Originals
POTUS Notes

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Penn
Waldman
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Penn/Waldman/Reed/Sperling – Please
Would we be willing to draft a new program
Idea? — Tie
– Wasabourder
LEAP program

January 8, 1999
Memorandum to the President
From: Al From
Subject: The State of the Union and Your Last Two Years

In this memorandum, I will outline the approach I think you ought to take in your State of the Union address, an approach that I hope will allow you to frame the debate for the next two years and solidify your legacy as a Third Way reformer.

I know this is an awful time for you, but I'm confident that, in the end, even this shall pass.

Despite all of the discomfort of the past year, I believe you have the opportunity to leave office on January 20, 2001, with an unbelievable record of achievement and a lasting positive legacy in place.

The Republicans can never take your accomplishments away from you, no matter how many investigations they pursue or partisan articles of impeachment they pass.

Your accomplishments in redefining the Democratic Party, changing the shape of American politics by defining a new center, and leading a new Third Way politics throughout the Western democracies are, if secured, a lasting legacy that will only grow as time passes.

I swell with pride every time I think about how far that effort we started together eight years ago has come – and largely because of what you've accomplished in office. It is more than a footnote; it is truly historic.

Our challenge now – and your challenge in the last two years of your Presidency – is to assert firm ownership of the politics that we created. We need to assure that the Third Way is clearly known as New Democrat and that smart Republicans, like George W. Bush, don't co-opt it or even worse steal it away from us. Meeting that challenge is not only essential to securing your legacy, but it is also critical to the political success of the Vice President and the Democratic Party in 2000 and beyond.

Continuing to own our politics will be much more difficult without you, for we will never see a political leader in our lifetime with your political skill. For that reason, I believe it is imperative that you do everything you can to secure ownership of the Third Way for the Democratic Party. My strategy for doing that starts with the State of the Union.

The State of the Union

The tone of this State of the Union is unusually important. You need to be bold, visionary, and strong! When you finish, you want the political press to say, impeachment or not, you are in charge, setting the agenda with bold and innovative ideas, while your political opponents wallow in impeachment. You want to remind ordinary voters why you're such a good President and why they give you a 73 percent approval rating.

The way to do that is by offering a big and visionary theme and by backing it up with a few ideas that are bold enough and unexpected enough to turn heads.

The key is being big and bold. If you want a legacy grand enough to counter impeachment, it has to be as a Third Way reformer. You need to make it clear that you're not going to pull back or become timid because of impeachment. If anything, you're emboldened and more determined than ever to secure a place in history by completing the political revolution you started in Cleveland in 1991.

1) The Big Theme

In this speech you should declare an "era of new progress". In your 1996 State of the Union, you declared that the era of big government had ended. In the 1999 State of the Union, on the eve of a new century, you should declare the "era of new progress" has begun. Replacing the era of big government with the era of new progress should be the framework for your speech.

That framework offers a context for reminding people of your record – the progress we've already achieved. You can offer your litany of achievements – on the economy, the budget, welfare, crime, streamlining government, etc. In detailing your achievements, you can make the case that they were made possible, in large part, because you ended the era of big government in a progressive way. You replaced a big government with a smaller, more effective, empowering Third Way government that gives people and communities the tools they need to solve their own problems. A $75 billion dollar surplus underscores your point – in terms of our reaping the benefits of a strong economy, fiscal restraint, and a streamlined more cost effective government.

That framework provides a perfect segue for moving to your new ideas – the next steps in the era of new progress.

2) The Ideas

Over the past several days, you've put forth a number of good ideas that will be part of your speech. But I think, in the end, whether this speech has any lasting or defining impact will depend on what you say on Social Security, Medicare, education reform, and a handful of other issues.

To really have impact, you need to raise the stakes on those issues with what is easily perceived as big, bold and innovative. Here are some suggestions.:

On Social Security: you could propose the grand bargain Will Marshall outlines in his piece in the next issue of the *New Democrat* (article attached). The essence of that bargain is as follows:

You reaffirm your commitment to preserving the system's social insurance for the disabled and survivors, for which there remains no plausible private alternative, and back reforms aimed at strengthening Social Security's basic guarantee against poverty, both by raising the minimum benefit all retirees get and changing the outdated formula the produces high poverty rates among elderly women, especially widows.

You could then support diverting a small percentage of payroll taxes into personal retirement accounts. By lifting the "floor" for everyone – and thereby guaranteeing that no low-wage worker would be made worse off by market-based reform – you would be able to the challenge the premise of opponents of personal accounts that only by investing the money itself could government shield individuals from undue market risk. Government could provide further safeguards by emulating the Federal Thrift Savings Plan, which limits federal workers' choices to rule out investments that are overly conservative or too risky. That plan also offers a model for keeping overhead down: have Social Security continue to collect all payroll tax revenue and transfer some portion to individual accounts designated by workers.

Finally, you could challenge those on all sides of the Social Security reform issue to ensure the system's solvency while also financing the transition to a partially funded system. It makes sense to dedicate a healthy chunk of future surpluses to that purpose. In addition, Congress should embrace a gradual increase in the retirement age to 70 by 2030, in keeping with the advances in the average life span of older Americans. The best way for boomers to help solve the problems their retirement will create is to work longer, keeping the work force from shrinking as rapidly and boosting payroll tax revenues. Less dramatic but still important ways to close the funding gap include bringing state and local employees into the system and adjusting the Consumer Price Index downward.

The plan that comes closest to that "grand bargain" is the 21st Century Retirement Security Plan issued last summer by the National Commission on Retirement Policy, which was co-chaired by Senators Breaux and Gregg and Congressmen Sternholm and Kolbe. That plan has bi-partisan support and you could offer it as the starting point for considering Social Security reform this year. Breaux had a piece in the last *New Democrat* on the plan which I've already sent you, but is attached.

On Medicare: I think you should think hard about pledging to work with the proposal that comes out of the Breaux-Thomas Medicare Commission. I realize that is likely to be controversial, but the Medicare crisis is more immediate than Social Security and identifying with Breaux's proposal would be a bold and, I think, the right thing to do.

On education: The key here is to go back to your 1997 message of standards, testing, accountability, and choice and de-emphasize the 1998 message of more spending first. I have no quarrel with most of the new spending, but every bit of it ought to be tied tightly to performance and accountability.

Both accountability and spending are parts of education reform, but if you emphasize accountability you gain credibility as a reformer. If you emphasize spending without hammering on accountability, you make the Democratic interest groups happy but you lose a lot of the reform edge because you send the message that you are willing to feed a broken system.

I think you took a major step this week with your emphasis on ending social promotion. That sends the message that you're unwilling to stand for business as usual.

My ideas on education are very simple, and probably controversial with the educational establishment, but it would leave no doubt that you're really serious about improving public schools. And, if you pursued it, I think it would give you freedom to propose more money for schools.

