THE WHITE HOUSE

WASHINGTON

July 28, 1997

MEMORANDUM TO THE PRESIDENT

FROM: Chris Jennings

SUBJECT: Children's Health and Medicaid Budget Developments

cc: John Podesta, Bruce Reed, Gene Sperling, John Hilley, Fred DuVal

This responds to your request last night for a quick update of developments in the budget negotiations relating to children's health and Medicaid. Unfortunately, both subjects have individual provisions that -- as of early this morning -- continue to hold up final resolution on the budget: children's health benefits and the Disproportionate Share Hospital (DSH) cut formula. It is worth noting, however, that most other major issues -- like financial accountability in the children's benefit, cost-sharing protections, and the rest of the Medicaid issues -- are either resolved are almost resolved.

Children's Health Benefits

Both sides perceive that they have moved a long way on the benefit question. Both are right, but the current conference package is still a long way away from the benefit that overwhelmingly passed the Senate, which required that -- to be eligible for the $24 billion grant funding -- states offer the FEHBP Blue Cross/Blue Shield PPO benefit with assurances that vision and hearing would be covered and a requirement for mental health parity. It is also a long way from the Medicaid approach we supported earlier this year with our endorsement of the Chafee-Rockefeller bill.

The Republicans' current package requires that a state-eligible plan be the FEHBP plan outlined above, a state-employee plan, or the most popular HMO plan in the state. In addition, it gives states the flexibility to become eligible for grant money if they develop a separate plan that is substantially actuarially equivalent plan to the dollar value of one of these three, and it provides: (1) inpatient/outpatient hospital care; (2) physician services; (3) X-Ray and lab; and (4) well-baby and well child care. Although the first three options would assure that the benefit plans would cover prescription drugs and mental health (and the vast majority already cover vision and hearing services), the fourth plan option would not guarantee this coverage. [NOTE: The health care packages for Florida, Pennsylvania, and New York are waived in; they do not have to design a new benefit plan.]

In our discussions with the Republicans, we have stressed our desire to ensure maximum state flexibility balanced with accountability on the benefits. We have accepted their automatic approval of any State package that meets their three benefit designs (assuming it also includes vision and hearing services.) We have agreed to their provision to waive in certain states. We have rejected, however, their actuarial value option because a benefit could be easily designed to exclude, for example, mental health benefits. This is not just a hypothetical concern: it happens frequently. For instance, for financial and political reasons, only 13 of the over 30 states who have children's health benefit cover such basics as prescription drugs, mental health, dental, and vision and hearing services. **(See attached one-pager on why these benefits are so important to kids.)**

Recent Benefits Negotiations

Over the last 48 hours, we have suggested ways to add flexibility. For example, we offered that any state could design a different package than one of the conference options as long as it could gain HHS Secretarial approval -- similar to countless welfare and Medicaid waivers. They rejected this option because they (and the Governors) don't want an HHS review process.

We then suggested (but did not offer) the possibility of adding categories of benefits to their basic categories, ensuring that they are meaningful, and setting up an automatic approval if the packages are actuarially equivalent to the other three options. We decided not to take this route because we feared that Republicans would vehemently reject the concept of adding new benefit categories.

Yesterday, we tried addressing their Secretarial review concern and their benefit category concern by offering to automatically approve any benefits package that was actuarially equivalent to the base three packages as long as the value of the individual benefits in the package was not designed to be less than 75 percent of the value of the benefit. We took this approach to ensure that the benefits we are concerned about could not be designed to be basically worthless -- again, mental health comes to mind. We thought the Leadership agreed to this proposal, but the staff (notably from the Commerce Committee) strongly objected and apparently was successful in urging the Speaker to reject it. Although many unfounded arguments were raised, one that is legitimate is that there are benefits in the three basic packages that children may not need.

Current Status

There are very few options left. The first, of course, is for either side to recede to the other. Since that appears unlikely, the only other option may be for us to add our four priority benefits (prescription drugs, vision/hearing, mental and dental) to their actuarial value base package and require the 75 percent actuarial value protection for just the eight categories. This would enable the states to design virtually any benefits package that was actuarially equivalent to one of the three base options as long as it included both sides' benefit categories. This would represent a move from the offer we made yesterday.

Status of the DSH Formula Fight

All along, we have been urging some moderation in the cuts high-DSH states would be forced to shoulder under the Medicaid agreement. Recently, we have been working with Congressman Spratt to develop alternative DSH allocation formulas. In the absence of reaching some sort of agreement, we will have major problems with our South Carolina, Texas, New Jersey, New Hampshire, Louisiana, and Missouri delegations on final passage.

We believe Mr. Spratt (working with us) has developed a formula that is acceptable to the high-DSH states. It, in effect, simply reduces the high-DSH states' cuts by capping their overall Medicaid reductions to 3.5 percent. In so doing, however, it holds all the other states harmless to the reductions in the House and Senate versions of the budget reconciliation bill. It accomplishes this by simply spending more money (or cutting less) and requires about $670 million more in DSH spending.

Yesterday, we thought we had an agreement with the Leadership to integrate Congressman Spratt's formula into the final package. However, the same Commerce staffer who objected to our children's health compromise objected to this option. As of this writing, the DSH formula remains a very open issue; it still does appear likely, however, that the Leadership will allocate additional dollars to address our individual state concerns, (as well as some of theirs). Unfortunately, with each passing day we do not reach agreement, the DSH fight will become harder to resolve as more and more states will want special deals. Moreover, the resentment of the low-DSH states will increase to greater levels as time goes by.

NGA Meeting

Although the Governors are quite satisfied with most of the agreement, they may well raise concerns about the benefits debate. As you know more than anyone, this issue is coming down to the longstanding trust/accountability debate between the Federal and state governments. As **the attached one-pager describes, the budget agreement will go much further than ever in providing great flexibility to states in the administration of Medicaid and the new children's health program.** However the benefits issue is resolved, it will not impose new costs on the states: it comes down to a Federal assurance that the new investment will deliver a set of meaningful benefits to children that some states may not otherwise provide. Because discussions are ongoing, Gene, Fred and I recommend not engaging on this issue to the extent possible.

If you decide to address this issue directly, you certainly could say that we remain open to -- and are looking at -- alternatives that assure some basic benefits of great importance to children. Gene and I will be sending Q&As on these subjects under separate cover. (Remember, the Republicans went on record of endorsing required benefits when they listed four benefits that must be covered in any actuarially-equivalent package; the debate will be around the additional benefits and whether to include some protection that the benefits are real.) However, you should carefully weigh any comments that you may make to be responsive to the Governors with the knowledge that your words will be carefully scrutinized by the children's advocacy community and many Democrats (and some Republicans) on the Hill.

IMPORTANT BENEFITS FOR CHILDREN

VISION

- **Why important to children:** Children are 3 times more likely than adults to have acute eye problems. However, children are less likely to recognize that their vision is poor.

- **Problem:** Almost 3 times as many uninsured versus privately insured children did not get needed glasses.

  Nearly one in five uninsured children needed but did not have glasses before enrolling in Pennsylvania's state program.

HEARING

- **Why important to children:** Children are 20 times more likely than adults to have acute ear infections.

  After colds and the flu, ear infections and ear conditions are the most common reason why children miss school.

  Untreated hearing impairments can delay language development and cause learning problems.

- **Problem:** Low-income children are more than twice as likely to miss school because of an ear infection or ear condition as high income children..

DENTAL

- **Why important to children:** Tooth decay is the most common childhood disease.

- **Problem:** Dental problems disproportionately affect children from low-income families.

  Almost 4.2 million uninsured children were unable to get needed dental care -- almost 3 times the number of privately insured children.

MENTAL HEALTH

- **Why important to children:** Children are 70 percent more likely to suffer from activity limitations due to mental disorders relative to working age adults.

  About 8 to 11 million children have a mental disorder.

- **Problem:** About one in four children who need mental health care did not receive it.

  Uninsured children are particularly at risk. Over 270,000 uninsured children needed mental health services but were unable to get them.

HEALTH CARE WINS FOR THE GOVERNORS IN THE BUDGET

HEALTH CARE IN GENERAL

- **Increase in Federal funds for states.** States come out winners – a net gain of at least $10 billion over five years (Medicaid & children's health combined). This does not even include the over $5 billion in State savings from new flexibility.

- **Liberated from excessive Federal oversight.** State have unprecedented **flexibility** in running both the children's health initiative and Medicaid.

MEDICAID

- **No per capita cap**, the NGA's number one concern at its January meeting.

- **Savings to states:** State savings over 5 years include:

  - **Repeal of the Boren amendment.** (Up to $1 billion).

  - **Medicaid rates for Medicare cost sharing.** (Up to $4 billion).

  - **Reduced rates for health clinics (FQHC/RHCs).** (Up to $200 million).

- **Repeals managed care waivers** that required a paperwork-laden, time-consuming review process.

- **Flexibility in cost sharing** for Medicaid beneficiaries.

CHILDREN'S HEALTH

- **Major investment for states.** $24 billion over the next five years.

- **Reduced matching rate**, from 43% under Medicaid, on average, to 30%.

- **No requirement to accelerate phase in of poor children 14 to 18 years old.**

- **Flexibility in:**

  - **Eligibility** to target children by area, age, or other circumstances.

  - **Benefits** so that, above a minimum, States determine the mix and amount of services. No early, periodic screening, diagnosis & treatment (EPSDT).

  - **Provider or plan payment rates** which States will negotiate without burdensome Federal oversight.

  - **Use of managed care** so that States may, for example, contract with one plan to deliver care to children.

August 5, 1997

MEMORANDUM FOR THE PRESIDENT

FROM: GENE SPERLING

SUBJECT: Laying down a marker on Social Security

As today's longer memorandum on Social Security notes, the decisions on Social Security reform involve at least three different levels:

- Overall process strategy: timing for a real deal, whether to call for a commission, whether to make a unilateral announcement, etc.
- Substantive decisions: Forging policy proposals to address the Social Security challenge
- Whether to lay down an early marker on the issue

Your advisers will clearly have extensive processes to evaluate different scenarios and options on the first two levels. The immediate question is whether you want to lay down an early marker on the issue. Your advisers have discussed this specific question both yesterday and today, and have narrowed the options to the following three.

1. <u>Declare tomorrow that you want to act on Social Security before Medicare</u>

   Possible language: "*While the Medicare commission is conducting its analysis, we must work in a bipartisan way to create solutions -- before the Medicare commission issues its report -- that will strengthen Social Security, so that Social Security will be just as strong and secure for the next generation as it has been for past generations. We must act not because we are in a state of crisis, but because we have the opportunity to act wisely to prevent a crisis from ever occurring. I will be asking my economic team to engage in broad consultation with the Congressional leadership, with Democrats and Republicans, with those who represent seniors and younger people, and with experts and hard-working citizens, so that we can find the best way to garner the full support of our people for such a significant reform.*"

   <u>PROS</u>

   - Signals that you want to do Social Security first and puts you out front on issue
   - Provides flexibility, since it commits us only to have proposals before March 1,

1999 -- when the Medicare Commission reports.

- May lead to questions about timing and process, but at least the questions would be about our actions and our strategy.

CONS

- Could raise expectations for a specific proposal
- Endless questions could make us look evasive
- Could still be seen as not quite stepping up to the plate

2. Maintain current stance and do not signal anything new on timing

Possible language: *"I want to explore a bipartisan process for strengthening Social Security, so that it will be just as strong and secure for the next generation as it has been for past generations. We must act not because we are in a state of crisis, but because we have the opportunity to act wisely to prevent a crisis from ever occurring."*

PROS

- Until we know how to proceed, we should not make any pronouncements
- Doesn't lock us in to anything specific

CONS

- Some will say you didn't seize the initiative when you were strong
- Leaves door open to other political leaders to be first to call for addressing Social Security
- Doesn't break new ground or make news because it doesn't make clear that we want to do this before Medicare.

3. Conduct a prominent interview (e.g., New York Times) next week in which message is the same as in Option 1 (Social Security proposals before Medicare) to lay a marker

PROS

- Still allows us to lay a marker without drowning out budget stories this week
- Gives us more time to analyze options and speak to you about them

CONS

- Leaves door open over the next week for other political leaders to be first to call for addressing Social Security
- Less high-profile than the press conference

Recommendations

The principal benefits of Option 2 are that it does not limit our flexibility on Social Security reform at all -- including whether to act on Social Security before Medicare. Along with Option 3, it doesn't drown out the budget stories this week. The principal danger with Option 2 is that the longer we wait to lay down a marker, the higher the likelihood that we will be criticized by opinion leaders and some on the Hill for not stepping up to the plate on entitlement reform.

In terms of tomorrow, most of your advisers support Option 2 rather than Option 1, although Gene and John Podesta support Option 1. A compromise position that Rahm, Sylvia, and Gene support is not to make news tomorrow, but rather to do a prominent newspaper interview next week (Option 3). Secretary Rubin wanted to stress that he is not against the idea of laying down a marker, but thinks that such a step should be taken only after you have had a chance to consider and internalize all the different options and constraints.

August 5, 1997

MEMORANDUM TO THE PRESIDENT

FROM: **GENE SPERLING**

SUBJECT: **Social Security**

While you have made clear your desire to enact meaningful long-term entitlement reform, it is crucial that we decide our strategy for how best to accomplish this goal. You have indicated to us in response to a previous memorandum that we should proceed on parallel tracks on Medicare and Social Security, but that you agreed with a strategy of putting an initial focus on Social Security reform. Achieving Social Security reform requires not just addressing difficult substantive issues. It also requires thinking carefully about our strategy for coming out with proposals, and for getting those proposals passed.

