jobless rate was about the same: 7.5% in January 1981 and 7.3% in January 1993. In both instances it dropped dramatically. By the time Ronald Reagan left office, the unemployment rate stood at 5.4%, while under Bill Clinton's stewardship, it fell to 4.8% last month, the lowest in a quarter-century.

The Credit Card

Who do you give the most credit for the country's economic upswing?

The Clinton Administration	29%
Increased Worker Productivity	17
The Federal Reserve	14
American Corporations	13
Congress	5

The stock market also more than doubled under both the Reagan administration and the first part of the Clinton administration. Under President Reagan the Dow Jones Industrial Average soared to 2235 from 950; the average was at 3241 when Bill Clinton was first sworn in as president and as of yesterday stood at 7654.25.

Reagan partisans argue that unlike Mr. Clinton, their man faced raging inflation—averaging 12% in 1980—and getting that down to 4% while at the same time boosting the economy is a bigger achievement. The Clinton forces, however, reply that while the budget deficit soared in the Reagan years from $79 billion to $152 billion, it has dropped substantially during Mr. Clinton's watch—from $255 billion to an estimated $67 billion this year.

Not surprisingly, the question of who deserves credit for today's bullish economy depends on whom you ask. Mr. Clinton gets the highest marks from Democrats, blue-collar workers, African-Americans and most of the middle-income population. He does less well among Republicans, conservatives and the wealthiest Americans. Among those groups, the Federal Reserve gets more accolades. Very few people in any group think Congress deserves much credit.

—Albert R. Hunt

The New Living-Room Detente

Trashing TV is a popular pastime with politicians and conservative pressure groups. But ordinary parents don't seem inclined to demonize television.

TV just isn't a source of conflict in most families, according to the Wall Street Journal/NBC News poll. Far from it: Most say television brings families together, and as many parents say television is a good influence on their children as those who decry it.

Among the medium's harshest critics are conservatives, Republicans, women and those 65 and older, with well over 60% of each group saying TV quality has worsened in the past decade. Far less critical were men, African-Americans, liberals and young adults.

For years, the networks' standard retort to critics of racy and violent programs was to remind them that they could always turn off the set. Now, parents seem to be acting on that advice—often by substituting videotapes or computer games. Thus some of TV's provocative power has been neutralized.

Family Factors

Parents' views on the positive or negative effects of TV on their children and families

[illegible]	47%
[illegible]	24
[illegible]	36%
[illegible]	35

Nonetheless, pressure from Congress and parent groups led broadcast and cable networks to agree this year to a voluntary content rating system. TV shows now carry codes similar to the movie industry's "PG" and "R" system, and are likely to soon carry new labels flagging sex, violence and bad language. Beginning next year, new televisions must be equipped with the so-called "V-chip," by which adults can block out objectionable programs.

Most parents, however, contend they have the situation firmly under control without outside assistance. "One way to prevent problems is to be there," says Mary Bodel of Simi Valley, Calif. She approves in advance the shows watched by her daughters, ages 10 and 12. And because she is there—she runs a business from her home and home-schools her daughters—she figures she doesn't need the content ratings.

Fully 71% of parents surveyed in the Wall Street Journal/NBC poll reported that television is "rarely" or "never" a source of parent-child tension in their homes. Only 11% said they fight "very often" over television viewing.

Indeed, nearly twice as many parents—47% compared with 24%—said that TV brings them together as a family rather than divides them. Still, the rise of the multiset household means that family members often watch different shows in different rooms. Of parents surveyed, 44% said they "fairly often" or "very often" watched TV in a different room from other family members.

John Malknecht of Minneapolis has held the line on bedroom TVs for his two daughters: "That would tend to make them antisocial, cocooned in their room," he says.

Americans are ambivalent about television's impact on their children. Thirty-six percent said it was predominantly a good influence, while 35% a poor influence. These ratings were slightly less favorable than in 1962, when a survey by the Gallup Organization found that 39% thought TV was a good influence and 2[illegible] a bad influence.

"TV has changed our lives for the better," declares Terese Hickerson of Unalakleet, Alaska, a town of 800 on the Bering Sea. M[illegible] families can't conceive of a time when television wasn't a powerful presence in their homes. But until six years ago, when cable finally arrived, Unalakleet was not really part of the television age. TV's arrival has brought changes, both good and bad.

Reachable only by boat or plane, Unalakleet doesn't get daily newspaper delivery. Now, with CNN, "we're right up there with the world," says Mrs. Hickerson, who has three teenage sons.

Yet children in the village have changed, she says. At first, instead of hunting and fishing, they closeted themselves indoors with television—often staying up until 3:00 a.m. on school nights. Some of the novelty has worn off. Even 13 channels, she says, "break the monotony of wintertime."

—Ellen G[illegible]

THE WALL STREET JOURNAL
FRIDAY, JUNE 27, 1997

"American Opinion"

"AMERICAN OPINION

IT DOESN'T GET MUCH BETTER

Despite Our Prosperity, We Worry The Good Times Won't Last

By ALBERT R. HUNT
Staff Reporter of THE WALL STREET JOURNAL

AMERICANS VIEW THE ECONOMY a bit like most Chicagoans see their NBA champion Bulls: It's a terrific time, and it'll last for a while, but not forever.

Three out of five Americans express satisfaction with the economy and even more express satisfaction with their own financial situation, this month's Wall Street Journal/NBC survey of more than 2,000 Americans finds. This optimism cuts across nearly every age, regional, educational, occupational and racial fault line.

"American attitudes toward today's economy are as bullish as the economic statistics themselves," note pollsters Peter Hart and Robert Teeter, who conducted the survey. "Every number is the highest or most positive recorded in the eight-year history of the Wall Street Journal/NBC news survey."

The public, however, doesn't believe the economy has undergone permanent changes that assure perpetual prosperity. There's a clear sense that there won't be a recession within the next year but there will be one within the next five.

"For all the optimism that Americans express about today's economy," say Messrs. Hart and Teeter, "this satisfaction is matched by equal amounts of apprehension toward the economy of tomorrow."

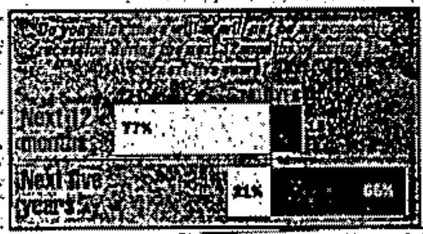
Yet it's almost impossible to exaggerate the bullishness of today's economic circumstances and climate. It was Ronald Reagan, during the 1980 campaign, who framed the politically astute question of whether Americans felt they were better off than four years earlier; then, a strong majority did not, which also was the case when President Clinton defeated incumbent George Bush in 1992.

In this month's poll, 59% of the public says their families are better off than they were four years earlier. That's a historic high and 10 points higher than last October. Moreover, a clear majority believe their kids' generation will enjoy a higher standard of living than they do, which the pollsters say is more a reflection of the present than the future.

Some of the soaring optimism derives less from personal experiences than just the general notion that these are good times. "Until very recently, the people who thought the economy was good were those that the economy was, in fact, good for," says Mr. Teeter. "But now we're seeing a quantum leap in the number of people who just think it's good." As a corollary, he postulates that the number of ingrained pessimists has dipped to about 25% of the public from a short while ago.

Not surprisingly, this is redounding to President Clinton's advantage. His ratings on handling the economy are at record highs, and voters credit him for the good times: even 43% of Republicans approve

Please Turn to Page R6, Column 1



Continued From Page R1

of the president's performance on the economy. "The American people are judging President Clinton on what counts for them, and that's the economy," says Mr. Hart. "Americans' high paychecks translate into higher Clinton ratings."

On almost every issue, most Americans are sanguine about the present. Three times as many respondents, for example, are satisfied with their job security than are dissatisfied. Majorities also are positive about opportunities for career advancement, income keeping up with the cost of living, interest rates and retirement security. One negative area is dissatisfaction with the amount of money being saved. (Inflation has remained below 3% despite the conventional wisdom of the past that with a jobless rate below 5%—it's now at 4.8%—prices should take off. Yet almost half the people still worry about the cost of living.)

Interestingly, Americans see the robust economy as technology-driven, and they like that. The most frequent reason cited for the economy's growth is that the U.S. has quickly become a world leader in the information- and technology-based industries. That view is especially pronounced among both upper-income and younger Americans.

The public also believes that workers are better trained—two out of five say they've either received retraining or taken college courses for their job—and that American companies are more efficiently run. The Federal Reserve gets high marks and a general sense emerges that government hasn't messed up the economy.

But people don't buy the argument that a less-influential labor movement—with fewer strikes—has played a major role in the economy's success. And there is considerable skepticism over the globalization of the economy, which, on balance, is viewed negatively.

One of the most oft-used measurements of public opinion on the economy—first developed 40 years ago—is the so-called ladder scale, in which people choose a number between one (very bad) and 10 (very good) to characterize condition[s]. Customarily, Americans have shown more opt[im]ism about the past than the present and a[re] more enthusiastic about the future. But in th[is] survey, the present does better than both the pa[st] and the future. Almost half rate today's econo[my] somewhere between seven and 10, and only a[bout] in seven score it four or below. Again, this cu[ts] across virtually all groups.