Simply, to establish some requirements that states have to meet to get federal aid for education.

For example, you could say that no state would receive aid which didn't impose standards and testing by a certain year. You could have a formula for descending amounts of aid for non-compliant states so they would not be cut off entirely.

You could deny aid to states that didn't, in effect, make every school a charter school by developing a performance contract with specific goals.

Or you could limit aid to states in which schools spent more than a particular percent of their education funding on administration and not in the classroom.

You get the point. The idea is to leverage the federal aid to force accountability in the education system. I think that's the clearest, most direct signal you can send that you want to see the quality of education improve.

On National Service: I think this is the time to call for an expansion of Americorps. No program expresses the New Democrat ethic of mutual responsibility better than Americorps. I've spoken to John Podesta and Bruce Reed about using an expanded service corps to provide home care

for elderly people who might be able to live at home instead of in a care facility if they had someone who could visit them every day, make sure they can get medicine, groceries, and to doctor's appointments, etc.

On trade: I think you need to be very clear that despite the growing protectionism at both ends of the political spectrum, you remain firmly committed to expanded trade and to opening markets for American goods.

I believe you should offer a new bargain on trade.

One part of that bargain is making it clear that the United States stands for expanding, not restricting trade, by coming back with a fast track proposal and any other trade initiatives that are necessary to keep the economy growing.

The other side of that bargain should be a new commitment to an investment package to expand the winners' circle, so that every American will have the chance to share in the benefits of the new economy and expanded trade.

In the most recent edition of the DLC's new journal, *Blueprint*, Bob Litan has a piece (attached) on expanding the winners' circle in which he discusses a number of ideas. But two that I think are especially noteworthy are:

* an idea Rob Shapiro has promoted to make on-the-job training more accessible to all workers, not just the top echelon workers in companies. It is to add a "non-discrimination" clause to the tax deduction firms now get for training expenses for employees – so that they would only get that deduction if training is offered to a broad spectrum of workers, not just the top employees. A similar "non-discrimination" clause for deductions for health care and pensions.

* a new idea for funding training and continuing education that we call LEAP (Lifelong Education Advancement Pursuit) loans, modeled on the college loan program. Through LEAP loans, people with household incomes below a certain threshold (such as the $100,000 for education tax credits) would be eligible for a certain amount of financing (such as $40,000) over their lifetime. The loans would be provided at subsidized interest rates, carry long maturities, and defer repayment for a fixed period (say four years). Such a program need not be that expensive. If, say, two million workers borrowed an average of $5,000 a year with an annual interest subsidy (counting the delayed payment benefit) of 10 percent, the government's cost would be 10 percent, or one-sixth of the annual cost of the recently enacted education tax credits. An added twist would be to base repayments on the borrower's income so workers would not find themselves overburdened with loan payments if their incomes do not rise initially.

On welfare and poverty: Come back with your day care proposals to ease the transition from welfare to work. And, I'm in favor of whatever ideas Andrew Cuomo has for increasing home ownership among poor people. I would make that idea - achieving the American dream of owning a home possible among disadvantaged Americans - a spotlighted part of the speech.

On corporate welfare: Far and away the best way to pay for any initiatives – as you've already indicated – is to cut corporate welfare.

The rationale for that course is absolutely consistent with the first principle of the New Democrat movement and the animating principle of the Democratic Party since the days of Andrew Jackson: equal opportunity for all, special privilege for none.

You ought to make it clear that federal dollars should be spent on investments that help the whole economy grow and create opportunities for all Americans, not on subsidies that give advantage to powerful industries or interests.

The best way to get at corporate welfare without getting your head chopped off is still the original Rob Shapiro idea of creating a Base-Closing like commission that recommends, for an up or down vote, each year which subsidies should be eliminated or trimmed. You should propose creation of that commission with a target of eliminating $50 billion in corporate subsidies a year, each year for the next five years. Sen. John Kerry has sponsored a bill to implement the Shapiro plan. And, it is an idea that should get support from all parts of the Democratic Party and that puts the Republicans, eager to cut spending for social programs, on the spot.

Those are my ideas for the State of the Union.

Follow Up

Since this memorandum is longer than I expected already, I won't add a detailed plan for following up the State of the Union with a plan to make sure we continue to own the politics we created after you leave office.

But it is important that we think about that. In Stephen Skowronik's 1996 piece on Third Way Presidents, which I've shared with you before, he makes the point that no Third Way President in this century has seen his politics continue after he leaves office. You will be the first – and we are committed to making it happen.

That's why we're making a major effort to train several hundred up and coming state and local leaders around the country on how to practice your politics in their day to day activities. I'm actually writing this memo at a hotel room in Phoenix where we're training legislative and local leaders today.

We need to launch a real education effort over the next 18 months both to educate the American people on the Third Way and to create a real identity for the New Democrat brand. As Tony Blair said at the meeting we had at Chequers, we need to brand our politics so we can occupy the territory.

I think branding our politics, building the New Democrat brand so voters understand what it means, should be your last campaign. You should use that campaign, after the impeachment trial ends, to help ensure that your legacy is what it should be. I'm ready to do whatever's necessary to make sure that happens. And, I've got some thoughts about how we do it that we can discuss whenever you're ready.

Good luck.

MEETING ON SOCIAL SECURITY AND STATE OF THE UNION

Cabinet Room
January 14, 1999
4:00 pm

AGENDA

I. STRENGTHEN SOCIAL SECURITY

II. EXTEND MEDICARE

III. UNIVERSAL SAVINGS ACCOUNT

IV. CRITICAL DISCRETIONARY INVESTMENTS

V. DEBT REDUCTION

STRENGTHEN SOCIAL SECURITY

- **Transfer 50 percent of the UB surplus for the next 15 years to the Social Security trust fund.**
  - Total transfer would be roughly $2 trillion over 15 years.
- **Invest 35 percent of the transferred surpluses in equities to achieve higher returns for Social Security**
  - If a satisfactory mechanism can be found to invest the trust fund's assets with private managers, this option could extend the trust fund's life to 2050
  - If asked, would say that the trust fund would own an average of about 4 percent of the stock market.
- **Lead a bipartisan process to make tough-minded but sensible choices to extend Social Security to its traditional goal of 75-year actuarial balance.**
- **Reduce poverty among widowed and divorced elderly women.**
  - Will support efforts to enhance Social Security benefits for widows and divorced beneficiaries, groups that have high poverty rates.
- **Question: Should we propose eliminating the earnings test over the next several years?**
  - Eliminate the complex and often misunderstood earnings test that discourages work and participation in the economy by elderly Americans.

EXTEND MEDICARE TO 2020

- **Dedicate 18 percent of the surplus to Medicare.**
  - If we take this money and do nothing else, we can extend the trust fund until 2020. But if we work in a bipartisan way to improve and modernize the system, we can make room for prescription drug coverage, and still extend the program through 2020.