Given the importance and complexity of the issues involved, we thought it would be useful to think through a variety of strategic scenarios on how to achieve reform. This memorandum examines some scenarios that may help you think about how to maximize the probability of effecting reform, and discusses whether you should lay down a marker *this week* on Social Security. *Your immediate decision is whether to make an announcement on Social Security this week -- and if so, what the announcement should say -- while we are mapping out our plan.* An appendix provides a brief overview of the Social Security problem, and outlines the three schemes proposed by the Gramlich commission on Social Security.

I. Possible scenarios

We face an extremely complicated and difficult -- but compelling -- challenge. While there are well-defined options, it is important to realize that all of them involve highly controversial reforms that will be portrayed by critics as raising Social Security taxes or cutting Social Security benefits. (Investing the Trust Funds in equities raises other difficult questions -- such as perceived and real risks of market volatility -- and is seen by some as more of an accounting gimmick than a true solution.) Indeed, the only measures included in all three Gramlich Commission plans were expanding the taxation of benefits (which we learned was difficult in 1993), and extending coverage to state and local workers (which may prove very unpopular in California and Ohio).

In considering our best strategy for going forward, we must consider the various elements and steps that will play out under any scenario. In doing so, it is helpful to keep in mind the following goals and the means to achieve them:

- *Fundamental goals:*

-- Long-term viability: 75-year or perpetual balance; is the year-to-year path important?
-- Keep some social insurance/progressivity in system
-- Establish Presidential leadership

- *Key issues/other goals:*

-- Increase national savings
-- Impact on budget reform
-- CPI
-- Acceptability of partial solutions

- *Optional means:*

-- Expert commission
-- CPI commission
-- Public education advisory board
-- Public education campaign

- *Eventual real process for proposals:*

-- You simply announce a proposal (alone or following commission or public education effort)
-- Leadership-designated negotiating process
-- Non-leadership bipartisan process
-- Commission with fast-track/base-closing vote
-- Key players commission (similar to second possibility above), including chairs of relevant committees, etc.

Three scenarios

Keeping the above factors in mind, it may be helpful to think through the timing of when specific proposals will need to be discussed seriously and released publicly. This "real deal" period could be the State of the Union 1998; March/April 1998; or post-election/State of the Union 1999. Within these three different scenarios, there are still many decisions to make about which elements would be useful (the scenarios do have some different implications for the feasibility of some potential elements of the process -- such as outside commissions or public education boards). Considering the timing for releasing specific proposals seems one useful way of organizing our thoughts.

Scenario 1: State of the Union 1998

Elements:

- Timing constraint would probably not allow the creation of an outside commission.
- Since we would be acting soon, it may be difficult (if not impossible) to do a CPI commission. If we want a CPI fix, we may therefore have to do it our own.
- Key to success may be large-scale consultations. Could look to working with outside Republicans and key Democrats to get buy-in and bipartisanship for announcement.
- If our proposals do not generate support, you could call for a bipartisan process to report back after the 1998 elections. But in the meanwhile, we could have undermined our chances for achieving reform.
- For better or worse, the timing means that the fall would likely be filled with stories of our substantive discussions on controversial issues and specific proposals.

Options:

- Option 1: You announce proposals in State of the Union 1998. We could then either follow the normal legislative procedure or convene some sort of ad hoc high-level negotiating process with the Hill leadership.
- Option 2: You announce Leadership/POTUS negotiating process.

Pros:

- With defined, specific proposals, a January move would be seen as demonstrating great Presidential leadership on Social Security. You would be addressing a critical long-term reform as the focus shifts from deficit reduction to entitlement reform.
- If we use consultation period well, we could garner some bipartisan support and outside validation, although it is unlikely that we would succeed in obtaining the support of the Republican leadership along.
- Our window of opportunity may be short-lived, especially given the budget and electoral cycle. So acting in January would push the process along.
- An early move could help focus the debate and the public education process.
- Given that it is unlikely that legislation will be passed quickly, it may be helpful to release proposals to demonstrate your leadership on this issue.

Cons:

- Even the most basic proposals are likely to create a firestorm in the absence of strong bipartisan support. For example, taxing benefits proved to be extremely controversial in 1993, and including state and local workers from California and Ohio is also likely to generate significant opposition.
- Democrats may be upset at again having process that few could get involved in.
- Acting soon may not permit us enough time to invest in public education/outreach.
- Putting out specific proposals without bipartisan cover may push Democrats and Republicans to make "no Social Security tax hike or benefit cut" pledges in the fall elections, thereby setting back our reform effort.

Scenario 2: Release proposals in March or April 1998

Elements:

- Aiming to release specific proposals in March or April 1998 allows a longer consultation and public education period, and opens up the possibility of appointing a short-tenured commission of either outside specialists or the real players.
- May allow enough time for a CPI technical advisory panel. But we may still have to release a CPI adjustment on our own, with little bipartisan cover.

Options:

- Option 1: Turning the issue over to an official commission comprising top-level representatives of Congress and the Administration, perhaps with some sort of "fast-track" mechanism for ensuring passage of the commission's proposals.

- Option 2: Convening a commission of eminent Americans -- such as Bob Dole, Warren Rudman, Bill Bradley, and George Mitchell -- to report back by early next year. We would flesh out our own ideas internally over the same period, and then engage in high-level negotiations with the Republican leadership -- possibly also involving the eminent Americans. Such an approach would mirror the informal method ultimately used by the Greenspan Commission.

- Option 3: Engaging in a more extensive public education and outreach effort to obtain Republican validation for reform effort, while allowing more time for an internal policy process to develop our own proposals. We could then release our proposals and either follow the normal legislative process or engage in a special high-level negotiating process with the Hill leadership.

Pros:

- Allows more time to educate the public and generate bipartisan support before releasing specific proposals
- Allows enough time for a commission to report back, if we want a commission

Cons:

- May provide too little time before the fall 1998 elections
- May still not permit us enough time to invest in a comprehensive public education and outreach effort before releasing proposals.
- Putting out specific proposals without bipartisan cover may push Democrats and Republicans to make "no Social Security tax hike or benefit cut" pledges in the fall elections, thereby setting back our reform effort.

Scenario 3: Release proposals after the fall 1998 elections, perhaps in State of the Union 1999

Elements:

- We would have more time to develop an extensive public education effort and to allow the public to digest the various options.
- May allow enough time for a CPI technical advisory panel. But we may still have to release a CPI adjustment on our own, with little bipartisan cover.
- Moving after the fall 1998 elections would also facilitate, if we wanted, having a longer-term outside commission that would issue its own policy recommendations.
- The AARP, Pew Foundation, and others will be undertaking year-long public education efforts. Our efforts could dovetail with theirs.

Options:

- Option 1: Public education effort including public education advisory board, while developing specific proposals. The public education effort could involve a panel of prominent Americans -- such as Bob Dole, Warren Rudman, Bill Bradley, and George Mitchell -- in addition to the Administration's own efforts and those of the AARP and the Pew Foundation. This approach would be a type of "commission-lite."

- Option 2: Engage in public education effort without blue-ribbon public education board while developing our own specific proposals. Then use a variety of implementation strategies: announcing our own package, conducting ad hoc high-level negotiations, or forming a commission of top officials with tight deadline and mandate to come up with a specific package.

- Option 3: Form a longer-term outside commission that would issue its own policy recommendations (the panel of prominent Americans mentioned above would not issue policy recommendations). The benefit may be bipartisan buy-in. The substantial cost is "commission-itis" -- especially after the Gramlich commission. We would also still need an implementation strategy for turning the commission's proposals into law.

Pros:

- Allows more time to develop policies and bipartisan support for policies.

- Allows a full-fledged commission, if we want one.

Cons:

- May look weak.
- Runs into Medicare, since the Medicare commission must report by March 1, 1999.

II. Laying down a marker this week

Depending at least in part on when you decide that you may want to come out with proposals, you may want to lay down a marker soon to ensure that the Administration is identified as leading on the Social Security reform effort. Your message could be:

"This balanced budget agreement is the most significant package of savings and reforms to strengthen and modernize Medicare in the history of the program.

"Yet because we must also prepare for the retirement challenges of the next century created by the aging of the so-called baby boom generation, I am pleased that this budget legislation includes a bipartisan Medicare commission that will report back by March 1, 1999 on how to keep Medicare strong for decades and decades to come.

Then you could follow with one of the following options.

Option 1: Deadline before Medicare commission reports

"But while the Medicare commission is conducting its analysis, we must work in a bipartisan way to create solutions -- before the Medicare commission issues its report -- that will strengthen Social Security, so that Social Security will be just as strong and secure for the next generation as it has been for past generations. We must act not because we are in a state of crisis, but because we have the opportunity to act wisely to prevent a crisis from ever occurring. I will be asking my economic team to engage in broad consultation with the Congressional leadership, with Democrats and Republicans, with those who represent seniors and younger people, and with experts and hard-working citizens, so that we can find the best way to garner the full support of our people for such a significant reform."

PROS

- Signals that you want to do Social Security first and puts you out front on issue
- Provides maximum flexibility, since it commits us only to have proposals before March 1, 1999 -- when the Medicare Commission reports.
- May lead to questions about timing and process, but at least the questions would be about our actions and our strategy.

CONS

- Could be seen as not quite stepping up to the plate
- On the other hand, it may raise expectations for a specific proposal
- Endless questions could make us look evasive

Option 2: No deadline

"But I want to explore a bipartisan process for strengthening Social Security, so that it will be just as strong and secure for the next generation as it has been for past generations. We must act not because we are in a state of crisis, but because we have the opportunity to act wisely to prevent a crisis from ever occurring."

PROS

- Until we're sure of how we want to proceed, we should not make any pronouncements
- Doesn't lock us in to anything specific

CONS

- Doesn't break new ground or make news because it doesn't make clear that we want to do this before Medicare.
- Leaves door open to other political leaders to be first to call for addressing Social Security

Option 3: Deadline before Medicare commission reports and CPI commission

"But while the Medicare commission is conducting its analysis, we must work in a bipartisan way to create proposals -- before the Medicare commission issues its report -- that will strengthen Social Security, so that Social Security will be just as strong and secure for the next generation as it has been for past generations. We must act not because we are in a state of crisis, but because we have the opportunity to act wisely to prevent a crisis from ever occurring. ***We must start by addressing the bias in the consumer price index. I am therefore calling for a commission on the CPI."***

PROS

- Adds more specificity to commitment to address Social Security by calling immediately for CPI commission
- Lives up to our commitment to address CPI outside budget

CONS

- Putting initial Social Security emphasis on CPI focuses the debate on benefit cuts
- Best way to deal with CPI may be as part of overall broader Social Security reform that "saves Social Security," and when negative impact from CPI fix could be mixed together with other reforms that have progressive effects

Option 4: Announce that you will make proposals in State of the Union

"But while the Medicare commission is doing its work, I want to explore a bipartisan process that will lead to proposals to strengthen Social Security. After broad consultation with the Congressional leadership, with Democrats and Republicans, with those who represent seniors and younger people, and with experts and hard-working citizens, ***I will be announcing a plan to save Social Security in my next State of the Union address."***

PROS

- Will be a bold, news-generating step.
- Will generate support and credit from important policy-makers, both Democratic and Republican, and influential opinion leaders.
- Will make our internal and external steps on substantive Social Security issues the main focus of domestic policy debate for the fall and winter.

CONS

- Takes away our flexibility if we decide we need more time or more of a bipartisan process.
- Could set up partisan reaction: Republican leadership may pull back and wait to see approach; Democrats may feel excluded and want to distance themselves from perceived Social Security tax increases or benefit reductions. Without bipartisan cover for our proposals, Democrats and Republicans may make "no Social Security tax hike or benefit cut" pledges -- thereby setting back our reform effort.
- Will make our internal and external steps on substantive Social Security issues the main focus of domestic policy debate for the fall and winter.

Appendix: Overview of the Social Security challenge

According to the 1997 intermediate projections of the Social Security actuaries, the combined Old-Age and Survivors and Disability Insurance (OASDI) Trust Funds would be exhausted in 2029. The same projections suggest a 75-year actuarial deficit in the OASDI program equivalent to 2.23 percent of taxable payroll. In other words, immediately raising the combined employer-employee OASDI payroll tax by 2.23 percent (from 12.4 percent to 14.63 percent) would produce long-run balance in the program -- income from payroll taxes and interest on the Trust Fund assets would be sufficient to meet projected expenditures over the next 75 years. If the payroll tax rate is not increased immediately by 2.23 percent, other changes to the tax system or benefit provisions would be necessary to eliminate the long-run actuarial deficit.

One underlying question that we must address is what our goal is in reforming Social Security. One goal may be to eliminate the 75-year actuarial imbalance and extend the life of the Trust Fund. But that may be too narrow: we may want to ensure that reaching balance doesn't involve unsustainable flows either into or out of the Trust Fund during sub-periods of that 75-year horizon. Or we may want to focus on the more fundamental goal of ensuring that any reform boosts national saving, thereby raising future income and reducing the burden implied by our falling worker-beneficiary ratio.

At the same time, other priorities may include maintaining the system's progressive benefit structure and its protection against elderly poverty. Social Security benefits currently represent more than three-quarters of money income for elderly households in the bottom two quintiles of the income distribution. Social Security benefits keep some 15 million people above the poverty line, and are commonly associated with the dramatic reduction in elderly poverty over the past several decades. The elderly poverty rate has fallen from more than 35 percent in 1959 to just 10.5 percent in 1995. Balancing the desire to maintain the social insurance aspects of the program against the desire to restore long-run solvency and raise national saving is perhaps the fundamental trade-off in the effort to reform Social Security.