But just as Chicagoans realize that Micha[el] Jordan and Scottie Pippen won't be around fo[r]ever, Americans don't believe that the busine[ss] cycle has been repealed, that robust growth a[nd] stable prices are a permanent condition. Wh[en] asked whether the economy has changed so th[at] traditional economic cycles are outdated, mea[n]ing recession can be avoided for long periods, t[he] public by a decisive 4-to-1 ratio says no.

Most don't believe that there will be a reces[s]sion in the next year, but two-thirds believe there will be one in the next five years. Every subgroup expects a downturn by 2002.

When asked what will be the likely cause of any recession, the public doesn't cite the busine[ss] cycle but points the finger at accumulating too much debt—governmental and consumer. (Whi[le] red ink remains anathema to most individuals, [a] majority also believe that a strong economy alo[ne] isn't sufficient to help the poor and that more g[ov]ernment aid—like expanded education and job-training programs—is needed.)

There are specific concerns about the future. By a huge margin, most people think the econom[y] will be creating more low-paying jobs than high-paying ones. "Those most emphatic in this belie[f] that the new jobs are low-paying are those most likely to be filling those jobs: blue-collar worker[s], in particular women, members of union house-holds, African-Americans and young adults," sa[y] Messrs. Hart and Teeter, the pollsters.

And if the stock market hasn't heeded Alan Greenspan's admonition last December about "irrational exuberance"—it has risen more th[an] 1,200 points since then—the general public shares the Federal Reserve chairman's worry. The respondents, 40% of whom said they own a[t] least $5,000 of common stock or mutual funds e[i]ther individually or through a retirement savings program, by a 3-to-2 ratio say the stock market high makes them less likely to invest i[n] the future. A plurality of upper-income individ[u]als share this bearish view.

The survey also suggests the resiliency and adaptability of Americans. About 15% say they've been laid off from their jobs over the past three to five years. Contrary to conventional wisdom, there is little variation by income, education or occupation. But the vast m[a]jority of these people have gotten new work. U[p]ward mobility seems more than ever a staple [of] the American dream. Two out of every five in[di]viduals say they've left a job to take a better [po]sition. This is especially true for 18- to 34-yea[r-]olds, African-Americans and high-tech worke[rs].

Despite the apprehensions over globalizati[on], the public sees this country as the pre-emine[nt] economic power in the world. Even those who might be less inclined to regard the U.S. as a[n] economic superpower—those with jobs in man[u]facturing or people who've been laid off—still think of America as a "formidable economic force," Messrs. Hart and Teeter note. This is much more so than when the same question w[as] asked both five years ago and seven years ag[o].

Whatever apprehensions exist about the future, the optimism surfaces when asked wheth[er] they'd rather work and live under the anticipa[ted] conditions of the next 30 years or the condition[s] of the past 30 years. By 48% to 39%, Americans opt for the uncertain future.

THE WALL STREET JOURNAL
FRIDAY, JUNE 27, 1997

Sure, the Economy May Be Sizzling, But Some See Room for Improvement

By JACKIE CALMES
Staff Reporter of THE WALL STREET JOURNAL

The economy may be as good as it gets, but that's not good enough for the folks in both political parties.

For liberal Democrats, what stands out following month after month of good news on unemployment, inflation, interest rates and stock prices are the stubbornly stagnant wages of the least-skilled workers and, in turn, a growing gap between the incomes of the richest and poorest Americans.

"The economy is, on the numbers, better than it's been in 25 or 30 years, and there's no doubt about that," says House Democratic Leader Richard Gephardt of Missouri. "Having said that, there are many places, mainly among the low-middle class, people in the middle, and people trying to get in the middle . . . , who are not feeling the benefits yet of the productivity they have helped produce."

Conservative Republicans, meanwhile, allow that the economy has thrived on President Clinton's watch. But they contend it could be humming even more if taxes were slashed, particularly on investors' capital gains from the sale of stocks and other assets.

"We would have had a more robust recovery" after the recession that opened this decade, insists Rep. James Saxton, had it not been "slowed down" by bad fiscal policy." The New Jersey Republican, who heads Congress's Joint Economic Committee, cites President Clinton's 1993 deficit-reduction plan that raised top earners' income taxes. Growth would be greater had taxes been cut, he says. The credit for what growth there has been, Mr. Saxton adds, "all goes" to the Federal Reserve Board's monetary policy.

Both sides can find support in the latest Wall Street Journal/NBC News poll. By an overwhelming 81% to 17% margin, those polled agreed with the typical Democrat's view that the strong economy has mostly benefited the top wage earners, "and more

needs to be done to close the gap between the rich and the poor."

A narrower but still strong overall majority of 60% to 37% endorsed the common Republican view, that the economy "could perform even better if we made deeper cuts in taxes." To a separate question, however, 53% said cutting taxes for businesses and individuals wouldn't make much difference and could even hurt the economy.

Predictably, respondents who identified themselves as Democrats were more likely than self-described Republicans to express concern about yawning income inequality.

Assessing Public Opinion on the Economy

Party Divisions

Which of the following statements comes closer to your point of view?

	DEMOCRAT	REPUBLICAN
The poor should have more help from the federal government	[illegible]	[illegible]
The poor do not need more help from the federal government	[illegible]	[illegible]

The benefits from the strong economy over the past few years have gone mostly to the top wage earners, and more needs to be done to close the gap between rich and poor.

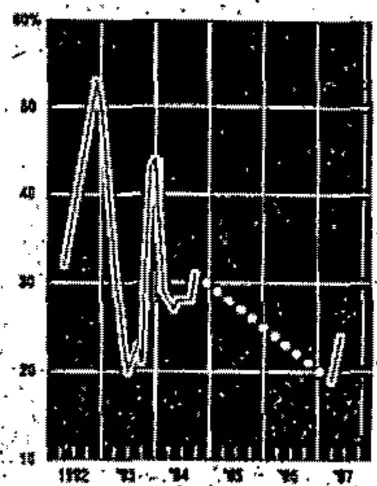
	DEMOCRAT	REPUBLICAN
Agree	[illegible]	[illegible]
Disagree	[illegible]	[illegible]

While the current economy is strong, it could perform even better if we made deeper cuts in taxes.

	DEMOCRAT	REPUBLICAN
Agree	[illegible]	[illegible]
Disagree	[illegible]	[illegible]

Returning Optimism

Percentage of respondents who feel the economy will get better during the next year



Republican respondents, on the other hand, were more likely to say the good economy still could benefit from tax cuts.

Whatever reservations the public may share with the politicians, "Americans' attitudes toward today's economy are as bullish as the economic statistics themselves," say Peter Hart and Robert Teeter, who conducted the Journal/NBC poll. The latest survey questions yielded the most positive responses in the poll's eight-year history, they note.

Nearly two-thirds of respondents rated the economy a six or more on a scale of one to 10. Three out of five said they are better off today than they were four years ago. "Satisfaction with the economy cuts across race, income and education level," Messrs. Hart and Teeter say. More Americans are optimistic about the future: A 53% to 42% majority expects its children's generation to be better off, while the opposite view drew a similar majority just 18 months ago.

The public attitude is hardly a surprise given the drumbeat of good economic news. At 4.8%, unemployment is at a 24-year low, and consumer confidence is at a 28-year high. Inflation is just 2.2%, and for the first time since 1952, producer prices actually have declined for five months running. Interest rates remain low, and record numbers of Americans own homes. The stock market hits records routinely. The federal budget deficit, as a percentage of the economy's total goods and services, is at its lowest level since 1974.

"I'm not surprised if people are feeling a little better," says Jeff Faux of the Economic Policy Institute, a liberal Democratic think tank. "But this is not the 1950s," he adds. "Growth is not being distributed the way it used to be." After declining for years, wages for less-skilled workers are at best keeping ahead of inflation now. "Workers have just begun to share, just a bit, in the prosperity their front-office bosses have enjoyed," says Rep. David Obey, a leading liberal Democrat from Wisconsin.

While Republicans make this point far less often, one who harps on it is Jack Kemp, a potential Republican presidential candidate and advocate of the urban poor. His biggest complaint about the economy, he says, is the widening "division in our society between the haves and have-nots, or the have-littles."

Mr. Kemp and the liberal Democrats part ways, however, on their prescriptions for the problem. Supply-sider Mr. Kemp would cut capital-gains taxes even more than his fellow Republicans in Congress propose, arguing that new private investments would spawn jobs. And he'd allow workers an income-tax deduction against their payroll taxes.

But Mr. Obey says flatly, "The answer is not to produce a tax package that gives a big tax break to Michael Eisner," the Walt Disney Co. chief executive, and other wealthy businessmen. The Democrats want more government spending on job training, education—from Head Start to college—and on research and development. They don't want the Fed to raise interest rates.