ESTABLISH UNIVERSAL SAVINGS ACCOUNTS

- We should also strengthen the second and third legs of the retirement security system, by ensuring that every working household can have a USA savings account to meet the costs of retirement and long-term care.

- The accounts would offer working families a flat contribution to their accounts and/or a government match of their saving that would give the most significant incentives to save to average and hard pressed working families.

MILITARY READINESS AND DOMESTIC PRIORITIES

- Reserve 13 percent of surplus for military readiness and pressing national domestic priorities.

- Detailed blue print for military readiness over the next 6 years.

- Set aside block for education and research.

DEBT REDUCTION

- Pay off $150 billion in debt with the surpluses between fiscal year 1998 and fiscal year 2003.

- For the remainder of the fifteen year period, set aside 10 percent of the surplus for additional debt reduction.

KEY ISSUES IN SOCIAL SECURITY PROPOSAL

KEY ISSUE #1: Investment Strategy for Surpluses Transferred to Social Security

- Recommendation:
  - One-third (possibly 35 percent) of the surpluses transferred to Social Security would be invested in equities.
  - After the fifteen years of surplus transfers are completed, we will limit the share of the trust fund invested in equities to 20 percent in order to keep the trust funds' share of the stock market from becoming excessive.
  - This would permit the exhaustion date to be extended to 2050.

KEY ISSUE #2: Strategy for Answering Questions About the Share of the Stock Market Owned by the Trust Fund

- Recommendation:
  - We would not go out of our way to raise this issue.
  - If asked, we would say that, on average, the trust fund would own about 4 percent of the stock market.
  - If further pressed, we could report that the maximum share of the market held by the trust fund would be around 6 percent.

KEY ISSUE #3: Corporate Governance

- Recommendation:
  - Do not start with specific mechanism for collective investment of the trust fund in equities.
  - Instead, say that we believe that we can work together to find a way of investing that is:
    - -- independent
    - -- non-political
    - -- hires the top private sector investment funds to do the investing
    - -- prevents loss of Social Security retirement income to high fees and administrative costs.

KEY ISSUE #4: Attitude Toward Add-on Individual Accounts

- Recommendation:
  - Best approach is to strengthen the traditional guaranteed benefit Social Security program while creating universal savings accounts that are outside of and in addition to Social Security.
  - Any individual accounts that are part of Social Security would raise a lot of difficult questions that would have to be resolved to ensure that we were not adding unnecessary risk and administrative complexity to a system that has worked so well for so many decades.

KEY ISSUE #5: Ruling Out Carve-outs Without Creating Momentum for Taking Social Security Off Budget.

- Recommendation:
  - We would say that we do not think that we should divert a part of the Social Security payroll tax in a way that would replace part of the guaranteed Social Security benefit with a risky and untested individual account.

KEY ISSUE #6: Double Counting

- Issue:
  - We may be criticized for taking dollars from the Social Security payroll tax that have already been credited to the trust fund, and spending them again both to strengthen Social Security and fund other priorities.
- Recommendation:
  - We can debate government accounting rules forever. What is clear is that we are taking over $2 trillion that could be spent on immediate short-term needs, and we are saving them and investing them for Social Security.

KEY ISSUE #7: How Do We Make Sure That the Amounts We Transfer from the Surplus to the Trust Fund Do Not Stay Around to Get Transferred Again.

- Issue:
  - Under current budget scoring rules, intergovernmental transfers from the unified budget to the trust fund that are used to buy Treasury bonds do not result in a reduction in the unified budget.
  - Thus the dollars would appear to be available to spend a second (or third or fourth) time.
- Recommendation:
  - We will make it clear that we intend for dollars transferred from the unified budget surplus to the Social Security and Medicare trust funds to reduce the surplus available to spend on other things.
  - We will work with Congress to modify the budget rules so as to make sure that this happens.

KEY ISSUE #8: Widow Poverty

- Issue:
  - We could release a specific proposal in the State of the Union. However, it would raise long-term costs a bit, and might lead people to question why we are being specific about the benefit increases but not about the tough choices.

  Options:
  - Announce specific proposal to provide elderly widows with a benefit that is 75 percent of the pre-widowhood benefit received by the married couple rather than the 50 to 67 percent widows receive today.
  - Alternative would be declare commitment to addressing the problem of widow poverty and to promise to release proposal later.

KEY ISSUE #9: Eliminate the Earnings Test

Options:

- Do not mention this now.
- Call for the immediate elimination of the earnings test.
- Call for eliminating it over the next several years.
- Eliminate the earnings test at age 65, but not at age 62.

KEY ISSUES IN UNIVERSAL SAVINGS ACCOUNTS

KEY ISSUE #1: How Specific Should We Be Now?

- Recommendation:
  - Announce that the Universal Savings Accounts will provide a small, equal contribution for every participant, and that in addition, the government will provide matches for worker contributions using a progressive formula.
  - The exact size of the contributions, match rates, and income limits will be announced later.

KEY ISSUE #2: How Soon Will the Accounts Start?

- Issue:
  - There are likely to be significant administrative considerations to address before these accounts can be set up.
  - While we do not have a good estimate for a start up date, it is possible, for example, that they would not be able to start until 2003.
  - It might be possible to make four years worth of contributions in the start-up year in order to make up for the delay.
- Options:
  - Announce that we will start them as soon as feasible.
  - Announce that they will not start for a few years.
  - Announce that they will not start for a few years, but that we will make extra contributions in the first year to make up for the delay.

KEY ISSUE #3: At What Incomes Should Eligibility for the Contributions and Matches Be Phased-Out?

- Issue:
  - If the accounts phase-out quickly (for example by $60,000 of Adjusted Gross Income), the costs will be less than if the program gives generous amounts to upper-income families.
  - On the other hand, many middle-class suburban workers will receive little or no benefit if the phase out is rapid.
- Recommendation:
  - Wait to make this decision until we have better cost estimates from Treasury.

KEY ISSUE #4: Do We Have Enough Funds Allocated to This Proposal?

- Currently, we have only $20 to $30 billion a year allocated to the USAs, so it may not be possible to be very generous.

KEY ISSUES IN DEBT REDUCTION AND MEDICARE COMPONENTS

KEY ISSUE #1: How Do We Describe the Debt Reduction Component?

- Issue:
  - While we are planning to allocate 9 percent of the 15-year surpluses to debt reduction, the amount allocated to debt reduction in FY 2001-2004 is very small because discretionary spending uses a larger share of the surpluses in earlier years than in later years.
- Recommendation:
  - Announce that over the first five years $150 billion of surpluses will be used for debt reduction, and that after that, 10 percent of the surplus will be contributed to debt reduction.
  - We will count the FY 1998 and FY 1999 surpluses toward the $150 billion.

KEY ISSUE #2: How Do We Describe the Medicare Component?