Gramlich Commission options

The Advisory Council on Social Security, led by Ned Gramlich, produced three different plans for addressing the long-run actuarial imbalance in the program: the maintain benefits (MB) plan, the individual accounts (IA) plan, and the personal security accounts (PSA) plan. The plans include several extremely controversial proposals, including establishing individual accounts -- either managed by the government (as in the IA plan), or by individuals themselves (as in the PSA plan) -- and investing the Social Security funds in equities.

The Maintain Benefits (MB) plan would (numbers in parenthesis show the reduction in the long-run actuarial imbalance resulting from the change):

- Increase the payroll tax rate in 2045 by 1.6 percentage points (0.22);
- Consider investing 40 percent of the Trust Fund in equities (0.82);
- Change the benefit computation period from 35 years to 38 years (0.28);
- Phase out the low-income thresholds for taxation of Social Security benefits (0.16);
- Redirect revenue for taxation of high-income benefits from HI to OASDI Trust Fund (0.31);
- Tax benefits in the same manner as private defined benefit pension plans (0.15); and
- Cover all state and local employees (0.22)

The Individual Accounts (IA) plan would:

- Require all workers to contribute 1.6 percent of their taxable wages to government-administered individual savings accounts;
- Accelerate the increase in normal retirement age (0.10) and index it to life expectancy (0.40);
- Reduce benefits to middle- and upper-income recipients by roughly 20 percent (1.32);
- Change the benefit computation period from 35 years to 38 years (0.28);
- Phase out the low-income thresholds for taxation of Social Security benefits (0.16);
- Reduce the spousal benefit from 50 percent to 33 percent (0.17);
- Replace the surviving spousal benefit with highest of spouse's benefit, own benefit, or 75 percent of combined benefit (-0.32);
- Tax benefits in the same manner as private defined benefit pension plans (0.15); and
- Cover all state and local employees (0.22)

The Personal Security Accounts (PSA) plan would:

- Redirect 5 percentage points of combined employer-employee OASDI taxes to Personal Security Accounts (-4.60);
- Replace current benefits with basic flat benefit equivalent to $410 per month (3.82);
- Accelerate the increase in the normal retirement age, index to life expectancy, raise early retirement age, and limit disability benefits (1.25);
- Increase payroll tax by 1.52 percent of taxable payroll from 1998 to 2069 (1.42)
- Phase out the low-income thresholds for taxation of Social Security benefits (0.16);
- Replace the surviving spousal benefit with highest of spouse's benefit, own benefit, or 75 percent of combined benefit (-0.39); and
- Cover all state and local employees (0.22)

While the three plans clearly adopt different approaches to fundamental aspects of Social Security -- differences with which we will have to grapple in formulating an Administration position -- they do share several common elements. It is often argued that these elements could form the basis for an Administration approach to Social Security reform. It is important to recognize, however, that these steps would not suffice to address the long-run actuarial imbalance by themselves. And many of them could prove quite controversial -- we had difficulty passing raising taxes on benefits for high-income beneficiaries in 1993, and state and local government workers in California and Ohio will resist inclusion in the Social Security system. The common elements of the plans include:

Provision	**Percent of 75-year taxable payroll**
Measures included in all three plans:	
Expand coverage to state and local workers	0.22
Remove low-income thresholds for taxing benefits	0.16
Sub-total, provisions included in all three plans	*0.38*
Measures included in two of three plans:	
Tax benefits like other pensions	0.15
Change averaging period for calculating benefits, reducing average benefit by 3 percent	0.28
Accelerate increase in normal retirement age	0.10
Index normal retirement age to life expectancy	0.40
TOTAL	*1.31*
PROJECTED 75-YEAR DEFICIT	*2.23*

The Gramlich Commission plans illustrate two points:

- There is substantial controversy over whether to allow individual accounts or investments of the Trust Fund in equities.

- Even the steps that are common to the plans -- including changes in the coverage of the system and the tax treatment of benefits -- could be very controversial and would not by themselves eliminate the 75-year deficit in the program.

THE WHITE HOUSE

WASHINGTON

August 7, 1997

MEMORANDUM FOR THE PRESIDENT

FROM: **GENE SPERLING**

RE: **Line Item Veto**

Over the past several days, we have conducted a review of the line item veto process.

On the tax side, the Treasury Department started by weeding thru the 79 provisions to narrow the items that could be realistic candidates. We have attached six for discussion.

Excluded were a large number of equitable transition measures which are small measures designed to ensure certain taxpayers are not unfairly harmed by their reliance on a changing tax provision. Also excluded were provisions that are proper or good policy. Finally, other provisions excluded included those we disagreed with, but had agreed to as part of the balanced budget agreement.

On the spending side, Frank Raines and Jack Lew identified four issues that they thought were worthy of consideration. Two of which we are bringing to you for discussion.

In making a decision, there are differences in overall strategy approaches to take as well as differences as to which measures one would line item veto under a given strategy.

Strategy Choice 1: Avoid any line item veto now and wait for the appropriations bills. The strategy here is that there are no ideal tax measures to line item veto and any one we could select would be difficult to argue is worthy of a veto as compared to the other measures you didn't select. Thus, it is better to wait for a more favorable time. *This is Bob Rubin's and Larry Summers' preference although they would be willing to accept a minimal amount of line item veto.*

Strategy Choice 2: Line item veto only one or two spending provisions but no tax provisions. This argues that one should follow the advice of Senator McCain and others who argue one should first test provisions on the spending side, and that the tax provisions that are likely to be vetoed are supported by a strong number of Democrats and that would be damaging to our supporters by isolating their preferences. *John Hilley and Janet Yellen support this* *measure.*

Strategy Choice 3: Choose to line item veto one spending and one tax provision as a test case and signal to show willingness to use veto for both spending and tax provisions. This option would argue that it is hard to find a rationale for why certain items in the spending or tax sides remain standing and others are line item vetoed. Thus the best rationale is to choose one spending and one tax provision to signal your willingness to veto both spending and tax provisions. *Frank Raines and Jack Lew support this choice.*

Strategy Choice 4: Look for several provisions to show seriousness in using the line item veto for government reform. This choice argues that employing the line item veto on several provisions shows more seriousness to strike out unnecessary special interest provisions. Public opposition from our supporters, while painful, will illustrate it is real and significant and that it is best to show your willingness to exercise these options even if we don't have a perfect rationale for the items that were selected and the others that were left standing. *Variations of this option are supported by myself and Rahm Emanuel, while Erskine would look for two tax and two spending provisions.*

As you look at the provisions, I want to draw your attention to one specific area of significant debate among your advisors:

- **Farms Coops:** Several of your advisors see this as the best case for a line item veto. They argue that this provision is poor tax policy and that it is associated with helping Harold Simmons, a single sugar beet producer, and is therefore the closest to the ideal special interest provision worthy of a line item veto.

  On the other hand, others argue that it is widely supported by supporters, such as Daschle, Dorgan and Stenholm and will be portrayed as an anti-farm measure.

Tax Provisions

Treatment of Remainder Interest for Purposes of Excludable Gain on a Principal Residence (Sec. 312(a) (partial))

This provision treats the sale of a remainder interest in a home in the same manner as the outright sale, and thereby permits the taxpayer to claim the full $500,000 exemption.

There are only moderate tax policy objectives to this provision, but there may be non-tax policy reasons to cancel it. The businesses that will purchase remainder interests tend to charge exorbitant interest and fees, and are subject to criticism by consumer advocates and others.

This provision is apparently supported by Congressman Thomas.

The revenue loss from this provision is not separately stated on the revenue table for the Act.

Deferral of Gain on Sales of Stock in Farm Product Refining Firms to Farms Coops Which Supply the Firm With Raw Farm Products for Refining (Sec. 968)

The provision grants deferral on the sale of stock of a refiner or processor to a farmers' cooperative to allow farmers more control and "gain better economic footing."

This provision is objectionable on tax policy grounds. The provision does not assure the benefits of he tax deferral will go to the farmers, nor that the farmers benefitting, if any, will be small businesses or families. This provision is a special interest provision for a sugar beet producer. It was supported by Senator Conrad and Congressman Stenholm. (This provision is reportedly promoted by investor Harold Simmons of Texas).

This provision is estimated to lose $84 million over five years and $104 million over ten years.

Reduce Excise Tax on Hard Cider (Sec. 908)

The provision taxes hard cider as the rater applicable to beer produced by small breweries (22.6 cents per gallon) rather than the higher rate that applies to wine or to larger beer breweries.

This provision is somewhat objectionable on tax policy grounds. The tax imposed on a particular alcoholic beverage should be revised only in the context of a general review of alcoholic beverage rates. This is a special interest provision for New York and Vermont cider producers. It was favored by Senators Moynihan, Leahy, D'Amato, and Jeffords.

This provision is estimated to lose $3 million over five years and $7 million over ten years.

Provide Above-the-Line Deduction for State and Local Government Officials
(Sec. 975)

This provision allows certain State and Local government employees to deduct business expenses in computing AGI ("above the line"). This treatment benefits eligible taxpayers in contrast to "below the line" deductions, including allowing the deduction even if the taxpayer does not itemize.

This provisions is somewhat objectionable on tax policy grounds. In general, the beneficiaries of this provision are not sufficiently unique to warrant special treatment. There are, however, some countervailing policy arguments. This provision is of particular interest to Senator Lott because local officials in Mississippi would be eligible for the deduction.

This provision is estimated to lose $27 million over five years and $58 million over ten years.

Exception from Subpart F for Active Financial Services Income (Sec. 1175)

Until 1986, a special exemption from current taxation applied to foreign "active financing income" for insurance companies and securities dealers; this exemption was repealed because it was unadministrable. The Act restores an exception for a single year.

This provision is objectionable on tax policy grounds. It inadequately addresses concerns raised in 1986 (when a prior exemption was repealed). It is also not worthwhile to provide this special rule for only one year (1998). Securities dealers and insurance companies, especially those in New York and Connecticut, have lobbied heavily on this issue.

This provision is estimated to lose $94 million over five years.

Oklahoma Technical on Indian Wage Credits and Development of Incentives for Property with 10-Year Lives or Less (Sec. 1604(c)(2))

A provision enacted in 1993 provided special tax benefits within Indian reservations, which term was mistakenly defined to include the majority of the state of Oklahoma. The Act ineffectively limits the definition of Indian reservation (so that it still covers an overly large portion of Oklahoma). The portion of the change that has been identified as a limited tax benefit, however, is a transition rule that prevents the technical correction from applying when taxpayers already took advantage of the earlier mistake.

This provision is objectionable on tax policy grounds because it grants special benefits to a group of taxpayers based solely on whether they claimed the questionable beneficial treatment. This rewards aggressive taxpayers. Of interest to the Oklahoma delegation, including Rep. Watkins and Senator Nickles.

The revenue loss from this provision is not separately stated on the revenue table.

Spending Provisions

Medicaid - New York Provider Tax Provision

Description of the Provision. Section 4722 of the bill includes a provision that deems permissible all of NY's illegal provider taxes for the purposes of Federal Medicaid match. The provision deems permissible an expired regional tax as well as several taxes the state continues to collect.

Background. Congress enacted the 1991 Medicaid provider tax law to address State "gaming" of the Medicaid program, through provider tax and donation schemes. The law was enacted to curb the unprecedented growth in Medicaid costs in the late 1980's and early 1990's. The law requires that all provider taxes must be uniform and broad based to prevent state "recyling" of Federal Medicaid funds.

Since the provider tax law was enacted, HCFA found that 16 states, including NY, continue to collect illegal provider taxes. According to HCFA staff, NY's impermissible provider taxes total $1.7 billion. Because HCFA has not yet taken a disallowance for the illegal taxes, CBO scored the reconciliation bill provision at only $200 million in FY98; however the total could be larger.

NY has three kinds of provider taxes that HCFA determined to be illegal: 1) a tax that varies by region that was given special consideration in the 1991 law; 2) other taxes that fail to meet the broad-based and uniformity requirements; and, 3) taxes on impermissible classes of providers. The bill deems approved for NY only the first two types of provider taxes. We understand that the intent of the 1991 law was to permit NY to levy the regional tax, but to prohibit the collection of other taxes that do not meet the standards of uniformity and broad-baseness. However, the provision in the reconciliation bill is too broad because it would also deem permissible the other NY provider taxes that fail the test of broad-baseness and uniformity. The Administration would support a correction to allow Nys regional tax only, but none has yet been proposed.

Arguments Against the Provision.

- The provision opens the door for other states to request forgiveness for similar illegal taxes. According to HCFA, 15 states currently have illegal provider taxes totaling $3.5 billion.
- Under the bill, New York is allowed levy provider taxes that are impermissible in other states.
- Deeming all of NY's provider taxes permissible would allow NY to continue to collect those taxes, therefore increasing future Medicaid costs.
- The provision undermines the Secretary's authority to determine which taxes are illegal.
- *This can be corrected administratively without legislation.* If the Administration wants to deem NY's regional tax permissible, it can do so thorugh a technical correction to the regulation so NY would not be subject to the disallowance.

Alaska FMAP

Description of Provision. Section 4752 of the reconciliation bill increases Alaska's Federal Medical Assistance Percentage above the level of the current law formula. Under current law, Alaska's FMAP would be 50 percent. The bill increases the FMAP to 59,8 percent for FYs 1998, 1999, and 2000 (which is approximately the national average).

Background. Under current law, the Medicaid Federal Medical Assistance Percentage (FMAP) is based on the average per capita income in a State relative to the national average per capita income. Over many years, States have argued that the FMAP is inequitable and does not accurately reflect each States' special circumstances. For example, it does not take into account the number of people in poverty in each State, the geographic differences in medical prices, a State's revenue capacity, etc. Alaska argues that their FMAP should be increased because the cost of delivering medical care in Alaska is so much higher than the rest of the country because supplies must be transported to remote areas by air and medical providers must be paid very well to entice them to come to Alaska. However, Alaska's personal income is higher than other states, which causes their current FMAP to remain at the minimum 50%.