Nearly six in 10 Americans agree with Democrats that the federal government should do more to help the poor, as with education and training programs, according to the Journal/NBC poll. Nearly three-quarters of Democratic respondents said so. But among Republicans, 55% said the strong economy can provide jobs and opportunities without help from the government.

Making the Grade

On a scale of 1 to 10, on which a "1" means very bad, and a "10" means very good, how would you rate economic conditions in America?

	FIVE YEARS AGO	NOW	FIVE YEARS FROM NOW
ALL ADULTS	[illegible]	[illegible]	5.8
Democrats	[illegible]	[illegible]	6.1
Independents	[illegible]	5.8	5.5
Republicans	5.7	6.3	5.8
Had manufacturing job	5.6	6.1	6.8
Have high-tech job	5.6	6.3	6.6
Own stock	5.7	6.5	6.0

Journal Link: For the full text of The Wall Street Journal/NBC News Poll, see The Wall Street Journal Interactive Edition at http://wsj.com

THE WALL STREET JOURN/
FRIDAY, JUNE 27, 1997

"AMERICAN OPINION

"AMERICAN OPINION"

THE WALL STREET JOURNAL
FRIDAY, JUNE 27, 1997

Media's Coverage Gets Good Marks

By SARAH McBRIDE
Staff Reporter of THE WALL STREET JOURNAL

In bad times, the public often wants to blame the messenger. In good times, the messenger predictably does better.

According to this month's Wall Street Journal/NBC News survey, three out of five Americans believe that news coverage of the economy is balanced. One in five thinks it's too negative and slightly less than that believe it's too positive.

Overall, more Americans feel negatively toward the media—41%—than feel positively about it—39%. But that is better than it was two and a half years ago when, by a 2-to-1 ratio, the public was disapproving.

But academics say the public may be letting the news media off the hook too easily. On economic coverage, most experts rattle off a list of problems such as placing too much emphasis on irrelevant issues while important but complex issues get short shrift. Television news is especially superficial, while large national newspapers generally do a good job, they say.

Richard Parker of Harvard University's Shorenstein Center on the Press, Politics and Public Policy, points to coverage of the Social Security overhaul. Since a government panel recommended options for change in January, the three major TV networks' evening news shows have carried only one segment each on the plans. Over the same period, they have aired nine segments on Internet access to Social Security records—a sexier topic but one that affects fewer Americans.

Other criticisms include:

■ Giving too little time to economics on television. Of the nearly 300 available minutes each week on the three major network news shows, an average of just 18 minutes are spent on economics, according to the New York-based Tyndall Report. For many of the 30 million American households that tune in to one of the three major evening newscasts each night, the shows are their primary news source.

■ Playing up conflict stories. Take layoffs, for example, says Stephen Hess of the Brookings Institution. When AT&T Corp. announces it will downsize, the headlines are huge, but "it's almost below the radar screen when it's someone who's going to hire 10 people," he says. "Collectively, it may be that they're going to hire more people than the big companies are going to lay off."

■ Politicizing economics. "How will this affect [House Speaker] Newt Gingrich?" Such is Mr. Parker's example of how economic reports are frequently framed in terms of the political impact instead of how the news will affect average Americans.

But there are bright spots. Analysts say that a sprinkling of television shows and major newspapers cover the economy thoroughly. In large newspapers especially, publishers have given business reporting a higher priority; gone are the days when the business page "consisted largely of [publicity] announcements from companies," says Victor Fuchs of Stanford University. Moreover, there are promising indicators: More young reporters want to cover business news and are better trained in economics and management.

Opinions Diverge on Globalization

A sense of buoyancy about the economy permeates all demographic groups in America: young and old, black and white, men and women. But sharper differences emerge on some particulars, especially when people start thinking about the global economy.

Men are slightly more optimistic than women about the American economy but not dramatically so, the latest Wall Street Journal/NBC News poll found. And there is very little difference between the attitudes of working women and homemakers; in the 1996 election, there was a much sharper divide between the sexes on the economic issue.

However, when it comes to globalization of the economy, a slight plurality of men think it has been good because it has opened up new markets for American products and resulted in more jobs. But a clear majority of women think it has been bad because it has subjected American companies and employees to unfair competition and cheap labor.

"People are united on the economy," notes David Iannelli, an associate of pollster Robert Teeter. "But the one aspect that most divides them is the effects of globalization on the economy. Typically, more economically pressured groups have the most negative reactions to this."

Other interesting distinctions surface on the basis of geography (urban and suburban vs. rural) and education (college- vs. noncollege-educated individuals).

Among rural residents, there is much more of a hint of nostalgia for the way things used to be. More would prefer living and working under the economy of the past 30 years than under the economy they expect for the next 30 years. But a majority of urban and suburban residents look to the future instead.

Thus, it follows that rural folks are less optimistic about the future and less convinced that the political and economic systems offer opportunities for everyone. While suburban and urban dwellers split down the middle on whether globalization has been good or bad for the American economy, rural residents, by almost a 2-to-1 ratio, say it is bad.

There is a similar divergence by education. College graduates overwhelmingly have positive views on globalization, while those with only high-school degrees just as strongly harbor negative attitudes.

—Albert R. Hunt

Globalization Attitudes

Is the fact that the American economy has become increasingly global good or bad?

	GOOD	BAD
ALL ADULTS	[illegible]	[illegible]
Men	[illegible]	[illegible]
Women	[illegible]	[illegible]
Whites	[illegible]	[illegible]
Blacks	[illegible]	[illegible]
Urban	[illegible]	[illegible]
Suburbs/towns	[illegible]	[illegible]
Rural	[illegible]	[illegible]
Under $30,000	[illegible]	[illegible]
$30,000-$50,000	[illegible]	[illegible]
Over $50,000	[illegible]	[illegible]
Professional/managers	[illegible]	[illegible]
White-collar workers	[illegible]	[illegible]
Blue-collar workers	[illegible]	[illegible]
High school or less	[illegible]	[illegible]
College graduates	[illegible]	[illegible]

THE WALL STREET JOURNAL, FRIDAY, JUNE 27, 1997

"American Opinion"

On Immigration, Party Leaders Aren't Necessarily In Sync With Feelings of Rank and File

By Albert R. Hunt
Staff Reporter of The Wall Street Journal

The immigration debate, steeped heavily in economic arguments, rages nationally, most notably in key states such as California. While Republican leaders have embraced the anti-immigration position, top Democrats generally have been more supportive of immigrants.

Yet, ironically, the rank and file split the other way: Republican voters nationally are more pro-immigration while Democrats are more negative.

The Wall Street Journal/NBC News survey draws two distinct conclusions: The public is closely divided over whether immigrants are a positive or a negative influence in America, and Americans' views are largely driven by their station in life and their economic outlook. The better off—disproportionately GOP followers—tend to be more tolerant while the lower end of the socio-economic scale tend to be more threatened by immigrants.

Thus, self-identified Republicans are narrowly pro-immigration while Democrats by a clear margin see more negative consequences. Managers and professional people think immigration is good for the economy, while blue-collar workers think it's bad. Among income groups there is almost a perfect curve: people with the lowest incomes, by better than a 3-to-2 ratio, express negative views, while those in the top bracket, by about the same ratio, voice pro-immigration sentiments.

Republicans, in a movement started in California three years ago, have blamed immigration for many of society's economic and social problems. Much of the earlier efforts to curb benefits were aimed at illegal immigrants. But last year, the GOP-led Congress adopted provisions in the welfare bill that denied certain government benefits to legal immigrants. With a few exceptions, top Democrats, including President Clinton, have fought these restrictions.

Despite the apparent dichotomy in the poll numbers, there are ample political reasons for both sides' stances. Republicans believe the anti-immigration issue may attract some working-class Democrats—frequently called Reagan Democrats—to their side. Further, they believe, the issue will resonate more whenever there's an economic downturn. (Some GOP leaders like Jack Kemp, however, take strong exception to the whole anti-immigration pitch.)

Democrats, on the other hand, argue that the GOP politically is writing off the fastest-growing slice of the electorate, Hispanics. Although in the Wall Street Journal/NBC News poll the number of Hispanic respondents is so small that the margin of error is considerable, it nevertheless suggests these Americans have an overwhelmingly positive view of immigration.

Illustration by Rupert Howard

Legal Immigration and the National Economy

	ALL ADULTS	INCOME					OCCUPATION			PARTY IDENTIFICATION	
		Under $20k	$20k-$30k	$30k-$50k	$50k-$75k	Over $75k	Professional	White collar	Blue collar	Democrats	Republicans
HAS A POSITIVE EFFECT	44%	36%	41%	44%	48%	56%	54%	47%	35%	41%	48%
HAS A NEGATIVE EFFECT	49	58	50	50	49	34	39	45	60	51	46

This Republican Tax-Cut Dog Won't Hunt

"Taxes are the killing fields for Democrats," Grover Norquist, the irrepressible conservative activist, predicted to Time magazine this week.