- Recommendation:
  - If we take this money and do nothing else, we can extend the trust fund until 2020. But if we work in a bipartisan way to improve and modernize the system, we can make room for prescription drug coverage, and still extend the program through 2020.

TRADITIONAL REFORM OPTIONS

IMPACT OF PROPOSAL ON ACTUARIAL BALANCE	
Current 75-year OASDI balance	-2.19
Change from surplus transfer and equity investment	+1.28
Remaining Balance	*-0.91*

Note: Because of interaction effects, we will need further changes that total between 1.10 and 1.20 percent of payroll to achieve 75-year actuarial balance.

POTENTIAL OPTIONS TO ADDRESS REMAINING IMBALANCE:

Computation Years	
Increase number of years used in calculating benefits from 35 to 38 (Phased in between 2001-2003)	0.25
Increase number of years used in calculating benefits from 35 to 38 (Phased in between 2006-2014)	0.19
Raising the maximum level of earnings covered by the OASDI payroll tax	
Maintain share of all earnings taxed at 86 percent	0.15
Raise share of earnings taxed to 87.5 (Phase in 2000-2010)	0.27
Raise share of earnings taxed to 90 (Phase in 2000-2010)	0.55
Cover New State and Local Government Workers	
Cover State and Local Government New Hires Beginning in 2020	0.16
Cover State and Local Government New Hires Beginning in 2010	0.18
Retirement Age	
Eliminate 11-year hiatus in transition to normal retirement age of 67 67 advanced by 11 years 2011 instead of 2022	0.11
Index normal retirement age to life expectancy beginning in 2023	0.30
Raise retirement age from 67 to 68 between 2022 and 2028	0.30
Raise retirement age from 67 to 68 between 2034 through and 2039	0.17
Across the Board Benefit Cut	
5 percent reduction in promised benefits phased in between 2000 and 2040. In 2040, benefits in real dollars would be 134 percent of current benefit levels instead of 141 percent under current law.	0.22
Cost of Living Adjustment	
Reduce COLA by 0.2 percent	0.30
Taxation of Benefits	
Tax benefits like private pensions (in short term, does not result in extra people subject to taxation, thus this would have no immediate impact on 74 percent of beneficiaries)	0.13

January 27, 1999

MEMORANDUM TO GENE SPERLING

FROM: Doug Elmendorf

SUBJECT: Social Security Status Report and Agenda

DE
Thanks. Let's talk
GS
1/29/99

TOPIC #1: $4.5 trillion vs. $4.9 trillion

The former is the surplus we say we're allocating 62/15/12/11. The latter is the baseline surplus to be announced next Monday in the budget. Two likely effects:

a. People are going to be confused and will need explanations.

b. Budgeteers will start to ask how we calculated the interest difference. Then:
- -- Some will object to the imputed interest on equities.
- -- Some will note that by counting interest payments on the new, transferred debt as an intergovernmental transfer, our buydown of debt will not equal the accumulated debt held by the Trust Fund down the road (the Reischauer point).
- -- Some will start to wonder about how we're scoring equities down the road. Our original release didn't require decisions about this, but OMB's graph of long-run surpluses under this plan -- released today -- has made some implicitly.

OMB has written a memo of recommendations on some of the scoring issues; they have Jack Lew's approval of some issues but have not covered their whole list with him. After they get Jack's signoff, Joe will be happy to present this to the TWG.

Recommendation: Ask Joe to present scoring options and recommendations to the TWG, and then ask OMB to present this to the principals. These decisions are too important to be left to the experts. If we had not imputed the equity return or counted the new interest payments as intergovernmental, we would have had $3.7 trillion not $4.5 trillion to spend. The Social Security group did not give this issue enough thought in advance of the SOTU, and we're about to get behind again when the budget is rolled out next week.

TOPIC #2: First thing we do, let's kill all the lawyers.

Barbara has organized good meetings on two related topics:
- -- determining the right mechanics of transfers and equity purchases
- -- drafting legislation to set this up

Recommendation: Have Barbara present preliminary results at TWG meeting. Set deadline for completing the English (not legal) description of the mechanics.

TOPIC #3: Putting debt reduction first.

We need to finish the paper on fiscal discipline and related Qs and As.

Recommendation: Have Doug bring new draft to TWG meeting for discussion.

TOPIC #4: Are we disciplined enough?

This topic is less pressing now that OMB has produced a chart showing UB surpluses under the plan amost as far as the eye can see.

Recommendation: Have Doug keep working on possible approaches.

TOPIC #5: Could we rebalance our way to zero trust fund balance?

Yes, but there's no way to avoid it, and it's not a risk worth worrying about. There are two topics here:

- what are appropriate rebalancing rules?
- what is the true risk (so we describe it honestly)?

We've made some progress on both these fronts.

Recommendation: Have Gary and Doug bring results on these two issues to next TWG meeting.

TOPIC #6: Born in the USA

I've received some of Len's work on this subject, and they're doing a careful and imaginative job. As you've probably heard, the amounts per person are pretty large, as your intuition said. The primary concern of very large amounts is the effect on private pensions.

Recommendation: Schedule principals' meeting on USAs for Monday.

TOPIC #7: The Other Guys

CBO will release its budget numbers on Friday. Paul Van deWater says they'll only show "detailed numbers" for the first ten years, but it's hard to imagine they won't give 15-year surplus numbers after the SOTU.

MEETING ON CONGRESSIONAL AND THINK-TANK SOCIAL SECURITY REFORM APPROACHES

Cabinet Room
July 22, 1998
5:00 PM

AGENDA

I. RISK

II. INTEGRATIVE APPROACH

III. ADMINISTRATIVE COSTS

IV. CORPORATE GOVERNANCE

V. RATE OF RETURN

KEY POINT #1: THE CASE FOR EQUITIES

- Stocks have out-performed bonds over nearly all long periods of time in the US during the past century.

  -- The "equity premium" is the difference between the average annual rate of return earned by stocks and the rate earned by bonds. The table below shows this difference in returns between the S&P 500 and the bonds held by the Social Security trust fund for various time periods.

- During the 20th century in the US, even large stock market declines have been more than made up for by the extra return earned by stocks.

  -- A portfolio of a worker who lived through the 1929 crash during which the S&P 500 lost 85 percent of its value between September 1929 and June 1932 would have fully recovered by the end of 1936.

Equity Premium
S&P 500 over Social Security Trust Fund Bonds
(percent per year)

		End Year					
		1949	**1959**	**1969**	**1979**	**1989**	**1996**
Start Year	**1939**	6.91	11.63	9.16	6.69	6.65	6.51
	1949		16.56	10.30	6.61	6.58	6.42
	1959			4.37	1.96	3.45	*3.84*
	1969				-0.39	3.00	3.64
	1979					6.50	6.09
	1989						5.52

KEY POINT #2: CAUTIONS ABOUT EQUITIES

- **Markets fall**. While 20th century US markets have always rebounded strongly from large market declines, this need not be the case in the future.