Arguments Against the Provision. While the Administration has consistently supported efforts to examine alternatives to the current Medicaid matching structure, we believe that changing the FMAP for Alaska alone is unwarranted and does not address the underlying inequities in the current system.

This provision could open up Pandora's box. Other states will be encouraged to seek similar legislation, with the result that Medicaid costs will rise and the program will become less evenhanded. For example, New York has argued consistently that the current FMAP formula is inequitable. Making a similar change to New York's FMAP would cost much more thatn the $200 million federal cost of the Alaska provision.

There are many measures of State "need" or fiscal capacity that could be the basis for Federal Medicaid payments to states. States often argue that the measure most beneficial to them is the measure upon which the national formula should be based. Any comprehensive, budget neutral change in the formula results in "winners" and "losers." The Administration proposed to establish a Commision in the FY 1997 and 1998 President's Budget bills to examine and make recommendations on the most appropriate way to change the formula. Changing the formula for certain states in piecemeal manner will create only "winners" at a cost to the Federal Treasury.

THE WHITE HOUSE

WASHINGTON

August 10, 1997

MEMORANDUM FOR THE PRESIDENT

FROM: **GENE SPERLING**

RE: **Articles on Farm Coop Tax Provision**

Attached are a sampling of clips from both Hulshof's district (co-sponsor with Stenholm) as well as transcripts from recent ABC News programs that are just an illustration of how the media is perceiving this tax break. Whatever Stenholm's and Hulshof's intentions and despite the occasional references about the farm groups, it is repeatedly being played regionally and nationally as a special interest tax break.

St. Louis Post-Dispatch

August 8, 1997, Friday, FIVE STAR LIFT EDITION

SECTION: EDITORIAL, Pg. 06B

LENGTH: 482 words

HEADLINE: HULSHOF AND THE SUGAR BEET KING

BODY:

As President Bill Clinton hunts for special interest goodies to ax from the new tax law, he should pay special attention to a provision by Rep. Kenny Hulshof. The "Agriculture for the 21st Century Act" reportedly gives an old-fashioned tax break worth tens of millions of dollars to a Texas billionaire.

The loophole, one of 79 identified by the Joint Committee on Taxation would be worth $ 20 to $ 63 million to Harold Simmons of Dallas, according to press reports. Mr. Simmons, the "Sugar Beet King," reportedly could defer taxes on the sale of a processing plant to a farmers' cooperative. On Thursday, a Simmons spokesman acknowledged pushing for the provision, but said he wouldn't benefit because his sale is already consummated.

Mr. Hulshof pleads innocent. His press aides told Post-Dispatch reporter Jo Mannies that he didn't know Mr. Simmons when he drafted the measure and that he pushed it to help the 105,000 Missouri farmers who are members of cooperatives.

Neither of those claims is the whole story. Mr. Hulshof acknowledged on Thursday that he had been introduced to a Harold Simmons at a dinner earlier this year, along with other members of Congress. (He says they didn't discuss the tax break.) Nor will the Hulshof provision benefit the 105,00 farmers already in coops if the coops continuing to be run as they now are. The tax benefit goes to the processor who sells to a coop. Mr. Hulshof hopes this will be an incentive for processors to sell to coops, enabling the farmers to earn more from processed goods.

Coop ownership of processing plants may be the way to go; many farm groups support the Hulshof provision. The problem is the way this provision got inserted in the tax bill at the last minute.

Maybe Mr. Hulshof hasn't figured out the ways of Washington. He's a freshman on the tax-writing House Ways and Means Committee. But he should have been a little more suspicious when Chairman Bill Archer of Texas greased the skids for his proposal. Democrats on the committee and others who watched the process say the Hulshof provision was one of the so-called "rifle shots" that benefit special interests. Mr. Simmons has given about $ 1.5 million to Republican causes since 1980.

The fact that the Joint Committee on Taxation identified the Hulshof provision as one of the 79 special interest breaks is evidence that both Democrats and Republicans realized its appeal was quite a bit narrower than Mr. Hulshof suggests. The committee only identifies those provisions that benefit fewer than 100 taxpayers.

Republicans in Congress say Mr. Clinton shouldn't use his veto on the tax bill. Mr. Clinton has said he will use the new power to veto a handful of provisions that benefit special interests.

If there ever was a reason to use the line-item veto, this is it. If there ever was a provision that deserved scrutiny it's Mr. Hulshof's.

LANGUAGE: English

LOAD-DATE: August 8, 1997

St. Louis Post-Dispatch

August 7, 1997, Thursday, FIVE STAR LIFT EDITION

SECTION: NEWS, Pg. 01A

LENGTH: 692 words

HEADLINE: HULSHOF DENIES TAX BREAK IN BILL IS 'BACK-ROOM DEAL'; CRITICS SAY IT MOSTLY HELPS BIG GOP DONOR

BYLINE: Jo; Mannies; Post-Dispatch Political Correspondent

BODY:

Did U.S. Rep. Kenny Hulshof, R-Columbia, sponsor an agriculture tax-break provision to help thousands of farmers in Missouri and elsewhere, as he says?

Or was Hulshof's aim to help one specific farmer, Texas billionaire and GOP benefactor Harold Simmons, as the congressman's critics allege?

Those questions are at the heart of a controversy over the freshman congressman's sponsorship of a tax break now under the scrutiny by the White House. The provision is among 79 "limited tax benefits" threatened with a presidential veto.

All 79 are part of the budget package signed by President Bill Clinton on Tuesday. The president said Wednesday he may use his new line-item veto powers to kill off some of them.

The provisions are targeted because the congressional Joint Committee on Taxation lists them as benefiting 100 or fewer taxpayers. Hulshof and his allies say the GOP-controlled committee is wrong about his provision and that they are lobbying Clinton to save it.

Critics are lobbying for a veto. The federal Office of Management and Budget says Clinton must make a decision by Monday, the day before he visits St. Louis.

Hulshof's provision allows the deferral of taxes on the sale of agricultural processing facilities to farmer-owned cooperatives. Rep. Jo Ann Emerson, R-Cape Girardeau, is among the 14 co-sponsors of Hulshof's original bill, later melded into the budget package.

Randy Jones, senior vice president for the National Council of Farmer Cooperatives, said the provision's aim is to help some of the nation's 4,000 farmer cooperatives. A cooperative is a group of farmers, generally in the same area, who form a legal arrangement to share resources.

The co-ops can buy processing plants that handle their products, thus giving the farmers a bigger share of the profits from the processed goods, like soybean oil or processed meat.

The tax break would make it more lucrative for plant owners to sell.

The Joint Committee's assessment is based on the tax benefits to the plant sellers, said Jones and others. The panel's staff declined to comment Wednesday.

Various press accounts in the last week, including articles in The Wall Street Journal and USA Today, zero in on Simmons, who is cited as saving tens of millions of dollars in taxes on a planned sale of sugar beet processing facilities.

Simmons, along with relatives and his various corporate political action committees, is a prominent donor to Republican candidates and groups around the country, having given close to $ 1.5 million since 1980. Hulshof has received no donations from the Simmons family or their PACs, federal records show.

Hulshof spokeswoman McCall Cameron said the congressman knew nothing of Simmons when he crafted the measure. Hulshof was thinking about the 105,000 farmers in Missouri who are members of 73 cooperatives, she said. All could benefit by the provision, she said.

However, a spokeswoman for the Democrats on the House Ways and Means Committee, on which Hulshof sits, said the fact that his provision made the targeted list of 79 means that tax experts from both parties have determined that it benefits few Americans.

"If it helps a Missouri farmer, let him show you one," said the spokeswoman, Democratic press secretary Ellen Dadisman.

The Democratic Congressional Campaign Committee, which hopes to oust Hulshof next year, issued a statement Wednesday that called on Hulshof to explain "why his first legislative accomplishment as a freshman lawmaker is a back-room deal."

Hulshof has countered with a letter to Clinton that asks the president to discount such "misinformation."

"According to some press accounts, this bill is a 'rifle shot' designed to benefit a single individual," Hulshof wrote. "Nothing could be farther from the truth."

The letter includes supporting documents from various agricultural groups, including the American Farm Bureau Federation.

At Wednesday's press conference in Washington, Clinton said some tax breaks that would affect small numbers of people might be justified if they were in the public interest or if they corrected injustices.

GRAPHIC: PHOTO, Photo headshot - (Kenny) Hulshof

LANGUAGE: English

LOAD-DATE: August 7, 1997

ABC NEWS

SHOW: WORLD NEWS TONIGHT WITH PETER JENNINGS (6:30 pm ET)

AUGUST 5, 1997

Transcript # 97080505-j04

TYPE: PACKAGE

SECTION: NEWS

LENGTH: 470 words

HEADLINE: BALANCED BUDGET BECOMES LAW

BYLINE: JOHN COCHRAN, DIANE SAWYER

HIGHLIGHT:
WILL CLINTON LINE-ITEM VETO LITTLE TAX BREAKS?

BODY:

DIANE SAWYER: At the White House today, the hoopla is finally over and the 1997 balanced budget deal at last became a law. President Clinton signed the bill with plenty of talk about bipartisanship. He now has five days to decide whether to use his new line-item veto power to strike down some of the special tax breaks that crept into the bill, the ones that benefit only a handful of people. There are 79 such breaks inside the new law. ABC's John Cochran tells us about a few of them.

JOHN COCHRAN: (voice-over) The politicians in Washington, they brag that their budget deal helps the whole country. But up in Vermont and New York State, a few apple growers and makers of hard cider are happy about the breaks that apply only to them. Their home state Senators got tax cuts that will make cider cheaper and make it easier for them to win over beer drinkers.

TINA MACLEOD, Liquor Store Owner: I think the reduction in the tax will help sales grow.

JOHN COCHRAN: (voice-over) But that was small beer compared to the goodie Congress gave to the Texas billionaire who operates out of this Dallas building. Harold Simmons, known as the sugar beet king, could get a break of up to $63

million on the sale of a processing plant. Simmons, by the way, has admitted making illegal campaign contributions in the past to Republicans and Democrats. His tax break was one of many that came out of closed-door bargaining in the final hours of budget negotiations.

FRED WERTHEIMER, Democracy 21: The way the system works, it's very, very difficult for the public to stop one of these from happening. They're done quietly, behind the scenes. They're sprung at the last minute and by then, it's too late.

JOHN COCHRAN: Calm down, say members of Congress. This sort of thing happens all the time.

Rep. JOHN KASICH, Chairman, Budget Committee: Any time you have a tax bill somebody's going to slide some provisions in it.

JOHN COCHRAN: One of those special provisions will help the richest man in the country -- multibillionaire Bill Gates, by providing tax breaks as exports at Microsoft and other software makers.

(on camera) And it's a safe bet this is one tax break president Clinton will not veto. It was his idea in the first place.

John Cochran, ABC News, Capitol Hill.

DIANE SAWYER: And on Wall Street today, the Dow Jones Industrials lost nearly 11 points to close at 8187. On the NASDAQ Market, stocks gained 16 points.

(Graphic: Dow Jones 15-day trend: Change-10.91, Close- 8187.94, Volume 525,661,800.

NASDAQ 15-day trend: Change-16.08, Close 1621.53, Volume 731,731,576.)

When we come back, the suspects in the New York City bombing plot -- what were they really up to?

(Commercial Break)

ABC NEWS

SHOW: ABC WORLD NEWS THIS MORNING (6:30 am ET)

AUGUST 6, 1997

Transcript # 97080605-j03

TYPE: PACKAGE

SECTION: NEWS

LENGTH: 509 words

HEADLINE: CLINTON MAY VETO LINE-ITEMS ON TWO SIGNED BILLS

BYLINE: NANCY AMBROSE, MARK MULLEN, ASHA BLAKE

HIGHLIGHT:
BILLS CONTAIN SPECIAL INTEREST ITEMS

BODY:

...And President Clinton has four days left to decide whether he'll exercise his new line-item veto power on two bills he signed into law yesterday. The president is praising the bipartisan cooperation that made the tax cut and budget bills possible. But as ABC's Nancy Ambrose reports, not everyone is happy with the deal.

NANCY AMBROSE, ABC News: (voice-over) President Clinton, surrounded by Democrats and Republicans, sounded almost Reaganesque as he hailed the balanced budget and tax cut agreement as a "true milestone for the nation."

Pres. BILL CLINTON: We can say with pride and certainty that those who saw the sun setting on America were wrong. The sun is rising on America again.

NANCY AMBROSE: (voice-over) The theme of the day was bipartisanship.

Rep. NEWT GINGRICH (R), Speaker of the House: This has been a long time coming. It has been a difficult process. But in that process, we have proven together that the American constitutional system works.

NANCY AMBROSE: (voice-over) Noticeably absent from the signing ceremony was House Democratic leader Dick Gephardt, who opposes the agreement. Gephardt called on the president to use his line-item veto authority to strike a provision that allows tobacco companies to deduct the 10-cent-per-pack increase in the cigarette tax from the proposed tobacco settlement. This provision, it turns out, can't be cut by the line-item veto.

But administration officials haven't ruled out a veto of other special interest items including -- a tax break for producers of hard cider, a $568 million export credit for Microsoft and other computer software makers and a $63 million tax break for Texas billionaire Harold Simmons for the sale of his beet processing plant. Simmons has admitted to making illegal campaign contributions to candidates of both parties.