After the government shutdown and minimum wage defeats of the last Congress and the disaster relief debacle of last month, the GOP hopes that finally the political game is being played on their turf. They're living in yesteryear.

The case for any tax cut in this booming economy is dubious. If President Clinton gets his way, precious few additional kids are going to get college educations because of this tax bill. If the Republicans get their way, the tax bill is going to add precious few jobs.

Moreover, voters should feel duped by this debate. Last year, the Republicans stressed a simpler and flatter tax code;

Politics & People

By Albert R. Hunt

their proposals create more special preferences and a more complicated code. In 1996, the Democrats emphasized equity; whatever emerges, however, will be skewed heavily to upper-income individuals and exacerbate the income gap between rich and poor.

Thus the battle over the size and shape of tax cuts over the next month is about politics. The heart of the GOP tax cut effort—capital gains and estate tax relief—resonates with campaign contributors, not with voters. When it comes to the specific proposals before Congress today, according to this past weekend's Wall Street Journal/NBC News poll, Americans side with the Democrats by a lopsided 2-to-1 margin.

The House and Senate both likely will pass separate Republican-crafted bills this week. Both bills, however, are so bad—a bonanza for the affluent, crumbs for the working class and eventually costly—that President Clinton will enjoy enormous leverage in the negotiations over distribution and costs. The Republican-run congressional tax committee has put out phony estimates of both the distribution effects and the costs, only calculating the first five years; the bills are back-loaded so that tax cuts for capital gains, estate taxes and new retirement accounts explode in five to 10 years.

According to more reliable Treasury estimates, when the bill is fully effective, the top 1% of taxpayers would get 19.3% of the benefits under the House bill and 13.3% under the Senate version. Conversely, the bottom three-fifths of families get only about 12% in both measures. The liberal Center on Budget and Policy Priorities argues that the Treasury underestimates the case; it calculates that under the House Republican tax and spending measures, the poorest 20% of the population would actually lose income while the wealthiest 1% ultimately would get an annual average tax cut of $27,155.

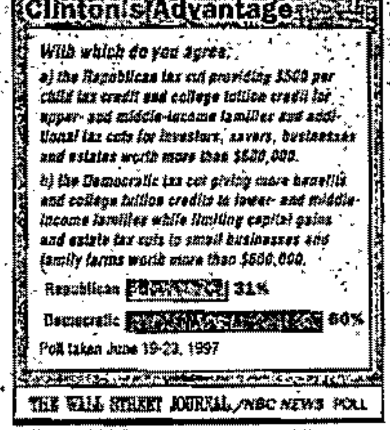
Under this so-called balanced-budget agreement, the net tax cuts can't exceed $250 billion over the next 10 years. But with the back-loading in the following 10 years, the House bill would cost between $650 billion and $700 billion, while the Senate version would cost around $600 billion.

Even worse, in order to shoehorn in tax breaks for their wealthier constituents, the Republican bills shamefully shortchange the working poor. Conservatives have long argued that the tax code shouldn't be used to redistribute income. Yet that's exactly what these Republican bills do.

A critical issue is whether the politically popular, if economically questionable, $500 child credit goes to the working poor. Last week House Speaker Newt Gingrich charged that the Democrats' efforts to give more to the working poor amounted to a "welfare" sop.

Republicans would deny the child credit to workers who already are receiving the earned-income tax credit. They argue that since the EITC wipes out income tax liabilities for these people, they don't deserve the credit.

The real reason they want to deny these taxpayers the credit is that they want to use the money for tax breaks on capital gains, estates and retirement accounts. Both the GOP's Contract With America in 1994 and the tax bill that Senate Republican leader Trent Lott introduced earlier this year proposed to give the child care credit to EITC beneficiaries. The House bill would deny this to six



million kids and the Senate bill would deny it to four million in this category. Moreover, ever since the EITC was enacted in 1975, its purpose was to offset not only income taxes but the regressive payroll taxes that all of these recipients pay; until it became a budgetary inconvenience, most Republicans supported that notion.

This is best illustrated by a real situation. A starting police officer in Gwinnett County, Ga.—coincidentally part of Speaker Gingrich's district—is paid $23,978 a year. If his family has two kids, it gets a $1,868 earned income tax credit, which offsets its $675 in federal taxes and yields a check for $993. But that family pays $1,760 in payroll taxes (most economists would also add the employer's share of payroll taxes too) and another $354 in federal excise taxes. Thus, even after the EITC, this police officer's family's out-of-pocket federal taxes would be at least $1,121 and in reality more like $2,881.

Mr. Gingrich and company apparently believe giving that young police officer and his family the child credit is welfare. In truth, these are working people who most need help. The bottom line in the House GOP tax measure: Bill Gates would get capital gains and estate tax reductions and even a new IRA provision that would let him take a $4,000 tax break for educational expenses for his kids, but a $23,000-a-year rookie cop would be denied a tax credit for his kids.

The Clinton administration is calculating how to reshape the tax legislation in the next month and may set some benchmarks for what's unacceptable. One possibility under consideration is that the cost of the tax cuts in the second 10 years couldn't exceed $500 billion, about halfway between the House Democratic and Republican measures. And top administration officials say that at least 40% of the tax-cut benefits should go to the bottom 60% of taxpayers. That would still be regressive but much less onerous.

Republicans hope—and more than a few Democrats fear—that if the president gets his college tuition tax breaks, he'll cave on the other issues. Some also note that many of those Lincoln bedroom guests and campaign contributors of 1996 would do very well by these tax bills.

But congressional Republicans are notorious in misjudging Bill Clinton if the politics are on his side. In this fight, that's where they are.

In America

BOB HERBERT

Topsy-Turvy Tax Cut

Marie McCumbers and her husband, Rickey, have played by the so-called rules for years. They live in Frametown, a little hole-in-the-wall between Clarksburg and Charleston in West Virginia. Mrs. McCumbers is a secretary-receptionist for an organization that supplies food to soup kitchens. Rickey McCumbers is a greenhouse worker. Their combined income this year will be a shade over $20,000.

The McCumberses have two children: Beckie, 10, and John, 13. Not surprisingly, money is always in short supply. Every expenditure is harshly scrutinized.

"Vacation?" said Mrs. McCumbers. "Oh, we go to my mom's for vacation. She lives in Akron. That's about a four-hour drive."

The trip is made in the family's 1987 Blazer, which the McCumberses bought secondhand. "I'm still paying on it," Mrs. McCumbers said.

Luxuries? Entertainment?

"We don't have any frills whatsoever. We don't go out to eat. We don't go to the movies. We don't take our kids bowling."

"It's boring," said John McCumbers.

His mother laughed. "Our entertainment is to go to Sutton Dam. That's a state park. Doesn't cost anything."

The family lives in a three-bedroom, one-story home. Meeting the mortgage is a struggle. There is no financial cushion. Any unanticipated expense is a crisis.

Each year at tax time, the refund is used for something important. "It goes toward my property taxes and homeowner's insurance," Mrs. McCumbers said. "Or the kids' dental work or doctor visits. We can't afford medical insurance for the kids.

"I have to make sure they deduct enough from each paycheck, otherwise we'd have to pay at the end of the year. I make sure they have me down as single with no dependents."

When politicians talk about tax cuts to help working families with children, you would think they had families like the McCumberses in mind.

Families that need the tax credit most won't get it.

You would certainly think they were talking about children like Beckie and John McCumbers if they came up with a plan to provide tax credits worth $500 per child.

But if you thought that, you would be wrong. The McCumberses are among several million working and tax-paying families that will get nothing from the ballyhooed child tax credit passed by the House and Senate last week. They are ineligible for the child credit because their incomes are not high enough.

To exclude the McCumberses and millions of other working-class families from a child tax credit plan while giving the credit to well-to-do families, some with annual incomes higher than $100,000, is absurd. The legislation passed last week would deny the tax credit to families that account for more than 25 million children. That's 40 percent of all the children in the United States.

The proponents of this unfairness argue that families like the McCumberses benefit from the earned income tax credit and already pay very low Federal income taxes, which is true. But the families also pay payroll taxes and have a substantial net tax liability at the end of the year. The Center on Budget and Policy Priorities noted that families with incomes below $30,000 will owe $644 billion in Federal taxes in the period 1996-2000. Ninety percent of that liability will come from payroll taxes, not the Federal income tax. If anyone needs tax relief, those families do.

Three years ago Newt Gingrich's Contract With America promised to apply the child tax credit against any net tax liability. Under the contract, even the employer's share of payroll taxes was considered part of a family's tax liability. But the Republicans have broken that promise. Now families like the McCumberses are completely frozen out, not even eligible for a partial credit.

In previous Republican-sponsored proposals, the child credit was to be applied before the earned income tax credit was taken into account. That protected a few million more families than the current legislation. But there is only so much money available for tax cuts and the Republicans tightened the requirements over the past few weeks.