  -- On three occasions during the past 70 years, the S&P 500 index has declined over two years by more than 35 percent (in nominal terms).

  -- Japan's Nikkei index has fallen by 60 percent since 1989.

  -- The S&P 500 (including reinvested dividends) did not regaining its 1968 value in real terms until 1983.

- **Perceptions of options may be colored by recent stock market history.** The tremendous recent stock market performance has likely increased support for investing Social Security funds in equities. If the stock market were performing badly -- as it did in the 1970s -- it is unlikely that people would be as eager to invest Social Security funds in the market.

  -- In 1979, *Business Week* ran a cover story entitled "The Death of Equities: How Inflation Is Destroying the Stock Market."

- **Stocks may not retain their historic advantage relative to bonds**. While stocks have out performed government bonds by a wide margin during the past century, this gap may not persist into the future.

- **Shorter market exposure at beginning of new system.** In the transition to a new individual account system, older workers would only participate in the system for a few years before they reached retirement. These workers would not have a full 40 years of market exposure. If a downturn occurred during this period, the older workers could end up doing worse than in safer investments.

- **Lack of individual or political patience after downturn.** In a system of individual accounts, individuals might shift out of equities after a market decline, missing the recovery. Similarly, if the trust fund were invested in equities, there might not be sufficient political patience to stay with an equity-based system after a large market downturn. If equity investments were abandoned after the first large downturn, such a system could provide the worst of both systems -- the low returns on bonds plus the risk of equities.

- **People might not feel good even if they did well.** Individuals might feel like they fared poorly even if they did better over their lifetime in equities than they would have done in government bonds. For example, if the market fell substantially in the year a worker retired and annuitized his/her account, he/she might feel that it was unfair that workers who retired one year earlier had higher retirement incomes. Similarly, if a worker annuitized his/her account balance at a point when the stock market is below a previous peak, the worker might feel like he/she lost even though he/she did better over his/her lifetime.

- **Naïve investor risk.** Some individuals make lack the investment know-how to make wise investment decisions.

KEY POINT #3: RISK UNDER DIFFERENT REFORM PROPOSALS

- **Risk in current Social Security system.** The current system does not have market risk. However, it has other forms of risk.

  -- Political risk that tax or benefit rules will change. For example, Social Security taxes and benefits have changed numerous times in the past 60 years.

  -- Demographic risk that forecasts of mortality and fertility trends will turn out to be incorrect. For example, if projected fertility rates dropped by 0.3 children per woman, the actuarial imbalance would worsen by about 0.4 percent.

  -- Economic risk that productivity growth will be higher or lower than currently forecast. For example, if productivity growth accelerated by 0.5 percentage points, the actuarial imbalance would improve by about 0.5 percent.

- **In reforms, only a portion of benefits would be exposed to market risk.** Even in 2070, payroll tax revenue will be sufficient to provide two-thirds of current-law Social Security benefits. If the full payroll tax continues to be dedicated to providing the traditional benefit, then at most one-third of the total Social Security benefit would be at risk.

  -- If only a limited portion of the trust fund -- for example, 25 percent -- were invested in equities, less than 20 percent of benefits would be dependent on stock market performance.

  -- Individual accounts funded with contributions equal to $500 per capita or 2 percent of payroll would typically provide less than 30 percent of total Social Security benefits. Thus, more than 70 percent of benefits would be free of market risk.

- **By investing through the Social Security trust fund, some risks are reduced.** With the trust fund partially invested in equities, there would be no need to tie annual benefits to year to year trust fund performance. Thus, market risk could be spread both across workers and across generations. In addition, since individual workers would not be making investment decisions, there would be no "naïve investor" risk.

KEY POINT #4: SOME DOWNSIDE SCENARIOS

- To be added.

KEY POINT #5: VARIATION IN RETIREMENT INCOME FROM MARKET EXPOSURE

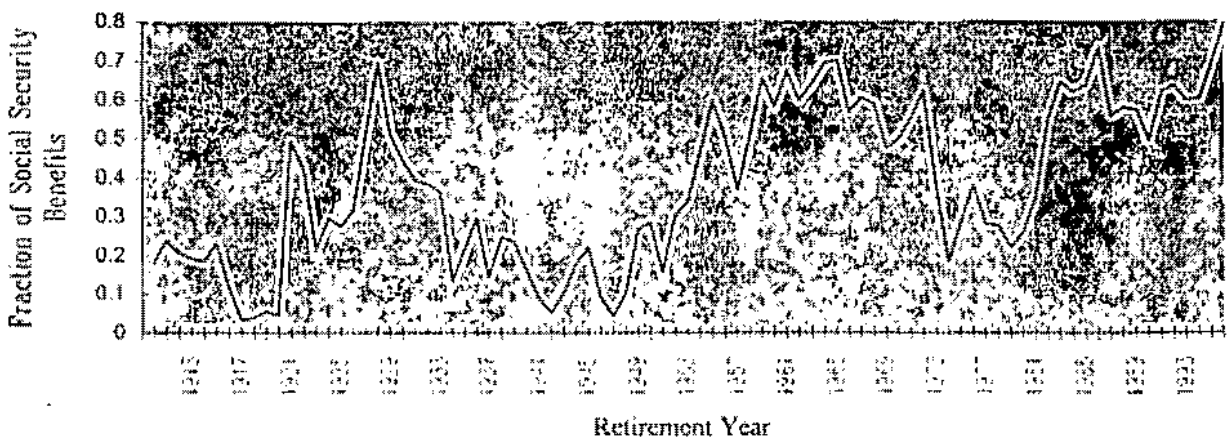
- **Outcomes from market investments depend on when individual retires.** Studies suggest that individuals would have widely different outcomes from market investments solely because of the market performance in the particular years in which they lived. For example, an average worker retiring in 1972 would have received a retirement annuity equal to more than 60 percent of their current law Social Security benefits. However, an individual who retired two years later, in 1974, would have received an annuity that was only 20 percent of their current law benefits.

- **In past century, Individual Accounts could have provided from 5-80 percent of an average worker's current law Social Security benefits.** If an average worker had had a 2 percent Individual Account and retired a different times in the past century, their retirement annuity would have varied greatly: from 5 percent to 80 percent of their current law Social Security benefits.

- **In most years, Individual Accounts could have provided a large enough annuity to ensure that current benefits were maintained.** One constructive way to view this result is that under the illustrative plans we discussed last week, the traditional Social Security program would continue to provide an additional 66 to 85 percent of current law benefits (depending on whether the Individual Accounts were implemented as carve-outs or add-ons). Thus, to maintain current benefits, the annuity from the Individual Account would have to be at least 15 to 34 percent of current benefits, depending on whether it were an add-on or carve-out Individual Account.