(on camera) That last item could get the ax, given the controversy surrounding it. But the president has pledged to use his veto authority sparingly, not wanting to jeopardize a deal that has been so long in the making.

Nancy Ambrose, ABC News, Capitol Hill.

LANGUAGE: ENGLISH

LOAD-DATE: August 6, 1997

USA TODAY

August 5, 1997, Tuesday, FINAL EDITION

SECTION: NEWS; Pg. 11A

LENGTH: 619 words

HEADLINE: 79 tax breaks could be veto bait Goodies hidden in provisions of budget deal

BYLINE: Jessica Lee

DATELINE: WASHINGTON

BODY:

WASHINGTON -- Five days after Congress overwhelmingly approved a landmark deal to cut taxes and balance the budget, lawmakers and tax experts are still trying to figure out how many taxpayers got special treatment and what tax breaks they will get.

From the White House to the Treasury Department to the tax-writing committees on Capitol Hill, tax specialists were scrambling Monday. Their goal: figure out who's going to benefit from the 79 tax breaks aimed at specific companies or individuals.

One reason those 79 are of interest: They could be struck from the legislation if President Clinton exercises the line-item veto, the controversial power granted to presidents just this year.

About a quarter of them in particular are under assault as "rifle shots," pushed by lawmakers who have remained mostly nameless so far, that are narrowly targeted for specific companies or individuals.

One would allow Texas sugar beet processor Henry Simmons to defer taxes on $ 104 million in profits from the sale of stock in his company to a farmers' cooperative that supplies him with raw farm products for refining.

Clinton said Monday he has asked White House chief of staff Erskine Bowles to "institute an intensive process to review both the spending and the tax bills to see if there were any items that would be appropriate for the line-item veto."

But Monday evening, White House aides were still trying to ferret out information about the 79 provisions.

At the Treasury Department, meanwhile, tax specialists were also examining details of the 79 provisions. By evening, they had identified most of the taxpayers who will get breaks, but not all.

Not even the lawyers, accountants and economists of the congressional Joint Committee on Taxation knew Monday precisely who will get the deductions and exclusions listed as "Limited Tax Benefits" in the tax bill.

The provisions subject to Clinton's veto each affect 100 or fewer taxpayers. Provisions in the package that will cut the tax rate on capital gains, lower estate taxes and give most families with children a $ 500 per child tax credit will not be vulnerable to a line-item veto because they affect thousands, or millions, of taxpayers.

While they were published in the July 31 edition of the Congressional Record, the 79 prospective tax breaks are written in legislative language, unintelligible to all but tax experts who know how to cross-reference the Internal Revenue Code.

"The average person couldn't possibly know what is squirreled away in there," says Robert Greenstein, director of the Center on Budget and Policy Priorities. "Big tax bills have traditionally been vehicles in which to bury special tax benefits."

That makes senators and representatives just as average as everyone else. Several exploded with outrage last week as details of some special breaks dribbled out.

Rep. Pete Stark, D-Calif., second-ranking Democrat on the tax-writing Ways and Means Committee, bitterly denounced as "criminal" the exception for Simmons.

That particular provision calls for changing a section of the tax code "relating to nonrecognition of gain on sale of stock to certain farmers' cooperatives."

Some critics complain that firms such as Disney, Microsoft and Amway will be big winners. But tax lawyer William Wilkins, a former staff director of the Senate Finance Committee who is now with the law firm Wilmer, Cutler and Pickering, disputes the notion that the 1997 bill is a big giveaway.

"In terms of writing a tax bill to benefit one or two taxpayers, (compared with what) we saw in 1986, this bill is pretty clean on that count," he said.

GRAPHIC: PHOTO, B/W, CBPP

LANGUAGE: ENGLISH

LOAD-DATE: August 05, 1997

12-1-97

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

THE DEPUTY DIRECTOR

Copied
Lew
Sperling
COS

November 26, 1997

MEMORANDUM FOR THE PRESIDENT

FROM: Jack Lew and Gene Sperling

SUBJECT: Discretionary and Mandatory Spending Constraints and Initiatives

As we noted at the budget briefing last Friday, the Balanced Budget Agreement (BBA) will finish the job of eliminating the deficit, most likely sooner than expected. To accomplish that goal, the BBA imposed tight constraints on discretionary spending and exhausted most of the mandatory savings that we had used in previous budget proposals. As Erskine requested, this memo outlines the extent of the resource constraints and how we could provide more room for new initiatives. We hope to review this material with you at our budget meeting on Monday, December 1.

Discretionary Resources

The budget agreement set the discretionary spending cap for FY 1999 at very close to a freeze of FY 1998 levels. Budget authority increases from $258 billion in FY 1998 to $262 billion in FY 1999 -- an increase of $4 billion, or half of the increase necessary to keep pace with inflation. To preserve resources for you to allocate to initiatives in FY 1999, OMB's guidance to the agencies was substantially tighter than the caps. At the same time, agency requests exceeded OMB's guidance by $37 billion and the statutory cap by $32 billion.

On November 25th, OMB gave the agencies FY 1999 budget levels that fund essential government services and past initiatives, but are nonetheless quite tight. (Separately, we have sent you an agency-by-agency summary to review.) As Frank indicated on Friday, the agencies received two sets of guidance -- base funding levels and a list of additional items to be submitted for your review as candidates for the resources that we have reserved. The cost of all of the items on the candidate list greatly exceeds the resources we have set aside for initiatives. There will be competing demands to both fund new initiatives and increase funding for "core" activities. In the meetings that follow, we intend to first bring forward options for initiatives and secondly consider any remaining agency appeals for "base" funding levels. A few examples of efforts necessary to maintain high priority programs helps illustrate the effect of these constraints:

-- The Department of Education requested an increase of 14 percent over FY 1998; the base recommendation will contain a freeze with additional options on the list of possible initiatives. Within the freeze, however, there are a number of

THE PRESIDENT HAS SEEN
12-1-97

increases (e.g., the maximum Pell award is increased from \$3,000 to \$3,100) and a number of decreases (e.g., in the education block grant).

-- NIH requested a 10 percent increase. OMB will pass back a freeze, and the increase will be on the initiatives list. To increase NIH, without severely reducing public health programs, we will recommend other reductions in HHS (e.g., in Low Income Home Energy Assistance).

The base recommendations attempt to preserve "core" government services. For example:

-- We moved \$225 million from the FAA airport grants programs to their operations account to ensure a continued high level of attention to safety and security.

-- The Internal Revenue Service receives \$8 billion, \$230 million more than the FY 1998 enacted level, to continue investments in technology and deal with the Year 2000 computer problem.

-- Veterans Affairs Medical Care receives \$17 billion, the same level requested in your FY 1998 budget and \$700 million over guidance. This level reflects the agreement reached last year between the White House and the VA. Funding for VA medical research is also maintained at the FY 1998 request level.

As the totals suggest, initiative candidates far exceed resources available under the cap. In addition to the examples noted above, there are substantial new resource requests for education initiatives (early mentoring, education empowerment zones, afterschool programs, etc.), research and development, child care and environmental protection. In some cases, discretionary increases can be presented as mandatory options, permitting additional resources to be made available under the caps, provided that there are offsets to make the new mandatory spending deficit neutral as required in the Budget Enforcement Act. We are also looking at changes to budget concepts that would allow new user fees or other governmental receipts to finance new discretionary spending outside of the existing caps.

Secretary Rubin asked that this memo note that he thinks the process should be reversed -- fund essential non-optional core activities such as the FAA and the IRS first and consider initiatives as candidates for whatever resources remain. He is concerned that if high visibility core functions are underfunded, the result will be a legacy of mismanagement.

Mandatory Offsets

In addition to major new initiatives, there are a number of prior mandatory spending policies that will compete for any available offsets. For example, large initiatives such as school

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construction and smaller items, such as the Africa trade policy, will compete with new initiatives such as child care, climate change and health care expansions.

The budget will need savings to offset any new mandatory spending. The BBA produced savings far greater than the new spending, which is why we have deficit reduction. As in all prior major budget deals, the BBA eliminated all balances that could otherwise have been used as offsets for new spending. Since the BBA contained most of the acceptable deficit reduction options on the table, offset options for this year's budget are quite scarce.

In particular, we are not likely to recommend substantial Medicare and Medicaid offsets -- with one possible exception -- which have provided the largest amount of resources in the past. The changes enacted in health programs in the BBA were large and should be implemented before an additional round of savings are enacted. Moreover, as you noted on Friday, the Medicare savings will be the subject of both the Medicare commission review and other attempts to address long-term Medicare solvency. One exception that we may wish to consider is a Medicare income-related premium, which could raise $5-10 billion in addition to the savings described below. A premium proposal could be used to finance health coverage expansions, such as the Medicare buy-in for individuals age 55-64.

Apart from any possible health care savings, we expect that between $2-3 billion of offsets in each of the next five years will be available to support mandatory initiatives in the FY 1999 budget. This estimate includes savings from the following policies:

-- curtailing state cost-shifting from the TANF block grant to the Federally-matched Food Stamps and Medicaid programs;

-- extending Superfund taxes, which traditionally have been used as an offset for mandatory spending, and which were protected in the BBA (which said that they should not be used as an offset for a tax cut); and

-- reducing the reserves held by education loan guarantee agencies.

Two additional offsets could significantly increase the amount of mandatory offsets available for the FY 99 budget: (1) proceeds of the tobacco settlement, and (2) a policy to address VA tobacco-related illness liability.

-- With regard to the tobacco settlement, we are exploring options to utilize at least some of the resources that would be available, without setting an upper limit on or placing an obstacle in the way of legislative action.

-- Reversing a recent ruling that extended VA coverage to tobacco-related illnesses for many veterans could theoretically save $25 billion over five years, but only a

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fraction can be recaptured for other purposes if we are to maintain any chance of accomplishing the policy.

Revenue Offsets

At the end of the BBA negotiations, Congress left on the table approximately $20 billion in additional loophole closers and reforms that we had proposed (in addition to Superfund revenues). We could re-propose these items and provide additional offsets. However, if they are used as offsets for spending, they are likely to be characterized as a tax increase. We are looking at options to pursue new initiatives on the tax side (e.g., child care tax credits; school construction through a tax provision). If policies that meet the policy objectives can be pursued as revenue measures, these offsets will not result in a tax increase.

Mandatory Initiatives

There are several mandatory initiatives under consideration through the policy councils. It is safe to say that, if we stay with $15 billion in mandatory savings and $20 billion in tax expenditure savings, we would be able to afford only a fraction of the ones you might be interested in.

Mandatory Initiatives	$ billions	
School construction	3 - 5	
Smaller class size	9	
Double NIH (normally discretionary)	20	tobacco
Child care	2 - 6	
0-5 initiative	2 - 4	
55-64 health care initiative	2 - 8	
6 weeks paid family/medical leave	10	
Subtotal	**48 - 62**	

Tax Initiatives		
Climate change	2 - 5	
Child care	5 - 10	
Subtotal	**7 - 15**	
TOTAL	**55 - 77**	

34 + 20 (?)

THE WHITE HOUSE

WASHINGTON

December 6, 1997

MEMORANDUM FOR THE PRESIDENT

FROM: **GENE SPERLING AND BRUCE REED**

RE: **Policy Initiatives for the FY 1999 Budget**

At the end of next week, we will be having a budget meeting with you in which you will begin making an assessment on how to spend limited resources on both existing programs and new initiatives. Our staffs have been working hard to complete their inter-agency processes on these new initiatives so that you could have a better understanding of them when we enter the budget process. It is important to note because of tight constraints, we are not asking you to make budgetary choices at this time, but rather to understand each of the initiatives so that you are in the best position possible to make such choices when Frank Raines presents you with the overall budget presentation.

Attached are many of these initiatives, including all of the education proposals. Over the next few days we will forward you several others and Katie McGinty will also be sending you a memo on new environmental policies.

cc: The Vice President
Erskine Bowles
Frank Raines

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THE WHITE HOUSE

WASHINGTON

December 6, 1997

MEMORANDUM FOR THE PRESIDENT

FROM: BRUCE REED
MIKE COHEN

SUBJECT: Class-Size Reduction Initiative

We are proposing for consideration in the FY 1999 Budget a $9.2 billion, 5-year initiative to improve early reading by reducing class size in grades 1 and 2 to a maximum of 18 (the current *average* is 22.5), and by taking the steps necessary to ensure that all teachers in those grades have the knowledge and skills necessary to teach reading effectively in small classes.

Reducing class size has long been an important goal for parents and teachers throughout the country. Although research on the impact of lower class size has produced some conflicting findings, two major well-controlled experiments undertaken in the 1980s in Tennessee and Indiana showed that reducing class size in the early grades to between 15 and 18 students has a significant effect on student achievement. All students benefit from smaller classes, but the effects are largest for the most disadvantaged -- low-income and minority students in inner cities.

A number of states are now launching their own class-size reduction initiatives. (Class size is also a lynchpin of Tony Blair's education agenda.) The proposed class-size initiative, structured as a partnership between the federal government and state and local governments, would help spread this effort across the nation. It also would provide a concrete way to demonstrate your commitment to help all students meet challenging national standards.

Class-size initiatives raise significant issues, especially involving teacher quality. For example, California's new initiative to reduce class size to 20 in the primary grades has exacerbated the shortage of fully qualified teachers and resulted in increased hiring of noncertified teachers, especially in urban areas. It also has increased the need for professional development for existing teachers, so that they can take full advantage of small classes. Finally, the initiative has placed added pressure on already overcrowded facilities.