The squeezing out of low- and moderate-income families from participation in the tax cuts was necessary to protect the big cuts in capital gains and other taxes that will primarily benefit upper-income Americans. That is how the Government works now, all benefits skewed to the top. The triumph of the well-to-do continues. □

Tax Fraud

Sunday, June 29, 1997; Page C06
The Washington Post

ONE OF the most bitter fights in connection with the tax bill Congress is now writing has to do with a device called the earned income tax credit (EITC). It's an obscure and underappreciated provision which, at $28 billion a year and rising, has become the major form of federal aid to low- and lower-middle-income workers. Partly to save money for other tax cuts heavily tilted toward the better-off, the Republicans propose to change the rules by which the EITC traditionally have been applied in a way that would vitiate it. The Democrats, led by the president, have mounted a defense. We hope on this they are unyielding. The rest of this bill is bad enough. To weaken a benefit for lower-income workers to pay for it is an outrage.

The EITC was created in 1975, in part to compensate low-wage workers for the increasingly heavy Social Security and other payroll taxes they were having to pay, and to sharpen the incentive to work. A number of other rationales have been used for increasing it over the years -- that it constituted a child care subsidy for the working poor by another name, for example, or that it could be looked upon as an alternative to increasing the minimum wage. The basic purpose, through all the labels, has been to increase the after-tax income of lower-income working families -- particularly those with children.

The credit thus comes at the very end of the income tax calculation; that's where it has come in the past, at any rate. First, workers figure what their tax would be -- the normal tax, you could call it -- using all the other provisions in the code. Then they figure their EITC -- a percentage of earnings, on a complicated sliding scale. They use the EITC to reduce or eliminate their tax -- and if there is any left over, the government pays them that amount. The tax code and Treasury are used to administer a government wage supplement.

The Republicans would reverse this order in the case of the children's tax credit that is a central element in their bill. What sounds like just a mechanical step -- who cares which calculation comes first? -- turns out to have an enormous effect. Instead of letting workers use the children's credit to reduce their liability and then collect their entire EITC in addition, they'd deny the children's credit to workers whose EITC was enough to eliminate their liability. Millions of low-income households would be losers, relative to other families with children. But at bottom it's not the children's credit they're playing with; it's the value of the EITC.

The sponsors say it's only fair to do as they propose, since the purpose of this bill is to give relief to taxpayers, not add to "welfare." Of all the distortions they have used to grease and sell this awful bill, none matches this. The implication is that the people who would lose from this provision are freeloading. The absolute opposite is true. These are working people, typically with children and with incomes in the range of, say, $17,000 to $27,000 a year -- precisely the kind of struggling, taxpaying, not-on-welfare Americans for whom the Republicans profess to bleed. The EITC may wipe out the income tax liability of many of them; it doesn't wipe out their total liability, counting the payroll tax. They remain net taxpayers. Is this really the part of the population that the Republican Party wants to stiff in order to pay for a tax cut for folks much better off?

The president long ago accepted the broad outlines of this bad bill. Our sense is that he is going to fight it mainly on the margins -- where it crosses, even in the present political climate, some outer limit of sensibility. Clearly this is one such area. The EITC is not a perfect instrument, but on balance it is benign. The president helped strengthen it in 1993, to his credit. We hope he now will draw a line; the Republicans need to understand that this one is out of bounds.

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EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

THE DIRECTOR

July 15, 1997

MEMORANDUM FOR THE PRESIDENT

FROM: Franklin D. Raines

SUBJECT: Background on FY 1998 Appropriations

The following is a summary of the major issues in the 13 appropriations bills. This provides background on issues that have arisen or are likely to arise as the Committees mark up the FY 1998 appropriations bills. We will prepare an update of this report each week with information about the current status of the bills.

In cases where high priority programs were funded below the Administration's requested levels, we have indicated our objections in letters and Statements of Administration Policy to the appropriate legislators. I have noted in this memorandum the few cases where we have indicated a veto threat over House or Senate provisions which are contrary to the Bipartisan Budget Agreement. In addition, I am attaching a copy of a list of violations of the budget agreement in appropriations bills.

Agriculture/Rural Development

Summary
The House Committee reported the bill on July 9; it is scheduled for a Floor vote on July 16. The Senate Subcommittee is expected to mark up the bill today. Based on preliminary scoring, the House bill totals $13.5 billion in discretionary budget authority (BA), $385 million below the anticipated levels projected by OMB based on the budget agreement.

Major Issues

- Women Infants and Children (WIC) FY 1998 funding level. The House bill funds WIC at $3.9 billion, $184 million below request, but three percent above FY 1997. This level supports a participation rate of 7.4 million, rather than the proposed 7.5 million level (a reduction of about $84 million and no reserve).

- Crop Insurance. Crop insurance is funded $38 million above the requested level, providing a $188 million increase (over 200 percent) above the enacted level, to accommodate reimbursement of private insurance companies' administrative expenses that shifts more funding than is necessary from mandatory to discretionary funding. This additional amount is unnecessary and will reduce mandatory reimbursement expenses by a like amount.

- Rural Development. The funding level for these programs is generally acceptable, although the Committee did not adopt the Administration's request to deliver these programs through a more flexible performance partnership structure authorized in the 1996 Farm Bill. In addition, the Committee provides $950 million for single-family housing direct loans, a five-percent reduction from the $1 billion requested, but a 62 percent increase over 1997.

Commerce/Justice/State

Summary
Based on Congressional scoring, the House Subcommittee bill (marked up July 10) provides $25.9 billion in general purpose discretionary funding, approximately $0.7 billion above the enacted level and $0.4 billion below the request (this includes $100 million for U.N. arrearages at the request level). The House bill also provides $5.26 billion in Violent Crime Reduction Trust Fund (VCRTF) funding, virtually at the requested level. Based on Congressional scoring, the Senate Subcommittee bill (marked up July 11) provides $31.6 billion in general purpose discretionary resources, but does not specify the split for the VCRTF.

Major Issues
- Census Sampling. The House bill restricts the availability of about three-quarters ($282 million of the $382 million) of the FY 1998 funds for the Decennial Census until an agreement over method (e.g., sampling) is reached.

- NIST (includes ATP and MEP). Under the House Subcommittee bill, NIST is fully funded ($693 million), but ATP is funded at $185 million, $91 million below the request (of $276 million). The Senate Subcommittee provides $200 million for ATP, $76 million below the request but $15 million above the House Subcommittee mark. The budget agreement identifies NIST as a protected domestic discretionary priority, but does not specifically protect the FY 1998 request level for ATP.

- Legal Services Corporation (LSC). The House Subcommittee provided $141 million for the Legal Services Corporation, $142 million below the FY 1997 enacted level (of $283 million) and $199 million below the request (of $340 million). Chairman Rogers (R-KY) suggested that this amount was pursuant to a prior "agreement"; however, it is unclear who was party to this agreement, and it was certainly not the Administration. Existing restrictions are retained. The Senate provided $300 million for the Legal Services Corporation, $40 million below the FY 1998 request but $159 million above the House Subcommittee mark.

- Ounce of Prevention Council and Globe. The House and Senate Subcommittee bills terminate both programs.

Defense

Summary
Based on Congressional scoring, the Senate bill (reported on July 10) provides $247 billion in discretionary budget authority, $3.7 billion above the request, about $1.1 billion below the House allocation, and about $3.2 billion (1 percent) above FY 1997. The House bill (marked up on July 10) provides $248.1 billion in budget authority, $4.8 billion above the request, about $1.1 billion above the Senate, and about $4.3 billion (1.6 percent) above FY 1997. The FY 1997 defense numbers reflect the FY 1997 enacted level plus the Administration's proposed supplementals, transfers and rescissions; however, Congress did not pass all of these proposals.

Major Issues

- Deviation from Budget Agreement. The House 602(b) reallocation shifted $2.6 billion in up-front funding BA away from Energy and Water programs to defense ($1.8 billion) and military construction ($0.8 billion). The Senate 602(b) increased defense by $1.1 billion and military construction by $0.8 billion. Statements of Administration Policy were sent to Congress stating that this is an unacceptable deviation from the budget agreement.

- Nunn-Lugar Former Soviet Union Threat Reduction Program. The House Subcommittee provided $282 million, $100 million below the request and $40 million below the Senate Committee level of $322 million. In Floor debate, the Senate accepted a Stevens amendment by voice vote to restore $60 million to the program.

- B-2. The House bill includes over $300 million of unrequested funds for advance work associated with procuring more B-2 bombers. The Senate bill does not include the funds.

- Bosnia. The House bill is expected to include language contained in the House-passed DOD Authorization bill which would prohibit the use of funds after June 30, 1998, for troops in Bosnia.

District of Columbia

Summary
No action has been scheduled in either the House or the Senate.