- **There are a number of limitations to this analysis.** The chart assumes that the entire individual account was invested in the S&P 500, and was annuitized at the Aaa corporate bond rate in the year that the worker turned 65. If a portion of the accounts were invested in bonds, or if annuitization happened in stages, the variation in experiences would be reduced.

Fraction of Social Security benefits replaced by 2% Individual Accounts



KEY POINT #6: WEALTH CREATION

Supporters of Individual Accounts make strong arguments about how such accounts help to create wealth and give lower-income workers a stake in the economy. Advocates base their argument on four ideas:

1. Because nearly half of all Americans have little or no financial assets, Individual accounts would give lower-income workers access to the higher rates of return offered by the stock market, and allow them to build wealth for their retirement.

2. Many Individual Account proposals would require retirees who have accumulated a large nest-egg to annuitize enough of the account to provide a basic retirement income, while allowing the retiree to take the remaining money in a lump-sum to be spent as they wish. In other words, retirees would have to set-aside a minimum amount of money, but the rest could be used for whatever they desire.

3. Some people die before they reach age 65, and Individual Accounts could be bequeathable to their heirs, thus making it possible for individuals who do not pass along any wealth to their heirs to do so. However, if a portion of individual accounts were bequeathable, the income available for consumption during retirement years would be reduced.

   -- Most reform proposal retain the existing structure for survivor benefits for young people. However, cuts to Social Security benefit formula -- as part of comprehensive reform -- would cut survivor benefits.

   -- To the extent Individual Accounts are bequethable, any cuts in survivor benefits will be offset by the funds in the account.

   -- Permitting bequests is particularly appealing to low-income and minority populations which have lower life-expectancy, and therefore, on average, would not receive their Individual Account annuity for as many years. For example, life expectancy at age 65 is 1.8 years shorter for Blacks than for Whites. (In the traditional Social Security system, the progressivity of benefit formulas offsets the shorter life expectancy.)

4. The experience of owning an Individual Account may lead people who do not save to begin saving on their own. By directly showing people the power of compound interest and the benefits of savings, we may alter people's consumption habits.

KEY POINT #7: OPTIONAL INVESTMENTS IN INDIVIDUAL ACCOUNTS

- If proposal included Individual Accounts, would workers be allowed to make *voluntary* contributions and up to what level would contributions be allowed? (The amounts that can be transferred are often limited to prevent individuals from shifting other savings into this tax-favored savings vehicle).

- If proposal did <u>not</u> include Individual Accounts, would workers be allowed to *voluntarily* contribute funds to their Individual Account, as Bob Ball and Moynihan-Kerrey allow.

II. INTEGRATING INDIVIDUAL ACCOUNTS WITH THE TRADITIONAL SOCIAL SECURITY BENEFIT

BASIC IDEA:

- Integrate an individual account with a defined benefit system so as to ensure a basic benefit.

- For example, plans can be designed to ensure that the combined income from the individual account and the traditional Social Security benefit exceed current law benefits (or an amount close to current law benefits if benefit cuts are part of the reform package).

- This approach shifts some of the risk of individual accounts from individuals to the federal budget.

- The simplest approach would be to provide a flat minimum benefit along with a large individual account. Carolyn Weaver's PSA plan from the Social Security Advisory Council took this approach.

EXAMPLE #1:

- **Provide a Safe Investment Option.** The individual account plan could include a safe investment option such as an inflation-indexed Treasury bond. With sufficient infussion of general revenues for the individual account, the plan could be designed to ensure that the combined individual account and Social Security income for a worker who invested in the safe option was almost always above current law benefits. Workers who chose to take on more risk could come out ahead or behind current law benefits.

EXAMPLE #2:

- **Clawback the individual account.** A portion of individual account accumulations could be used to pay for benefits under the traditional defined benefit Social Security system. This option would only apply to individual accounts that were funded out of the budget surplus. Since workers would continue to get their full benefit from the traditional system, their total income would be higher even though part of their individual account was "clawed-back."

  Clawback the traditional benefit. An alternative way to describe this approach is that the traditional Social Security benefit is reduced by some fraction (50 percent for example) of each dollar of income provided by the individual accounts. The advantage of this second way of describing the accounts is that it does not sound as much like a tax on the individual accounts. The disadvantage is that it reduces the portion of retirement benefits provided by the traditional Social Security program, and could lead to diminished political support for the traditional benefit.

ILLUSTRATIVE EXAMPLE OF INTEGRATIVE APPROACH

PLAN DESCRIPTION

- Fund individual account equally 2 percent of earnings using general revenue.
- Make common set of reforms (cover state and local workers, raise maximum taxable earnings limit; and increase number of years in computation base from 35 to 38.)
- Carve-out 50 percent of income realized from individual account accumulations, and use to fund traditional Social Security benefits.
- Make additional adjustments to traditional Social Security program to restore solvency.

KEY ATTRACTION OF THIS APPROACH
• Individual Accounts are provided while ensuring workers of retirement income of at least the traditional Social Security benefit.

KEY DISADVANTAGES OF THIS APPROACH
• Individual accounts need to be funded in perpetuity even though projected budget surpluses (under this plan) run out in 2023. • The clawback could be perceived as a tax and might not be politically sustainable.

IMPACT ON TRUST FUND SOLVENCY:

	Impact on 75-year actuarial balance
Common Set of Reforms: Cover state and local workers, raise maximum taxable earnings limit; and change computation base from 35 to 38.	+0.97
Revenue from Taxing Individual Account Accumulations.	+0.91
Remaining Actuarial Shortfall (75-year balance under present law is -2.19)	**-0.31**

IMPACT ON BENEFIT LEVELS

	IMPACT ON CURRENT LAW BENEFITS		
	Low earner ($12,000)	Average earner ($27,000)	High earner ($43,000)
Common Set of Reforms	-3.0 percent	-3.0 percent	-3.0 percent
Across-the-Board Cuts Implied by Remaining Shortfall	-3.1 percent	-3.1 percent	-3.1 percent
Expected Annuity Provided by Individual Account (2030)	+8.1 percent	+10.8 percent	+13.1 percent
Total	**+2.0 percent**	**+4.7 percent**	**+7.0 percent**

- The annuity provided by Individual Accounts assumes the stock market grows at its historic rate, an optimistic level for administrative costs (only 10 basis points); and reflects single workers only who do gain more from Individual Accounts than married couples.

III. ADMINISTRATIVE COSTS

KEY POINT #1: INTERNATIONAL EVIDENCE ON ADMINISTRATIVE COSTS IN INDIVIDUAL ACCOUNT PLANS

- **Administrative costs in Chile have been high.** The accumulation of administrative costs over a worker's career results in retirement income in the Chilean system that is 20 percent lower than it would be if there were no administrative costs.