The significant reductions in class size occurring in California, however, have had clear benefits. In the first year of implementation, most teachers report that smaller classes enable them to pay greater attention to individual students, to assign and help students with more challenging work, to communicate more often with parents, and to have less disruptive classes. Many parents echo these reports, and support for public schools appears to be on the rise throughout the state. And many schools and districts are finding ways of meeting the challenges of teacher quality and facilities. They have implemented effective training programs for both new and experienced teachers. And they have purchased portable classrooms or changed their use of existing facilities to make room for smaller classes.

The proposal described below is designed to help states and districts take advantage of the opportunities afforded by reductions in class size and to respond effectively to the challenges. We assume it will be coupled with a robust school construction proposal.

Purpose

The purpose of this initiative is to reduce class size and provide quality teachers in the early grades, so that all students learn to read independently and well by the end of the 3rd grade. Specifically, this initiative will help states and local communities hire an additional 89,000 teachers over 5 years in order to reduce class size in grades 1 and 2 to a maximum of 18. (The nationwide *average* is now 22.5.) At the same time, it will help states and school districts recruit and prepare new teachers and upgrade the skills of existing teachers in the early grades so that they have the skills necessary to teach reading effectively in small classes.

Funding Stream

The initiative would provide states and local communities with $9.2 billion over 5 years. Funding in the first year ($615 million in FY99) would cover the costs of hiring an additional 17,800 teachers, and funding in succeeding years would cover a similar number. The Department of Education would distribute funds to states on a formula basis, taking into account the number of additional teachers each state would need to reach the class size target, as well as poverty and teacher salaries within the state. We are also exploring ways to provide funds directly to the largest urban areas, as we did in last year's school construction initiative. In addition to paying for additional teachers, funds from this program would go towards measures to improve teacher quality, such as improved training for people entering the teaching profession, enhanced professional development opportunities for existing teachers, and new incentives for qualified teachers to teach in underserved areas. The federal government would cover 80% of the costs, with state and local communities providing matching funds for the rest.

State and Local Plans

The Department would require states to work with local school districts to develop a statewide plan for class size reduction. The plan would include a timetable for phasing in class size reduction, strategies for ensuring that every classroom has a qualified teacher and that every school has appropriate facilities, and a plan for financing the state and local share of the costs. The Department would encourage states and school districts to consider first how to make better use of *existing* staff and resources to reduce class size, such as by reassigning certified but non-teaching staff to classroom positions.

States and districts would have considerable flexibility in designing these plans. They could carry over federal funds from one year to the next, enabling jurisdictions to invest in preparing and training teachers at the front end of the process and scale up class-size reductions in later years. In cases where the lack of facilities or qualified teachers make it counter-productive to meet the class-size reduction target, jurisdictions could propose alternative approaches -- e.g., Reading Recovery or Success for All -- to provide intensive high-quality reading instruction in the early grades.

Quality Teachers

State and local plans would be required to address teacher quality in a number of ways. States and local districts would have to show that (1) they will work with institutions of higher education and others to recruit and adequately prepare teachers; (2) they will hire new teachers without increasing the percentage of uncertified teachers already in the classroom; (3) they will use tests and other certification requirements to ensure that new teachers have the appropriate knowledge and skills; and (4) they will ensure that new teachers get high-quality, sustained professional development. We are also considering a requirement that states and districts demonstrate that they have effective ways of identifying low-performing teachers, giving them help and, if necessary, quickly and fairly removing them from the classroom.

States and school districts would use funds from this initiative, as well as state and local funds and funds from other federal programs, including Title 1, America Reads, the Eisenhower Professional Development program, and Chapter 2, to fund the teacher quality component of the initiative. To assist state and local efforts, the Department of Education would launch a major effort to disseminate information about best practices and proven approaches to improving teacher quality and reading achievement.

Facilities

This initiative will place added burdens on existing facilities, and some school districts will have difficulty finding adequate space for smaller classes. It is therefore important for the Administration to propose a school construction initiative along with this proposal and press the Congress to enact it. In addition, as indicated above, this initiative will allow schools that cannot reduce class size to use federal funds for other proven approaches to teaching young children to read.

Accountability for Results

Under this initiative, local school districts will have to evaluate the impact of their class-size reductions on reading achievement and make midcourse corrections as needed. If a district cannot show significant gains in reading achievement after 3-4 years, it would not receive continued funding under this initiative. This provision will ensure that school districts have a strong incentive to make the most effective use of all of their resources and to use proven practices to improve the quality of teaching. In addition, the Education Department will conduct a national evaluation of this initiative to identify implementation problems and to learn about the most effective practices.

Budget Options

If the cost of this proposal needs to be scaled back, we can reduce the overall cost by aiming to reduce class size to an *average* of 18 with a ceiling of 20, or by reducing the federal share of the initiative to 70%. Alternatively, we could phase in the program over a longer period, such as 7 years. The chart below shows the total 5-year cost of these options.

	80% Federal Share	70% Federal Share
Class size ceiling of 18	$9.2 Billion	$8.0 Billion
Class size average of 18, ceiling of 20	$7.7 Billion	$6.7 Billion
Class size average of 18, ceiling of 20; 7 year ramp-up	$5.5 Billion (for first 5 years)	$4.75 Billion (for first 5 years)

THE WHITE HOUSE

WASHINGTON

December 6, 1997

MEMORANDUM FOR THE PRESIDENT

FROM: **GENE SPERLING**
BOB SHIREMAN

SUBJECT: **College-School Early Intervention Initiative**

In preparation for the budget decisions that will need to be made in the next few weeks, this memorandum is intended to provide you with a status report on the development of a possible college-school early intervention initiative, and an opportunity for you to provide direction to our continuing efforts. In order to move forward on the budget, there are three issues that need to be settled: (1) the basic parameters of the early intervention programs, (2) the issue of early notification (the "guarantee" of aid), and, of course, (3) funding.

With the approach described in this memo, you would be able to announce a new program that would, with an initial investment of up to $300 million --subject to the budget process:

- Provide families at high-poverty middle schools (and possibly others as well) with an official notification of the $20,000 or more that is already available for their children to go to college; and,

- Through colleges and other partners, provide intensive, long-term early intervention and support services to 200,000 to 400,000 new children each year (at 1500-3500 high-poverty schools), depending on funding.

<u>Background</u>

As you remember, this initiative began with your interest in the "21st Century Scholars Act" by Rep. Chaka Fattah. This legislation, which continues to garner significant support, including some Republicans, would guarantee sixth graders at high-poverty schools a maximum Pell Grant when they got to college; send a notice to them annually from the Secretary of Education reminding them of the availability of aid; and make them automatically eligible for the counseling, academic support, and other services provided by TRIO programs (such as Upward Bound) in high school and college.

Working with OMB and Education, we analyzed the specifics of the Fattah approach and found a number of problems: higher-than-expected costs and inefficiencies; inequities and perverse incentives; and the difficult issue of a new entitlement. Most important, the research on early intervention programs indicated that in order for them to be successful, it is *critical* that mentoring, counseling and tutoring be provided to students. Simply making them eligible for TRIO is not enough. As you know, Rep. Fattah is aware of these concerns and is flexible on the design of a program.

We felt strongly that the Administration needed a strong early intervention initiative that goes well beyond a notification about financial aid. Research demonstrates that programs that start early and are sustained for a number of years are effective. For example, in the rigorously-evaluated Quantum Opportunities Program, 42 percent of the participants attended college, compared to 16 percent in the control group. To have a significant impact on college enrollment of disadvantaged youth, it is clear that we need a full-fledged early intervention program.

Our idea is to center this effort on colleges reaching out to children at high poverty schools. College involvement is critical for a number of reasons. First, this approach creates an ethic of responsibility: it reminds colleges that they are responsible for helping to build a pool of disadvantaged youth -- disproportionately minorities -- who are well-prepared for college. Second, if college is to be the goal that sixth graders see, they need to have some connection to the institution. Third, colleges can ease student fears about college costs, and perhaps even offer guarantees or financial aid and admittance if students meet certain milestones. Fourth, colleges are best able to tell students -- and the schools they attend -- what types of courses and skills they need to succeed. Indeed, an ancillary benefit of this approach should be higher standards.[1] And finally, a stable, long-term institution needs to be there to ensure the quality and staying power of a program like this one.

In October, principals discussed options (DPC, OMB, Education, PIR, COS, and OLA were represented). At that meeting, there was strong support for the concept of Federal aid to partnerships between colleges and needy schools, to provide sixth graders with mentoring and other support that would be sustained through high school graduation. There was also strong support for getting early information to families about the availability of Federal financial aid for college.

Since the principals meeting, we have accelerated our consultations and research. I have spoken with more than 200 college presidents, both individually and in groups, and the response has been quite positive. Many of them have provided examples of their own efforts to tap into K-12 schools to recruit and offer help early. Education is reviewing all of the research literature,

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[1]In fact, in response to our consultations on this issue, we already have a proposal from colleges in the California State University system for an early intervention program that would focus on math as the gateway to college.

and with my staff has carried out an effort to identify model programs with the characteristics that we discussed at the principals meeting. Both Mike Smith and I have spoken with Eugene Lang, founder of the "I Have a Dream" program, and he agrees that we are on the right track. Lang is coming in to meet with me in mid-December. Even though he is best known for his promise of aid to Harlem sixth graders, he feels strongly that the early and sustained *support services* are the most important determinant of a successful program (and he agrees with the need for college involvement).

It is important that while pursuing this effort, we do not give the impression that we are denigrating two types of young people: those who do not go to college, but who prepare well for productive jobs without college; or those who only need one or two more years of post-secondary education or skill training to be successful in the workplace. Your School-to-Work initiative values equally a variety of pathways to success. We will ensure that the program design helps all children know they *can* go to college if they work hard and succeed through high school, without implying that they may be failures if they choose postsecondary education other than college.

Basic Parameters of the College-School Partnerships

Some of the colleges with whom we have consulted want the program to be very flexible, to incorporate a wide variety of program models. But we have pressed that while we support flexibility, there needs to be a vision -- some common elements that give the proposal an identity that will propel it to success both legislatively and, ultimately, programmatically. We recommend the following core components:

Start Early and Stay with Kids through High School. Students should begin in the program *not later than* the seventh grade. The program must continue to provide services through high school graduation (or at least for six years). (There will be some attrition due to dropping out of school or of the program, moving out, or participating in another program.) Programs should not pre-judge some kids as not having college "potential." Instead, we should encourage programs that involve whole classes or cohorts of students.

College as a Goal. The programs must make sure that every child in the class/cohort comes to believe that college is within grasp if he or she works hard, and that it is affordable with Federal aid. The message will also make it clear that the same kind of rigorous academic preparation is needed for careers that do not require college. Special consideration would be given to partnerships that guarantee enrollment in a college for participating students who reach particular milestones, and/or for programs that guarantee additional financial aid to cover the full costs of the college.

An Intensive Element. Programs must provide intensive assistance to students at least during some part of the program. For example, this may be a residential summer component at a college.

Community Involvement. Community organizations and businesses should be tapped to offer mentors, guarantees of additional financial aid in exchange for student performance, exposure to careers, and other support.

Full-Time Coordinator. To make the program a success requires the full commitment of the school district and the middle and high schools into which the college mentors will reach. It is critical that full-time coordinators serve as the "glue" between the colleges and the schools, ensuring that colleges come through on their commitments, and schools link their own counseling and guidance program and other services -- including Title I and systemic reform efforts -- to the college program on an on-going basis.

Family Involvement. It is also critical that families learn both about the college financial aid that is available, the courses that the child needs to increase the likelihood of success in college and career, and the resources that are available to help (tutoring, mentoring, etc.).

Note on relationship to TRIO programs. Some colleges already have Federal TRIO grants with some of the above characteristics, and/or they have other similar programs. The largest Federal investment, Upward Bound, provides counseling and intensive academic support to *selected* disadvantaged *high school* students who show aptitude for college. The Talent Search program provides a one-shot program of early information about college to middle school students. Those programs do not come close to addressing all of the need, so there would not normally be a problem with them duplicating some part of this new program. Applicants for the college-school partnership funds would have to describe how their existing early intervention programs would be coordinated with the new program. It is expected that some partnerships would apply for the new grants to extend and expand their programs, so that Upward Bound, for example, could essentially create a grade 4-10 feeder program, and Talent Search could add a more intensive component with follow-up during the high school years. Others might simply focus on high-poverty schools where the students are not being served by any current program.

Maintaining the separate TRIO programs with similar purposes could be an ineffective use of funds, if the new design turns out to work better for poor children. However, the politics of attempting to reform or integrate TRIO into the new design legislatively (as noted, we hope it will happen locally), argue against making the effort. We will design the evaluation of the new program to address comparisons to TRIO (and other models).

Early Notification/Guarantee

At the October principals meeting, there was concern that Fattah's idea of early notification guarantees not translate into any new entitlement to aid: first, it creates budget complications, both politically and practically; second, it creates the impression that the current programs are not secure -- contrary to the "universal access" message that we are sending in the wake of victories on HOPE and Pell.

Our feeling is that we do not need to go so far that we create a new entitlement. We can achieve Fattah's goal by providing children and their families with ***early, official notification*** of their eligibility for college financial aid. Because of the combination of student loans, Pell Grants, and HOPE Scholarships, virtually everyone is already eligible for at least $20,000 of aid for four years of college. We can make a firm statement about eligibility without creating the budget complications. (As with Federal pensions and some military benefits, the actual amounts would depend on the continuation of the programs.)

This would be part of the larger information campaign on access to higher education, which I will get you a memo on in the coming week. While the focus would be on getting the notifications to families at the highest-poverty schools, we would not need to be that restrictive and could reach a larger number than the Fattah legislation proposes. Our expectation is that we can provide a minimum level of information to every family on a regular recurring basis, and that we will find ways to make special efforts to tailor the message for poor families with children of all ages.