Major Issues

- Federal Assumption of District Governmental Functions. The FY 1998 Budget proposes to restructure the relationship between the Federal and District governments. Under the proposal, the Federal Government would: take on financial responsibility for certain District functions such as pensions, criminal justice, and Medicaid; establish the National Capital Infrastructure Fund to fund transportation projects in the District; establish an economic development corporation to provide grants and tax incentives for economic development; and collect some District taxes. In exchange, the proposal would end the annual Federal payment and retirement contribution. The Administration's recommended allocation of the budget agreement would support $759 million in funding for the District. The pending budget amendments for the National Capital Revitalization and Self-Government Improvement plan total $805 million. The current House and Senate 602(b) allocations provide the full $805 million in BA but only $479 million in outlays. That outlay level will not support the $719 million in outlays that would be necessary to fully fund the Federal payment and pension payments in the event that the DC Revitalization Plan is not enacted.

We are working with the House and Senate leadership to include your proposals in the reconciliation bill, which would resolve the 602(b) shortfall problem.

Energy and Water Development

Summary
The House Subcommittee marked up on July 11 in a closed session. Based on Congressional scoring, the Senate Committee provides $20.8 billion in total, $1.8 billion below the request and $0.9 billion above FY 1997. The total for defense discretionary funding is $11.8 billion, $1.8 billion below the requested level. The Senate bill provides: $160 million for the Nuclear Waste Disposal Fund (Energy), $30 million below the request; $50 million for California Bay-Delta Ecosystem Restoration (Interior), $93 million below the request; and $300 million for the Defense Environmental Management Privatization, $900 million below the request.

Major Issues

- <u>Deviation from the Budget Agreement</u>. Both the House and Senate 602(b) allocations shifted up-front funding BA away from energy and water programs to defense and military construction projects. Statements of Administration Policy (SAPs) on the Energy and Water appropriations bill were sent to Congress, stating that this is an unacceptable deviation from the budget agreement.

- <u>Yucca Mountain</u>. With Senator Reid becoming ranking member, we do not expect that language included in earlier versions of the 1997 bill to require construction of an interim nuclear waste storage facility at Yucca Mountain will be in the FY 1998 bill.

Foreign Operations

Summary
The House Committee reported the bill on July 9. Compared to the request, the bill cuts funding deeply but has minimal earmarks and few serious policy restrictions. The House holds BA at the FY 1997 total of $12.3 billion, $1 billion below the request. The House mark is $233 million below the 602(b) ceiling which itself is $500 million below the budget agreement protected level for the Subcommittee. **In a letter to the House Committee on July 9, we indicated that the**

Secretary of State, the Secretary of Treasury, and the National Security Advisor would recommend a veto if the Conference version of the bill contained the reduction proposed by the House Committee.

The Senate Committee marked up the bill on June 24, and Floor action is expected this week. Unlike the House, the Senate bill provides all but $20 million of the Subcommittee's $13 billion protected BA under the budget agreement, but has a myriad of funding earmarks and a number of troublesome policy provisions.

Major Issues

- Family Planning. A House Floor amendment is expected from Rep. Chris Smith in an effort to impose the so-called Mexico City policy on FY 1998 family planning funds.

- Foreign Operations Funding. The House bill cuts multilateral development bank (MDB) funding by $0.6 billion and aid to the Newly Independent States (NIS) by $0.3 billion. The Senate bill provides $16.7 billion (including New Arrangements to Borrow for the IMF), $125 million below the request, and $980 million above the comparable FY 1997 level. Much of the $125 million shortfall is payment for the International Development Association (IDA) arrears, which is provided in the budget agreement and could be accommodated through a cap adjustment if the Conference adds the funding.

- Jordan Funding. Senator McConnell is pressing to fund aid to Jordan by dropping the earmarks for Egypt. This provision is expected to be debated on the Senate Floor this week.

Interior

Summary

The House Full Committee marked up the bill June 26. Floor consideration began on July 10, but is not yet finished. Debate is scheduled to resume July 15. The House bill totals $13 billion, $0.8 billion below the request, but $0.2 billion above FY 1997. Most of the reductions below the request are in land acquisition, the National Endowment for the Arts (NEA), Energy Conservation, Fossil Energy R&D, the Indian Health Service, and the Bureau of Indian Affairs. **Statements of Administration Policy have indicated that senior advisors would recommend a veto if NEA funding is not restored.**

Major Issues

- NEA. The House bill eliminates funding for the NEA from the FY 1997 level of $99 million. A Yates amendment to restore funding to the NEA (up to the 1997 level) was defeated in Committee. The Ehlers amendment to terminate NEA and create Education Department $80 million block grants for the arts was defeated on the House Floor by a vote of 271 to 155. Rep. Chabot offered an amendment to terminate the National Endowment for the Humanities. A vote on this amendment scheduled for July 15.

- Land Acquisition. The $700 million for land acquisition in the budget agreement was not approved by the House. According to the budget agreement, the $700 million would enable the Secretaries of Interior and Agriculture to complete priority land acquisitions and exchanges that are on a scale that cannot be readily funded through amounts regularly appropriated directly to the land management agencies from the Land and Water Conservation Fund; we have proposed that $315 million should be used to purchase the New World Mine project and the Headwaters Forest. The House bill does include $239 million for traditional land acquisition, virtually at requested levels. This fully funds the Everglades activities, but reduces the regular NPS land acquisition account by $18 million (25 percent), probably eliminating most funding for the Elwha Dam (WA) acquisition.

- Bureau of Indian Affairs. The House Committee bill would provide $1.68 billion, $53 million below the request, but $72 million above FY 1997. The bill would fully fund the Tribal Priority Allocations (a protected program in the budget agreement), but funds for administration, construction, and settlements would be slightly below the request.

Labor/HHS/Education

Summary
House and Senate Subcommittee mark ups were today. Specific details are not yet available.

Major Issues

- Education Funding. The overall funding level for the Education, Training, Employment and Social Services function is "protected" under the budget agreement. Education Reform, Bilingual and Immigrant Education, Pell ($300 increase in 1998 maximum award to $3,000), and child literacy initiatives (consistent with the goals and concepts of the America Reads program) are identified in the budget agreement as protected domestic discretionary priorities.

- America Reads. The House is expected to provide the funding in FY 1999 and make it subject to authorization.

- Head Start. The budget agreement separately identified the Head Start program as a protected domestic discretionary priority. The FY 1998 Budget includes a $324 million increase.

- National Institutes of Health (NIH). Both Congressman Porter and Senator Specter have indicated that they would like to fund NIH at 7.5 percent, or $956 million, over the FY 1997 level. The FY 1998 request includes a 2.6 percent, or $337 million, increase over the FY 1997 enacted level of $12.7 billion. They are also expected to increase funding for Ryan White and CDC. As in previous years, it is unclear where Congress will find the money to fund NIH at greater than the Budget request. A concern would be that it could come from other Administration priorities in the bill.

- Language Riders. Limitations are expected on ergonomics standards and on human embryo testing.

Legislative Branch

Summary
The House Subcommittee marked up the bill on June 24. The bill totals $2.2 billion, $42 million above FY 1997. The bill does not effect the Executive Branch. The bill funds the House of Representatives at $709 million, $25 million, or 3.7 percent, above FY 1997. Within House totals, the Office of the Speaker would receive a 3.6 percent increase, the Office of the Majority Leader, a 6.6 percent increase, and the Office of the Minority Leader, a 7.7 percent increase. The bill is currently being held up over fights to increase staff for the Joint Tax Committee and an effort to use surplus funds to increase oversight staff to investigate labor unions.

Military Construction

Summary
The House passed the bill on July 8 (on a vote of 395-14). The bill totals $9.2 billion in BA, $0.8 billion above the request, but $0.6 billion below FY 1997. There is no Senate Subcommittee mark up; the Senate Full Committee is expected to mark up on July 15. The House includes $886 million for 94 specific, unrequested projects, partially offset by $86 million in reductions to requested programs and other adjustments. Over $200 million of the unrequested projects is for projects that are not in the five-year plan.

Transportation

Summary
The House Committee reported the bill on July 11. The Senate Subcommittee mark up was today (detailed information is not yet available).

Major Issues
- Infrastructure. The House Committee mark for infrastructure programs is $2.35 billion over the Administration's request. Possible funding problems are FAA Operations which were reduced by $36 million. The Subcommittee funded Amtrak at $793 million, or $4 million over the request. The bill would provide $283 million in operating assistance, rather than the $344 million sought by the Administration. Amtrak claims that it cannot operate at this reduced level.

- Surface Transportation. Programs were marked up according to current law. This means that most new Administration NEXTEA proposals were not funded. These proposals include State Infrastructure Banks, the Transportation Credit Enhancement program, and the Access to Jobs and Training program.

Treasury/Postal Service/General Government

Summary
The House bill is currently being held up over leadership discussions of whether to allow a January 1998 pay raise for Members and Cabinet Officials. (Since January 1993, this bill has been used to prohibit the raise, which is otherwise tied to increases in the GS schedule.) In addition, an effort is expected in the House to change the account structure for the Executive Residence in an effort to clarify responsibility for reimbursing the cost of use of the White House for political and other non-official purposes. The Senate Subcommittee marked up the bill on July 11. EXOP accounts are funded at requested levels. It does not limit Member's pay.