- **In Chile, fund management companies appear to compete on factors other than price.** The funds are highly regulated in the types of allowable investments, and offer very similar portfolios. Individuals are allowed to switch portfolios every 4 months. This has caused fierce competition. The funds spend huge amounts on advertising, have increased their sales force, and offer incentives such as televisions or trips to lure individuals to their particular fund. This non-price competition has driven up costs.

  -- In Chile there are 3.5 salespeople per 1,000 contributors. In the United States, there are 0.5 SSA employees per 1,000 insured workers.

- **Costs in the early years of the UK individual account system have been high as well.** In the UK, workers can opt out of the earnings-related defined benefit system, and instead contribute to an individual retirement account. A recent paper by Professor Peter Diamond reports that the charges for these individual accounts are large, complicated, and often not visible to the workers. He calculates that the total administrative costs in the typical UK account reduce retirement income by more than 24 percent.

- **The international evidence suggests that it is important to focus on ways to keep costs down.** The lesson from these two examples is not that individual account systems are necessarily expensive, but rather that it is important to design systems in a way that provides the desired services at a reasonable cost.

KEY POINT #2: ADMINISTRATIVE COSTS DEPEND ON SERVICES PROVIDED

- **Administrative costs can have a large impact on retirement income.**

Annual Administrative Costs (basis points per year)	Percentage Reduction in Value of Individual's Retirement Income
10	2.4
50	11.5
100	21.5

- **Current US system has very low costs.** The current Social Security system has maintained an extremely low level of administrative costs. Less than 1 cent of every dollar paid into the system by workers and employers goes to administrative costs.

- **Investing trust fund in equities would be extremely inexpensive.** Estimates suggest that costs would be only one-half of one basis point.

- **Costs vary widely depending on the services provided and on the way in which the accounts are administered.**

Estimated Administrative and
Investment-Management Costs for Individual Accounts
(bps = basis points)

Administering Body	Passive Mutual Fund	Active Mutual Fund
Government-Based (e.g., TSP)	8-16 bps	58-66 bps
Employer-Based (2,000 workers)	36-44 bps	109-117 bps
Employer-Based (25 workers)	76-86 bps	138-148 bps
Individual-Based (e.g., IRA)	81-91 bps	143-153 bps

- **Costs in the early years would be even higher.** Account balances would be small at the beginning, driving up cost ratios.

- **The costs of actively-managed funds are significantly higher than are the costs of index funds.** A 1998 Department of Labor study found average expense ratios for actively-managed retail large equity funds of 147 basis points, while average expense ratios for index funds were only 59 basis points.

- **Technological advances might reduce the costs substantially in the future.** If fund allocations could be handled by an automatic telephone procedure or over the Internet, individuals could be permitted to reallocate their portfolios frequently at a relatively low cost.

KEY POINT #3: THE TSP MODEL

- **The Federal Thrift Savings Plan has been a model for many individual account proposals.** Its costs are low -- roughly 10 basis points per year, excluding employer costs of reporting individual earnings to the TSP.

  -- Costs are low in part because TSP offers only 3 investment options, a stock index fund, a corporate bond fund, and a Treasury security fund. TSP contracts with private fund managers to run the funds.

  -- [Add another fact or two about why TSP is so cheap]

- **A national government-run system would face much larger challenges.** The TSP covers 2.6 million participants, all of whom work for one employer (the Federal government). A universal personal account system would eventually involve 180 million individual participants, who work for 6.5 million different employers.

  -- Last year over 55 million individuals called the SSA's 800 number. Many additional calls would need to be handled if individual accounts were set up. In recent testimony, Frank Cavanaugh, former Executive Director of the TSP, estimated that a Social Security reform plan modeled after the TSP "would require at least 10,000 highly trained Federal employees to man the telephone and answer employee questions."

- **Corporate governance issues could arise in a TSP-style plan.** Because the government would be contracting with a small number of private-sector managers to invest the aggregate holdings of the accounts, corporate governance issues could arise that are similar to those that would arise if Social Security were invested in equities.

KEY POINT #4: HOW WOULD SERVICES BE PERCEIVED?

- **How would services be perceived?** In a very inexpensive system, the services provided would likely be perceived to be inferior to workers' other investment accounts such as 401ks and IRAs. For example, workers might have their contributions deposited into their accounts only infrequently, be given limited opportunity to reallocate their portfolios, and receive less frequent statements of account balances.

  -- Some people fear that people would be disappointed when they realize that under some forms of a TSP approach deposits would not be made to individual accounts until October of the following year (the date at which SSA and IRS essentially finish reconciling the previous year's earnings). In 401k plans, contributions are made much more frequently.

  -- Others feel that the individual account will seem like a new entitlement program or tax cut and that people will be pleased to receive it, especially if we announced that from now on 2 percent of your payroll taxes will be deposited in your account within 90 days of your annual tax filing.

- **Keeping costs low conflicts with features that give individual accounts their popularity.** Proponents of individual accounts hold up savings account booklets and suggest that people could have frequent reports on account balances, wide investment choices, and the ability to reallocate their portfolios whenever they want. These features would raise costs.

- **Political pressure for added services could drive up costs.** There might be political pressure to introduce additional services, such as emergency loans against the accounts. The additional services would drive up costs.

V. DOES SOCIAL SECURITY GET A LOW RATE OF RETURN?

THE CHARGE:

- **Some claim they could do better investing on their own.** Many critics of Social Security point to the rate of return that workers will earn in the future on their contributions into the system, and argue that they could do better on their own investing in individual accounts.
  - -- According to the Social Security actuaries, a single male with average earnings retiring in 2030 will receive a real return of only about 1-1/2 percent per year.
  - -- By contrast, over the period 1926-1996, stocks earned a real rate of return equal to about 7 percent per year.

THE TRANSITION ISSUE:

- **If new money is invested in the Social Security system, it is indeed possible to receive a higher rate of return for a current worker by investing in private securities than by expanding the traditional pay-as-you-go system.**
- The story is different if we are talking about redirecting revenue currently allocated to paying benefits under the current system. **In this case, simply calculating rates of return for the individual accounts ignores the need to provide benefits for current and future retirees who have paid into the current Social Security system.** Ninety percent of contributions into the Social Security system are used immediately to pay benefits to today's retirees and other beneficiaries. If current workers put their payroll tax contributions into individual accounts for their own retirement, we will need to come up with some other way to pay retirement benefits for people who are entitled to Social Security benefits. **Rates of return that ignore this cost are misleading when compared to Social Security rates of return that include this cost.**

BACKGROUND:

The table below presents the real rate of return to Social Security contributions for different types of workers born in different years. Rates of return are lower for later cohorts; lower for high earners; and lower for single earners than one-earner couples

REAL RATE OF RETURN TO SOCIAL SECURITY CONTRIBUTIONS
(Percent per year)