As already noted, we would encourage partnerships to supplement Federal aid with additional financial assistance and/or guaranteed admission to a particular college if the student takes the right classes and works hard.

Funding

The costs of successful programs range significantly, from a few hundred dollars per participant to several thousand. The ability of a college and other partners to put up some of its own resources also varies. It was clear from my discussions with the presidents of Yale and Columbia that they mainly wanted to be associated with a national effort and would put a lot of their own (substantial) resources to the effort. On the other hand, in some parts of the country it would be important to be able to have a significant Federal contribution, at least at the start. Our work continues on these design questions.

For the purposes of estimating potential impacts, we have assumed an average $1,000 per participant cost in the first three years, and $800 for the remaining three. New cohorts of children are added each year, but there is a declining (national average) Federal match, with the local programs expected to take over after the sixth year (again, our work continues on these design questions). With those assumptions, a $300 million Federal investment in FY 1999 would allow us to serve 375,000 seventh graders (at about 3300 high-poverty schools). That is more than seven times as many as are now served by Upward Bound. The amount would need to ramp up somewhat as new cohorts of students are added. The initial, FY 1999 funding amount could be reduced either by reducing the size of the proposal, and/or by phasing in the number of partnerships funded.

Add at least $30 million. The TRIO programs have a strong, organized constituency. We are working with the association on this proposal, and so far they are supportive. But they are concerned that our interest in this new proposal may weaken our resolve as far as increases for the TRIO programs. Therefore, it is critical that an increase of at least $30 million be included in the Budget for TRIO if we move forward with the school-college mentoring partnerships. Doing so will help get the proposal through Congress. *An increase of $53 million for TRIO is suggested in my memo to you on Hispanic education.*

Legislative strategy. We are currently assuming that this would be a new, competitive direct grant program from the Department of Education, probably part of our proposal for reauthorization of the Higher Education Act. If funded on the discretionary side, it would benefit us in the appropriations process to use an existing authority, and there are a couple we could choose from. We are also exploring the possibility of funding the program on the mandatory side, which could have some strategic advantages.

Some of the Committee leadership on the Hill are expected to pursue a state-based model, making use of a program authorized in 1992 called the National Early Intervention and State Scholarship Program. It is funded at $3.2 million now and funds some useful models. Education opposes using this authority, however, because it would be more difficult to maintain a high-quality, highly targeted effort within a state formula grant program.

Next Steps

If you are comfortable with the general approach, then we will continue to draft the descriptions that will need to be included in the Budget, if funding is to be included. We will then continue to vet the idea, and will begin to develop a roll-out strategy.

Views and Recommendations

Secretary Riley strongly supports this initiative as a logical next step in our efforts to assure access to higher education for all Americans.

Sperling considers this to be as important as any education initiative this year, because (1) given the strong interest of colleges in the effort, we can have a considerable national mobilization, (2) it targets the age group that is most neglected in Federal education policy, and (3) it helps with the long-term needs relating to affirmative action. Reed and Kagan support the proposal for similar reasons.

Judy Winston considers this proposal to be fully consistent with the President's Initiative on Race, which includes a focus on *action* designed to bridge racial divides. She is exploring the possibility of including a representative of an effective early intervention program in the program for the December 17 Advisory Board meeting.

THE WHITE HOUSE

WASHINGTON

December 6, 1997

MEMORANDUM FOR THE PRESIDENT

FROM: **GENE SPERLING**
BOB SHIREMAN

SUBJECT: **Hispanic Education Investments and Actions**

This memorandum provides you with background on our efforts to improve educational opportunities for Hispanic Americans, and a possible further investment strategy for the FY 1999 Budget. Once budget decisions are made, we will have a comprehensive package of research-based recommendations, new investments, and administrative actions ready for an announcement. The announcement would include:

- a report on the Hispanic dropout problem by researchers named by Secretary Riley two years ago (in response to a request by Sen. Bingaman). The report includes research-based advice for schools, families, and all levels of government;

- new investments (proposed in this memo) in programs that address the needs of Hispanic and LEP children;

- a list of administrative and other actions -- including a Conference on Staying in School -- that Education, Labor and HHS are taking to improve Federal programs so that they better serve the Hispanic (and LEP) community; and,

- the Secretary of Education's plan to ensure that the major education programs and our agenda of research, standards and testing, teacher training, and outreach address the needs of Hispanic and LEP children.

Section I of this memo describes the consultations that have taken place and the legislative and appropriations actions that we have already taken. Section II is a reminder of some of the planned or possible FY 1999 investments that are generally important for minorities, but are not explicitly part of the Hispanic plan. **Section III lays out a possible investment strategy for Hispanics and LEP children and families for the FY 1999 Budget.** Section IV describes the other actions that agencies would announce as part of the Hispanic Action Plan.

Section V presents the views of your advisors.

I. Background

In response to your request, the NEC, DPC, OMB, Department of Education, as well as Maria Echaveste, Mickey Ibarra, and Janet Murguia set out to determine what we could do to address the Hispanic dropout rate and to generally improve the educational opportunities of Hispanic Americans. We aimed to:

- Improve then-pending Administration initiatives and reauthorization proposals so that they provide a greater benefit to Latinos (for example, adjusting funding formulas that do not adequately take into consideration growth areas).

- Identify Appropriation items in the FY98 Budget that have a disproportionate impact on the Latino population, so that we would be sure to take that into consideration in the continuing budget process.

- Identify and carry out additional administrative and legislative proposals that could be aimed at increasing Hispanic educational opportunities.

As a foundation for our efforts, we were able to use a report and recommendations released last year by the President's Advisory Commission on Educational Excellence for Hispanic Americans. We met with constituency groups, and held a series of meetings with Hispanic Caucus members and staff, where officials from Education, Labor, HHS, and USDA discussed their programs and some of the concerns and recommendations that have been raised. Most recently, we have been able to review the not-yet-released report of the Hispanic Dropout Project, by a group of researchers named by Secretary Riley at the suggestion of Senator Bingaman. We have also reviewed legislation proposed by Congressman Hinojosa and Senator Bingaman.

It is important to note that the consultative effort brought tangible results. As a result of these efforts:

- We insisted that our 35% increase for Bilingual and Immigrant Education be an explicit part of the Bipartisan Balanced Budget Agreement, a very exclusive list (only 13 items government-wide).

- The $199 million in Bilingual Education includes $25 million for training teachers to help limited English proficient (LEP) kids, a proposal that Republican appropriators fought last year. (Thank Delia for working with the appropriators this year to assure their support).

- We took another look at our America Reads legislation and added provisions to make doubly sure that States would have to make a particular effort to serve LEP children.

- Our proposal for Adult Education reauthorization -- a program that provides adult ESL -- includes a new formula that targets states with large numbers of LEP adults. (Unfortunately, no one in Congress is pushing the formula).

- We proposed and received an 11% increase in the FY 1998 appropriation for Hispanic-Serving Institutions (HSIs).

- In a reversal from our position to eliminate the program a few years ago, we proposed and received a small increase for HEP-CAMP (migrant college support services and early intervention program).

- Other selected FY 1998 Appropriations that provide disproportionate benefits for Hispanics include:

  --Job Corps -- an effective program in which 70% of the participants are minorities -- got $92 million increase (to $1.246 billion). 30 Job Corps Centers teach ESL.

  --Youth Opportunity Areas: $250 million to the highest poverty areas to help out-of-school youth (age 16-24) become employable. (Currently six cities are funded. In NYC, 67% of those served are Hispanic; in Houston, 65%; in Los Angeles, 50%.)

  --$1.4 billion increase in Pell Grants for low-income college students.

  --Obey's Comprehensive School Reform provides funds that will go to schools that need to be transformed -- first in line should be those with high dropout rates.

II. Generic Issues

It is important that our overall campaign for high standards and accountability remains to be seen as an important part of the answer for all children, *particularly* those who are at risk. For the announcement of the Hispanic Action Plan, Education has developed a document that describes how the key education programs work for Hispanic and LEP children.

There are also other new initiatives that have already been announced or are being considered that are oriented toward needs that have been identified in our work on Hispanic Education, including:

- **Teacher Training and Recruitment.** Your five-year, $350 million teacher training and recruitment proposal is aimed at improving teacher preparation particularly for harder-to-serve populations, and recruiting more minority teachers.

- **Education Opportunity Zones**. This new investment is aimed at spurring and rewarding effective reform efforts in school districts that tend to be predominantly minorities.

- **College-School Early Intervention Partnerships**. This is a proven response to the dropout problem: it takes children at high-poverty schools by the seventh grade, delivers a firm message about college opportunity, and then provides them with support through to high school graduation. We consider this a major initiative that should be announced in a broader context, but (depending on what is announced first) we can describe it as part of the dropout initiative.

III. Decision: Added Investments

For FY 1999, we recommend that you consider increasing funding in some key programs that are important to Latinos. This package addresses five of the six highest-priority items identified by the Hispanic Education Coalition (HEC). In a forthcoming letter, the Congressional Hispanic Caucus (CHC) is expected to ask for increases in the same six items listed below, although at higher levels.

Investment (in millions):	**FY 1998**	**Increase**	**FY 1999**
Bilingual Education - Teacher Training	$25	*$25*	$50
TRIO College Preparation Programs	$530	*$31*	$560
Hispanic-Serving Institutions (non-add; already approved)	$12	*[$16]*	$28
Adult Education - Model ESL Programs	n/a	*$20*	$20
Migrant Education Program	$305	*$50*	$365
Migrant Education: HEP and CAMP	$9.7	*$5.3*	$15
TOTAL:		*$153.3*	

Secretary Riley and the HEC also cite Title I as an appropriate area for investment. While people tend to think of it as a program for African Americans, *Title I now serves more Hispanics than Blacks*. If you decide to provide an increase to Title I, we might want to consider including it in the Hispanic Action plan as a way of changing perceptions about who is served by programs for disadvantaged populations.

1. Bilingual Education - Teacher Training. This program provides current teachers with the skills they need to address the English language deficiencies of their students. (Despite the name, it does not require a bilingual program). By doubling the FY 1998 investment and sustaining that level over five years, we could **train 20,000 teachers**. The need in this area is huge -- California alone has a reported shortfall of 20,000. The $25 million compares to a $56 million request expected from the CHC.

2. TRIO College Preparation Programs. A recent evaluation of the Upward Bound program (support for promising disadvantaged kids to go to college) showed dramatically positive results for Hispanics. This is an opportunity to showcase this success. We will also be making changes to the TRIO statute to encourage more funding to areas that are under-served, such as the Hispanic community. Even though we may be proposing an *earlier* mentoring program, it is important that we propose an increase in TRIO so that the very strong TRIO constituency does not see the new program as a threat. The $53 million would be a 10 percent increase. *The separate memo on the College-School Early Intervention initiative suggests at least a $30 million increase in TRIO.* The CHC is expected to ask for an increase of $70 million for TRIO, mostly in Upward Bound.

3. Hispanic-Serving Institutions. These funds go to strengthen colleges where at least 25 percent of the student body is Hispanic and a large portion are needy. The program is funded at $12 million in FY 1998. As a result of work on the Higher Education Act reauthorization and discussions with Rep. Hinojosa (chairman of the education task force of the CHC), we have sent a letter to Hinojosa promising an increase of $16 million. CHC members and the HEC have been very pleased with the $16 million proposed increase; nonetheless, the CHC is expected to ask for the authorized level, an increase of $33 million

4. Adult Education - Model ESL Programs. The largest single source of English-as-a-Second-Language funding comes from the Adult Education program (which also promotes adult literacy and GED attainment). There are a plethora of approaches, and huge demand for these programs. But there is little information about what types of programs are most effective for different populations. This five-year $100 million investment would go toward improving the ESL programs that we now fund through identification and dissemination of proven and promising practices. It could also be used to provide more training for adult ESL instructors, and/or to expand the use of the televised ESL series "Crossroads Cafe," if the evaluations of that program are as positive as expected. The CHC is interested in increasing adult ESL, but was unsure what level or method of increase to seek.

5. Migrant Education Program. Because of their mobility, migrant children -- more than 80 percent of whom are Hispanic -- often do not "belong" to any one school system or even one State. That is why the Federal role in this area is critical. Funded at $305 million in FY 1998, MEP is a State formula program that supports an extremely wide range of interventions specifically tailored to the needs of the local population it serves. Services range from the identification and recruitment of kids into schools, to all kinds of school-based interventions, to after school programs and summer sessions.

The 1994 reauthorization (of the Elementary and Secondary Education Act) focused MEP on the most mobile families, and resulted in more services are now being provided in the summer and between school sessions. Despite a narrowing of eligibility rules, the number of participating children has been increasing since the reauthorization, in part because of partnerships between MEP and several major agribusiness partners. These partnerships have led to improved service and coordination by local providers (education, health, public safety, library).

Increased funding would help to address the growing population of children who are being referred to the program, and to continue to provide a richer array of supplemental educational services. *A $50 million investment is proposed in a separate memorandum describing options for addressing Child Labor issues.* The CHC is expected to ask for a $70 million increase.

IV. Administrative Actions and Program Improvements

Based on our review of the Advisory Commission recommendations, other reports, and our meetings with the constituency groups and the Caucus, the agencies have signed off on a number of changes to, or enhancements in, current programs to better serve the Hispanic population. These are *not* a part of any budget decisions that need to be made.

Dropout Prevention:

- **Comprehensive School Reform.** The FY 1998 Appropriations bill included a new $150 million program to transform failing schools using proven models. The Secretary of Education will identify model school reform approaches that address the needs of LEP children and dropout prevention. States and school districts will use these funds to turn around low-performing schools, many of which enroll high concentrations of Hispanic students and have high dropout rates.