Major Issues

- Budget Agreement. The budget agreement specifies funding levels for the overall function 750, which includes many law enforcement programs within the Department of Treasury. The budget agreement also specifies that the Violent Crime Reduction Trust Fund (VCRTF) is "protected." While both are "protected," the allocation of funds within the function and the VCRTF is not specified; any allocation that is not consistent with the Administration's request will be controversial.

- Anti-Drug Campaign. It appears the Senate Subcommittee accepted the ONDCP proposal for an anti-drug public information campaign. However, the proposal was funded at $110 million, $65 million less than requested.

VA/HUD/Independent Agencies

Summary
The House Committee marked up the bill July 8. Overall the bill provides $69.8 billion in total domestic discretionary budget authority, slightly below the request. The Senate Subcommittee marked up the bill today (detailed information is not yet available).

Major Issues

- VA. The House Committee provides a total of $18.8 billion in discretionary budget authority for VA which includes the Administration's user fee proposal of $0.6 billion, as agreed in the budget agreement.

- EPA. EPA is funded at $7.2 billion in the House bill, $0.4 billion below the request. EPA's Operating Program, which is protected in the budget agreement, is funded at the requested level of $3.4 billion; however, there are numerous earmarks for unrequested projects. Superfund is funded at $1.5 billion, $0.6 billion below the request and the level in the budget agreement "if policies can be worked out." EPA's Brownfields program is funded virtually at the request.

- HUD. The House bill would provide $25.3 billion in discretionary BA for HUD, $0.3 billion below the request and $9.4 billion above FY 1997. This increase over 1997 is due, in large part, to an additional $5.7 billion required to renew expiring Section 8 contracts. Furthermore, $3.7 billion in excess balances was rescinded. The House bill does not provide funding for the following Presidential initiatives: Empowerment Zones ($100 million) and HUD Brownfields ($25 million).

- Corporation for National and Community Service (CNCS). The House bill funds CNCS at the FY 1997 level of $402.5 million, 27 percent ($146 million) below the request. This does not provide requested resources for your America Reads Initiative. **In a Statement of Administration Policy (July 15), we indicated that if amendments to terminate CNCS and the AmeriCorps program are passed, senior advisors would recommend a veto of the bill.**

Attachment

FY 1998 Appropriations Items Contrary to Bipartisan Budget Agreement

- **International Affairs Funding** --Based on House action to date on Foreign Operations, Commerce/Justice/State and Agriculture, function 150 is funded at a level about $1.1 billion below the request and the amount contained in the BBA. The most significant reductions are in Foreign Operations, which is $1 billion below the request and does not include funds for arrearages owed by the United States to multilateral development banks.

- **Land Acquisition** --The House Appropriations Committee has approved the FY 1998 Interior bill without any of the $700 million in additional funding for priority land acquisition and exchanges. It also includes a shortfall of $18 million (-25 percent) for "base" National Park Service (NPS) land acquisition, a "protected" program under the BBA.

- **Superfund**-- The House Committee-reported VA/HUD bill has a Superfund level of $1.5 billion, which is $0.6 billion (28 percent) lower than the level in the President's Budget. This is contrary to the Administration's interpretation of the BBA, which provides that Superfund appropriations will be at the President's level "if policies can be worked out". The President's Budget provides a total increase of $1.3 billion over FY 1998 and FY 1999 to accomplish an additional 250 cleanups by the year 2000.

- **National Institute of Standards and Technology (Advanced Technology Program)** -- The House Commerce/Justice/State bill is $91 million below the $276 million request for ATP and the Senate is $76 million below the request. The House Subcommittee does fully fund NIST (by providing increases for science and technology programs and cutting ATP) while the Senate Subcommittee bill does not fully fund NIST.

- **051/053** --The House and Senate-passed Defense Authorization bills move $2.6 billion in 1998 budget authority intended to fund environmental privatization projects and to forward fund specific Department of Energy programs (subfunction 053) to Department of Defense military programs (subfunction 051). Consistent with those actions, the House Appropriations Committee shifts $1.8 billion in BA to the Defense Subcommittee and $0.8 billion to the Military Construction Subcommittee. The Senate Appropriations Committee shifts $0.7 billion in BA to Defense and $0.8 billion to Mil Con.

  The House-passed Military Construction bill spends the $0.8 billion on 94 unrequested construction projects. Of that amount, over $200 million is for projects that are not even in DoD's five year plan. The Budget Agreement assumed that subfunction 053 would be funded at the President's request level, and that the additional spending in the agreement would go to Defense military activities.

- **America Reads** -- The House Committee-reported VA/HUD bill does not include the proposed $147 million increase for National Service which was based on the proposal to integrate National Service volunteer efforts into the President's America Reads literacy initiative (11,000 more volunteers).

- **Community Development Financial Institutions** -- [If this document is being used after July15th, it is expected that] the Senate Appropriations VA/HUD Subcommittee terminates CDFI, a protected Domestic Discretionary Priority Program.

THE WHITE HOUSE

WASHINGTON

July 18, 1997

MEMORANDUM TO THE PRESIDENT

FROM: Gene Sperling and Chris Jennings

SUBJECT: Secretary Shalala's Memorandum and other information about Medicare Income-Related Premiums

Attached are two documents on the income-related premium. The first is a one page side-by-side table summarizing the major issues involved in administering a mean-tested (our base Democrats prefers "income-related") premium by the Department of Health and Human Services versus the Treasury Department. We created this document integrating much of the information contained in the Secretary's memo, as well as new information from Treasury and the CBO.

The second attachment is Donna's memo itself. It details the many, serious concerns that are raised by the prospect of administering this premium through HHS. It concludes that HHS/SSA collection of a high income premium would be an administrative disaster, inaccurately collecting premiums from millions of beneficiaries based on data that is two to three years old. It points out that the inefficient administration would lose over 50 percent of the revenue due, would require at least $30-$50 million in new administrative costs, and require at least 300 new employees.

Donna also raises her opposition to eliminating the Medicare Part B premium subsidy altogether, arguing that it would create much greater incentives for healthy and wealthy beneficiaries to leave the program than would setting the premium at 75 percent of program costs. (Despite our argument to the contrary, the Mainstream Senators strongly oppose having extremely wealthy beneficiaries having any subsidy.)

We have made major efforts to work with Members of Congress on this issue and have made it clear, that if it can be done right, we want to get this done. On Thursday, we met with the Mainstream Senators (Breaux, Chafee, Kerrey, Conrad, Frist, etc.). On the same day, the Concord Coalition released a strong critique of the Senate proposal and an endorsement of your position. The briefing was so well received that virtually every Member of the group concluded that administration of the premium by the Treasury Department was the preferable way to go. (Senator Chafee said it was the only way to go.) Notably, the Mainstream Senators also agreed that the income thresholds should be indexed to inflation to assure that much larger and less well off seniors be unintentionally added over time.

We are following up on the Mainstream Coalition's request to refine the Treasury option by developing alternatives to the tax form to calculate and collect the high income premium. We will keep you informed of developments.

COMPARISON OF THE ADMINISTRATION OF THE HIGH-INCOME PREMIUM

PROVISION	SENATE BILL ADMINISTERED BY HHS*	SENATE BILL ADMINISTERED BY TREASURY*
Who Administers	Health & Human Services (HHS), Social Security Administration (SSA), & Treasury	Treasury
Savings	$3.9 billion (assumes loss of over 50% of savings in the first 5 years)	$8.9 billion (assumes traditional compliance rates)
Administrative Costs	$30 to 50 million per year	$5 to 10 million per year
How Eligible Beneficiaries Are Identified	HHS identifies beneficiaries by: (1) Getting income from the latest reviewed Treasury tax data, which is 2-3 years old (e.g., 1995 for 1998) (2) Sending notices to at least 3 million beneficiaries to ask if this past income is what they will receive in the next year and require them to respond in writing in 30 days **<u>Note</u>: Sharing income data across agencies raises significant privacy concerns**	Beneficiaries report their income, reference a schedule, and add the extra premium to the bottom line of their tax return
How Premiums Are Collected	Assumes that extra premium is subtracted from monthly Social Security check after HHS sends to SSA their estimate of who gets how much taken out of their checks	See above
Reconciling Income	To ensure that the right amount of premium was assessed, Treasury would send the actual income from reviewed tax data to HHS. However, because this would be done retrospectively this would take 2-3 years (e.g., 2001 correction for 1998 mistake)	Since income is not projected but is the actual reported income, no reconciliation is required.

* This policy assumes the Senate policy which phases in 100% of the premium for beneficiaries with incomes between $50,000 and $100,000 for singles, $75,000 and $125,000 for couples. The Administration opposes the Senate's 100% phase out, administration through HHS/SSA, and lack of indexing of the income thresholds.

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THE SECRETARY OF HEALTH AND HUMAN SERVICES
WASHINGTON, D.C. 20201

JUL 11 1997

MEMORANDUM FOR THE PRESIDENT

As you know, the Senate has proposed a number of changes that would affect Medicare beneficiaries, including the introduction of an income-related Part B premium starting at $50,000 for single beneficiaries and $75,000 for couples. In our letter to the Conferees, the Administration made clear that while we do not oppose income-relating the Medicare premium in principle, we have a number of concerns about the proposal as currently structured. I wanted to raise to your attention the two aspects of the proposal that I think raise the most significant problems. (I have discussed my concerns with Secretary Rubin).