- **Conference on Staying in School**. An option under consideration would involve the President and the Administration in a conference to share solutions to the dropout problem (Hispanics and others). The conference -- which may or may not be sponsored by the White House -- would highlight lessons from successful efforts to reduce dropout rates and to provide youth with alternatives to traditional high schools. Clearly this will need to be weighed against other scheduling requests and proposals for education conferences.

- **Clearinghouse on Successful Models for Dropout Prevention.** The Education Department, through is various research centers (and other clearinghouses), has a great deal of resources relating to dropout prevention. This would provide school and community leaders with "one-stop shopping" for ideas and information on best practices for keeping kids in school.

General:

- **Public Service Announcements.** Univision has agreed to produce a series of Spanish-language public service announcements on education, such as encouraging parents to read to their children at an early age, and telling families about college financial aid. The spots will be developed in cooperation with the Department of Education, and will refer viewers to the Department's toll-free line.

- **Toll-Free Number.** The Department of Education will establish a toll-free number that is answered in Spanish (or change the current number to prompt non-English speaking callers earlier), to ensure that there are no barriers to parents who want to find out how to better help their children succeed in school. The Department will explore how best to provide assistance in other languages as well.

- **Information Dissemination.** The Education Department will expand the number of publications that are translated into other languages, so that LEP parents have better access to information that will help their children learn. Working with the White House Initiative on Educational Excellence for Hispanic Americans, the publications will be more widely distributed in the Hispanic community.

- **Model High Schools:** Working with the National Council of La Raza and ASPIRA, the Education Department's New American High Schools Initiative will focus attention on schools that better prepare all students for college and careers. Four of the ten schools initially selected have a Hispanic population of 20 percent or more. In addition, the Department has awarded a two-year contract to improve student preparation at six urban high schools and to serve as models for other high schools. Three of the six have substantial Hispanic student participation.

Early Childhood and Parental Involvement

- **Early Head Start:** FY 1998 Appropriations nearly double the size of the Early Head Start program. Grants are awarded through a competitive process. The Department of Health and Human Services will ensure that the Hispanic community and Hispanic organizations, as well as other communities and organizations, are fully informed about these opportunities. The Department anticipates that about a quarter of the children served by the new programs will be Hispanic.

- **Head Start:** The Bipartisan Balanced Budget includes continued expansion of the program, toward the goal of serving one million children by 2002. The Department of Health and Human Services will implement an outreach plan to ensure that programs are reaching the Hispanic community. As a part of that effort, the Department will identify and disseminate a "best practices" guide for serving limited-English proficient (LEP) children.

- **Title I/parent training:** Parents who do not speak English well need extra care and support to gain their active participation in the schooling of their children. The Department of Education is compiling a set of "best practices" for implementing family literacy and parent involvement programs. This will include guidelines for working with LEP parents.

Improving teaching and learning

- **America Reads**: The Education Department and Scholastic, Inc., have developed and are distributing, posters featuring the message "Reading is Power/Leer es Poder." The back of the poster provides reproducible reading activities for classroom use. Spanish language tutoring kits have been developed and will be distributed to Hispanic communities. LULAC has been an active partner in America Reads effort.

- **Bilingual/Teacher Training**: The Bipartisan Balanced Budget Agreement secures a 27 percent increase for the bilingual education program. As part of that increase, the Education Department will dedicate $25 million to increase the number of teachers who are qualified to teach LEP children, and to improve teacher preparation programs so that all teachers can meet the needs of LEP students.

- **Technology**: To ensure that all schools take advantage of the funding available through the $2 billion Technology Literacy Challenge Fund and the discounts of up to 90 percent (for the poorest schools) that will be available through the FCC's Universal Service Fund, the Education Department will conduct a series of technical assistance workshops, including some that are targeted to communities with large populations of Hispanic students. [Mention VP's leadership of outreach effort?]

Migrants

- **Technology**: The Education Department has awarded six grants, at $15 million over five years, for projects that apply the use of technology to improve teaching and learning for migrant children.

- **Coordinated eligibility**. The Education Department is exploring the possibility of waiving eligibility requirements for Migrant Even Start and other education programs so that children of participants in the Job Training Partnership Act's migrant program (section 402), who have already been judged needy, will be automatically eligible.

Second chance and job training

- **Youth Opportunity Areas**: $250 million has been appropriated for FY 1999, targeted to the highest poverty areas in the country to help out-of-school youth (age 16-24) become employable. (Currently six cities are funded. In NYC, 67% of those served are Hispanic; in Houston, 65%; in Los Angeles, 50%.)

- **Bilingual Contextual Learning**. The Labor Department is currently evaluating the results of an innovative approach for training individuals for the burgeoning home health care field. The Department will broadly disseminate the "lessons learned" from this experience.

- **ESL in Job Training**. The Labor Department will include guidance for providing services to limited-English-proficient populations in JTPA or successor programs.

College opportunity

- **TRIO programs**: The Education Department's reauthorization proposal will include measures designed to make the programs more available in areas that are now under-served by TRIO, including those with substantial Hispanic populations.

- **Information about college financial aid**: The largest Spanish language newspaper in the country, La Opinion, is publishing and distributing a Spanish-language version of the Education Department's guide, "Getting Ready for College Early." The Department is seeking out other opportunities to better reach Latino families.

- **Hispanic-Serving Institutions**: The Education Department's reauthorization of the Higher Education Act will include the creation of a new part under Title III for Hispanic-Serving Institutions.

- **Community College Articulation**: The reauthorization also would allow the Fund for Innovation in Postsecondary Education to focus a special competition on projects that promote articulation between two-year and four-year institutions.

- **Graduate Education**: The Education Department's proposal for reauthorizing Graduate Assistance in Areas of National Need gives special consideration, in awarding grants, to institutions that show a strong past and continuing performance in serving populations traditionally under represented in academic programs in areas of national need.

Other efforts: The Education Department will release a plan that includes a number of other items, and improvements in data collection and research relating to Hispanic and LEP students.

V. Views and Recommendations

Secretary Riley supports these investments, but thinks there should be more. He would like to see them packaged with increases in one or more of the larger programs that serve Hispanic children, such as Title I.

Sperling thinks these investments are a necessary platform for promoting the many other steps that we are taking to address the educational needs of Hispanic Americans.

Reed agrees that these are important investments that need to be considered in the context of other priorities.

Judy Winston notes that associating this effort with the President's Initiative on Race would help its multiethnic focus, *i.e.* moving beyond the black-white paradigm.

THE WHITE HOUSE

WASHINGTON

December 6, 1997

MEMORANDUM FOR THE PRESIDENT

FROM: **GENE SPERLING**
BOB SHIREMAN

SUBJECT: **School Construction**

You have publicly made it clear on a number of occasions -- most recently in Chicago with Sen. Moseley-Braun -- that you will continue to fight to get Congress to address the problem of the crumbling school infrastructure. There are two issues on school construction that need to be considered in the context of FY 1999 Budget decisions: size and design (spending versus tax). This memorandum briefly describes some of the policy and political dynamics around the question of size, then lays out the pros and cons on the design issue.

Size

As with all of the new initiatives, we are not asking you decide at this time the amount of money that should be dedicated to the School Construction initiative. You should keep in mind, however, that because of the history of this proposal, its size in the FY 1999 Budget will be a substantive and political decision that will draw a great deal of attention.

The OMB passback funds the School Construction initiative at $1.9 billion -- down from the $5 billion that was proposed last year. That matches a Daschle-Gephardt proposal developed in the late summer as a last-ditch effort to get a down payment on the school construction issue. The amount was based on the size of the offset they were able to agree on (closing a tax loophole). There is no question that an initiative of that size would *not* be met warmly by supporters of a Federal investment in this area.

Pressures for us to re-propose a school construction initiative of *at least* $5 billion are coming from a number of quarters:

- **Defining issue for Democrats.** Democrats see this as a popular initiative that sets them clearly apart from Republicans. Some have argued that the funding should be increased *above* $5 billion in order to provide more help to suburbs.

- **Urban needs.** In the context of negotiations over the voluntary national tests, School Construction came up a number of times with the Black Caucus as one item that would demonstrate the Administration's commitment to the needs of urban schools.

- **Class size.** Some have suggested that a school construction initiative could be tied to the idea of smaller class sizes.

Obviously, a funding decision needs to be made in the context of the whole budget, taking into consideration proposals for child care, smaller class size, health care, etc. If we are constrained by funds available in the five year budget window, you should keep in mind that one way to accommodate school construction might be to stretch it over a longer period (such as $8 billion over 10 years, with $3.5 billion in the first five years).

Design

You need to decide whether we should continue to propose our School Construction initiative as a mandatory spending proposal or shift it to a tax credit.

Spending proposal. The bill you proposed, the Partnership to Rebuild America's Schools, provided a one-time appropriation of $5 billion for grants to States and localities to pay for up to one-half the interest cost of repayment of school construction bonds (or an equivalent amount in cases where an alternative financing mechanism is used). One-half of the funding was reserved for the 100 largest school districts. We estimated that the $5 billion would leverage $20 billion in new construction/renovation over four years.

Pros

- The Administration bill in the House gained 116 cosponsors, including __ Republicans. A letter signed by 112 of them urges you to include the same, $5 billion proposal in the FY 1999 Budget.

- The bill was designed to spur additional State and local effort (through a competitive portion of the funds) and to leverage the Federal funds. It is more difficult to design a tax credit that accomplishes those goals.

- This approach is more efficient at addressing our specific goals than a tax credit (tax incentives associated with bonds inevitably have some inefficiencies associated with them).

- The bill is flexible, allowing for creative funding mechanisms such as lease-buybacks, helping districts that are not able to float additional bonds.

Cons

- To propose $5 billion or more, we probably will need to rely on closing tax loopholes as the offset, creating a "tax-and-spend" scenario.

- With a tax-side offset, the spending proposal and the offset would have to move through different committees, making the plan more difficult to achieve legislatively -- unless there is a reconciliation bill.

- While the education groups prefer the spending program in the abstract, they would prefer a tax-side approach *if it means more money could be dedicated to the purpose.*

Tax proposal. As part of the Taxpayer Relief Act of 1997, Congress enacted a tax credit proposal by Rep. Rangel that *includes* school renovation (but not construction). The provision allows State and local governments to issue bonds totaling $800 million over two years. The Federal government essentially covers the interest on the bonds through a tax credit, providing the schools with an interest-free form of financing. These bonds can be used to cover certain costs of "academies" that link businesses with the schools to develop a curriculum that is employment-oriented (the description is not unlike your School-to-Work program). The bond proceeds can be used for a variety of expenses: rehabilitation, repairs, technology, equipment, curriculum development, and teacher training.

While supporters of school construction were pleased to see Congress ratify a proposal that included school renovation, they do not see the Rangel plan as a sufficient approach for two reasons: (1) its narrow focus on these school-business academies, and (2) the broad use of funds.

This bond/tax credit design could be expanded to focus more squarely on school construction and renovation, and beyond the academies in the Rangel provision. For example, Rep. Loretta Sanchez introduced legislation in October that would use the bond mechanism to support school construction in overcrowded districts. We would not need to provide detailed specifics in the budget. We could simply say that the bond/tax credit would be extended and expanded to assist school districts with their school construction and renovation needs. Then we could work with Mr. Rangel and others on the details.

Pros

- We can more easily propose a larger initiative on the tax side.

- A tax-side initiative will be revenue-neutral, and both the program and the offset would be handled by the same committees in Congress.

- The Senate sponsor of our School Construction legislation -- Sen. Moseley-Braun

Cons

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Pros

- We can more easily propose a larger initiative on the tax side.

- A tax-side initiative will be revenue-neutral, and both the program and the offset would be handled by the same committees in Congress.

- The Senate sponsor of our School Construction legislation -- Sen. Moseley-Braun

-- is on the Finance Committee and would support the idea of a tax-side approach that she could push there.

- We might be able to develop a proposal that would have the strong support of the ranking member in the House (Mr. Rangel).

- The contentious issue of Davis-Bacon, which has caused some problems even with some members of the pro-school construction coalition, has not been an issue on the tax side.

Cons

- The bond/tax-credit approach is unprecedented, so we do not yet know how well it will work.

- The bells and whistles that we built into our School Construction proposal -- leveraging, rewarding State investments, etc. -- would be more difficult if not impossible to design and enforce in a tax-side approach.

- The House sponsor of our School Construction legislation -- Rep. Lowey -- prefers the spending bill that we proposed this year.

- Rep. Rangel is very committed to his design, and may not be willing to make the changes that we would want to steer this toward school construction and renovation and away from his "academies" approach. There is a chance we would have to part ways with him, or accept something that we do not like and does not satisfy the constituency groups.

Views and Recommendations

Treasury strongly supports a spending-side strategy. The tax credit approach is awkward and inefficient. While Treasury is making every effort to implement the Rangel provision effectively, it is an unprecedented approach -- as would be any tax-side approach to subsidizing school construction.

Secretary Riley also prefers the direct spending approach.

Secretary Herman heard from the Congressional Black Caucus on this issue in her efforts on Fast Track. She would prefer the tax side because it would allow Sen. Moseley-Braun and Rep. Rangel to champion the legislation.

Sperling and Reed would ideally prefer to stick with the your carefully-designed spending proposal, but believe that we should be willing to propose a revenue-neutral $7 billion, 10-year approach on the tax side if necessary to make room for child care, health care or other proposals.

Judy Winston considers either approach to be consistent with the President's Initiative on Race, and with the agenda for the December 17 Advisory Board meeting which will include a discussion of racial disparities in educational resources including facilities.