First, if the Administration agrees to an income-related premium, I believe we should strongly oppose the Senate provision for HHS to administer the collections process. The Administration has consistently taken the position that any such premium should be collected by the Treasury Department, where it could be managed simply and efficiently as part of the filing of a beneficiary's tax return. (As you may recall, this is how we proposed to collect the income-related premium in the Health Security Act; we adhered to this position in the balanced budget negotiations). Part I of this memorandum sets forth in more detail the reasons why administration of an income-related premium by HHS would be impractical, expensive, and more burdensome to beneficiaries. Administration by HHS runs serious risks of alienating several million senior citizens.

Second, I am concerned that the Senate proposal has the potential to cause a substantial percentage of the highest income beneficiaries to opt out of Medicare Part B altogether, because it phases out the premium subsidy entirely at the top end of the income scale. Part II of the memorandum explains why it is very important that we not agree to an income-related premium that includes this feature.

I. Concerns about Administrability of Income-Related Premium by HHS

Administration of an income-related premium by HHS would be a formidable undertaking. HHS does not now have access to information on beneficiary income. In addition to serious concerns about the privacy of income information, requiring HHS to collect an income-related premium would mean establishment of a large and expensive bureaucracy at HHS, a task for which the Department has no expertise or comparative advantage. We estimate that such a bureaucracy, which would duplicate functions performed by Treasury, would require more than 300 new

Federal employees and cost more than $30 million per year (not counting start-up costs), and run counter to Administration and Congressional goals of downsizing the Federal government.

Furthermore, the inefficiencies inherent in the Senate proposal for HHS to collect the income-related premium have led both CBO and HCFA actuaries to estimate that less than half of the revenue theoretically obtainable would be achieved. We believe that CBO would estimate that the income-related premium in the Senate bill would raise about $8-$9 billion over five years if the collections were handled by Treasury, compared to only the $4 billion that CBO has estimated if the premium were administered by HHS.

A. What HHS Would Have to Do to Administer Income-Related Premium

The Senate bill would require HHS to undertake a complicated series of steps.

(1) The Senate bill requires Treasury to provide HHS with income information on Medicare beneficiaries since HHS does not have such information. Collecting and reconciling information about beneficiary incomes would be an entirely new function for HHS, one that some beneficiaries may not find appropriate, given the sensitivity of such information.

(2) The income information provided by Treasury would be three years old. Treasury would send HHS 1995 tax return information, the latest available information, in order to give HHS sufficient time to develop and send to beneficiaries an initial determination (i.e., a preliminary estimate which would need to be reconciled after the actual tax filing for the year) of their 1998 income and an initial determination of their 1998 income-related premium liability, and give the beneficiary an opportunity refute the HHS estimate.

Use of income data three years old is problematic. It.would be inherently confusing. Past income is not a good indicator of a Medicare beneficiary's future income. For example, income for beneficiaries who were working in 1995 but later retired would result in an overstatement of estimated 1998 income for the beneficiary. Similarly, if a beneficiary had a capital gain in 1995, that gain would be included in the beneficiary's 1995 income used to project 1998 income.

In contrast, if Treasury were administering the income-related premium, they would not have to use three year-old data. Rather, because the income-related premium would be collected as part of the filing of the beneficiary's tax return, it would be based on actual income information for the relevant year.

HHS would have to respond to the many letters from beneficiaries or Congressional Offices who might be concerned with the general notion of a governmental agency estimating their income for a year and why they had to supply income data to two different governmental agencies.

(3) The Senate bill requires that HHS send the beneficiary an estimate of their income by September 1 of the year before the year for which the income-related premium applied and that the beneficiary be given thirty days to refute the estimate. If the beneficiary refutes the HHS estimate, the Senate bill provides that the beneficiary's estimate would hold. If the beneficiary does not challenge the HHS estimate, the Senate bill specifies that the HHS estimate would hold.

(4) While the Senate bill does not specify how the income-related premiums would actually be collected, they could be collected either by HHS direct billing, or SSA deductions from the Social Security check (for the bulk of beneficiaries).

In the case of exclusive HHS direct billing, HHS would have to send quarterly bills to about 3 million beneficiaries in 1998. For those beneficiaries who did not make timely payment, additional efforts at collection would need to be undertaken.

Alternatively, the beneficiary-specific income-related premium liability could be sent to SSA before the beginning of a year and SSA could deduct the amount from the beneficiary's Social Security check. This method could be used for 85 percent of beneficiaries; the remainder would need to be direct-billed by HHS.

(5) If high-income beneficiaries did not make premium payments, they would be terminated from Medicare Part B coverage. Challenges to terminations could consume additional HHS resources. Termination may also involve correspondence with beneficiaries and Congressional offices.

(6) Since the initial premium payments for a year would be based on the "initial determination" of income and since "actual" income and the actual income-related premium liability for the year may be different from the estimated amounts, the Senate bill requires that there be a reconciliation after the year. The Senate bill requires Treasury to send HHS income information after the beneficiary filed their tax returns for the year. Using actual income, HHS would determine the actual premium liability for the year.

For income-related premium liabilities for 1998, the reconciliation would occur in 2001. This could be confusing to beneficiaries since the reconciliation would involve resurrecting their actual information from a tax return three years earlier and generate additional correspondence.

(7) After HHS reconciled estimated and actual income and income-related premium liabilities, underpayments would have to be collected from beneficiaries and overpayments would have to be refunded. If a beneficiary had died, collections would have to be made from, and refunds made to, the surviving spouse or estate. Special efforts may be needed to recoup underpayments from heirs where estates had already disbursed assets.

(8) The paperwork burden for HHS administration of an income-related premium is staggering. New forms would have to be developed to send income estimates to beneficiaries, receive their responses and reconcile estimated and actual income. Twelve million bills would need to be sent if HHS did exclusive billing for income-related premiums. Additional correspondence would be involved for delinquent collections. Up to 3 million letters might be sent to handle overpayments and underpayments for a year. Special paperwork might be needed to recoup underpayments from surviving spouses or estates.

B. Comparison with Administration by Treasury

In contrast, an income-related premium could be calculated through the income tax return, in a manner similar to the way that the tax on Social Security benefits is currently determined. One line would be added to the 1040 tax form representing the amount owed for income-related premium. Determination of the income-related premium owed would be calculated on a worksheet in the 1040 instructions in the same manner that individuals calculate the amount of their Social Security benefit subject to income taxation. If the individual pays estimated taxes, the income-related premium liability could be included as part of the individual's periodic filing. There would be some increase in Treasury's administrative costs to run this program, but we believe those costs are relatively small.

C. Potential Costs of Administration by HHS

In an era of ever more constrained funding for program administration, requiring HHS (and SSA) to take on these administrative functions would be impossible without a more than $30 million annual increase in administrative funding (and $20 million in start-up costs) and more than 300 new Federal employees. These estimates of administrative costs do not take into account the need to deal with inquiries or complaints from Congressional offices, or the IRS itself (which will continue to be identified as the source of final income data). In the absence of additional resources, processing those inquiries would detract from the capacity of those organizations to provide other services. Nor do those estimates reflect the additional costs to beneficiaries who believe -- rightly or wrongly -- that there are errors in the information on which their filings are based. Just as other taxpayers incur considerable expenses for accountants, lawyers, and so forth, so for the first time would thousands of Medicare beneficiaries.

II. Concerns about the Maximum Beneficiary Contribution in Senate Proposal

The Administration's Health Security Act proposed that beneficiaries pay a maximum contribution of 75 percent at or above the top income level. In other words, there would be a 25 percent subsidy for the highest income beneficiaries.

There is an important rationale for this policy. If the entire subsidy is removed, the younger and healthier persons among highest income beneficiaries would have strong incentives to drop out of Part B coverage. On average, Medicare spending for high-income beneficiaries is about 15 percent lower than for all beneficiaries. Since their average expenses would be considerably less than their Part B premium contributions, they could probably purchase a Part B benefit package privately, at less cost than a Medicare premium equal to 100 percent of the average cost for all aged beneficiaries. If a significant number of high-income beneficiaries dropped out, it would raise costs for those who remain. HCFA actuaries assume that about 30 percent of high-income beneficiaries would drop out if the income-related premium were set equal to 100 percent of average program costs. This would increase the Part B premium for every other beneficiary. The Administration believes that the maximum beneficiary contribution at the highest incomes should be 75 percent.

Conclusion

For all of these reasons, I strongly believe we should support an income-related premium only if it is administered through Treasury. I also believe that if this provision remains in the bill, the maximum beneficiary contribution should be 75 percent.

Donna E. Shalala

cc: Robert Rubin
Secretary, Department of Treasury

John Callahan
Acting Commissioner, Social Security Administration