Year born/ year age 65	Single male earner			One-earner couple		
	Low earnings	Avg. earnings	High earnings	Low earnings	Avg. earnings	High earnings
1920/1985	4.4	2.8	2.5	8.1	6.6	6.3
1930/1995	3.1	1.9	1.5	6.1	5.0	4.7
1964/2029	2.4	1.3	0.7	4.7	3.7	3.1
2004/2069	1.5	0.8	0.2	4.0	3.0	2.4

TECHNICAL WORKING GROUP

January 29, 1999

AGENDA

- Scoring Rules
- Drafting Legislation
- Rules for Equity Investments
- Rebalancing and Portfolio Risk
- Describing Fiscal Discipline (Double Counting)
- Benefits of Debt Reduction

January 29, 1999

BUDGET TREATMENT OF SURPLUS TRANSFERS TO SOCIAL SECURITY AND MEDICARE (HI)

1. How should the budget show the transfer of the designated amounts to the Social Security and Medicare trust funds?

- Treasury would increase the assets of the Social Security and Medicare (HI) trust funds by designated amounts. The reform legislation would need to require Treasury to transfer the funds from the General Fund to the trust funds. Since these funds are not spent, they are available for and will be used by Treasury to retire publicly held debt as a matter of course under current law.

- Treasury would increase the assets in the trust funds by transferring funds from the general fund to the trust funds in the same manner that payroll taxes are now transferred. The budget would record general fund outlays and trust fund receipts, as it does now for the transfer of payroll taxes.

- The proposed law—by modifying the BEA, the Congressional Budget Act, and Title 31 as it pertains to the President's budget—would reduce the amount of the surplus by the amount of the transfers. The budget would refer to the transfers as "Social Security and Medicare Lock-box Transfers" (or "Lock-box Transfers" for short in tables).

- This would have the following effects on the presentation of budget totals (see the attached table, "Proposed Budget Presentation of Social Security Reform"):

  - Wherever the unified budget totals are struck, the budget would show "Lock-box transfers" on a separate line. The surplus amount would be reduced by this amount.

  - Wherever the surplus is shown by itself, the amount would be the reduced amount.

  - Where on- and off-budget surpluses or deficits are shown, the budget would show "Lock-box transfers" on a separate line. The on-budget surplus or deficit plus the off-budget surplus, less the Lock-box transfers would equal the unified budget surplus.

  - All of the tables in the budget on outlays and receipts would show the outlays and receipts of the transfer as normal.

- As with other receipts to the trust funds, these receipts would be invested until needed to pay benefits.

2. How will these receipts be invested?

- The Social Security trust fund managers would be authorized to invest up to 21% of the amounts in the two Social Security lock-boxes (14.6% of the trust funds' invested assets) in private equities.

- They would invest the remainder according to current law. In practice, this has been in special non-marketable Treasury securities.

- The Medicare trust fund managers would invest the receipts in the Medicare lock-box according to current law. In practice, this has been in special non-marketable Treasury securities.

- Concurrent with the Social Security reform proposal, we propose to make a conceptual change in budget scoring for the purchase of privates securities, in consultation with the Congressional scorekeepers.

  Under current budget scoring rules, purchases of private securities would be treated like the purchase of any asset—the budget would record an outlay. When the equities were sold, the budget would record a receipt. In contrast, investments in U.S. securities are treated as asset exchanges—no outlay is recorded when they are purchased and no receipt is recorded when they are sold, except to the extent of earnings or losses. Conceptually, there is no basis for treating investments in private securities (debt and equity) for the same purpose differently from investments in U.S. securities, provided that they are "qualifying investments" as defined below.

  Therefore, we propose to no longer score outlays or receipts for purchase and sales of these securities, under the criteria detailed below. Instead, we would treat them as asset exchanges. (If we did not make this change, the Lock-box transfers to the surplus would have to exclude the amount of the transfers that we estimate will be invested in private securities. This is because the private investments would count as outlays and reduce the surplus by that means.)

- The revised budget treatment would apply to any qualifying investment, not just those of the Social Security and Medicare trust funds. To qualify, investments would have to meet the following criteria (this list may be refined later) in order to ensure that the Government was not using the investment as a "costless" way to provide subsidies or allocate resources for an industrial or social policy:

  - Investments in equities must be authorized in law.
  - They must be for investment purposes, not for the acquisition of assets to be used in carrying out Government programs.
  - Investments must be limited to indexed funds.

- Investments must be managed by an independent board.
- The Government must have no say in the affairs of any corporation in whose equities Government funds are invested.

- Under the revised rule, we must consider how the budget should record capital gains and losses. There are four options:

  - **When realized.** The budget would record gains and losses when realized—that is, whenever the equity is sold, even if the proceeds are immediately reinvested.

  - **When liquidated.** The budget would record gains and losses when any part of the investment portfolio (stocks and bonds) as a whole is liquidated to pay benefits.

  - **Continuously.** The portfolio would be marked to market on a daily basis. The budget would record cumulative gains and losses for the year.

  - **Hybrid.** Book a yield equal to that on Treasuries continuously, with additional gain or loss booked upon realization, or upon ultimate liquidation.

3. **What should we do about the debt subject to statutory limit?**

- Investments by the trust funds count under the current statutory limit. We estimate that the increased investments we propose for the Social Security and Medicare trust funds (together with the other effects of the proposal) would require a debt limit increase by the end of FY 2001. (Absent the proposal, no increase in the limit would be required in the foreseeable future.) The attached table, "Debt Subject to Limit with Social Security Reform," provides estimates of debt pending and with Social Security reform. The estimates for debt with Social Security reform reflect various options for redefining debt subject to limit, which are included in some of the options below.

- Our options are:

  - **Do nothing now.** We could simply wait until the increase is needed in the summer of 2001. This would avoid strapping the reform proposal with additional baggage, but it would require the next Administration to deal with the "must pass" legislation.

  - **Increase the limit in the reform legislation.** Increasing the debt limit as part of the reform proposal would allow us to more clearly justify the increase as necessary to save Social Security and Medicare.

  - **Redefine debt subject to limit in the reform legislation to exclude debt resulting from investing the transfers.** Rather than increase the limit, this option would define the increase in debt resulting from the transfers out from under the limit. It

could be justified as a special exemption needed to save the trust funds. On the other hand, it would difficult to explain why debt resulting from transfers was excluded but debt resulting from the investment of normal receipts was not.

- **Redefine debt subject to limit in the reform legislation to include only debt held by the public.** This would remove debt held by these trust funds and other Government accounts from under the debt limit. We would point out that it makes no sense for Congress to subject these investments to limit while simultaneously causing them to increase.

  Furthermore, most budget experts agree that debt held by the public is the more meaningful measure of debt and, if there must be a limit, that it should limit this debt. We could point to the fact that the nearly-passed resolutions for a balanced budget Constitutional amendment would have constrained debt held by the public, not debt held by Government accounts.

  On the other hand, some will not understand the proposed change and will be suspicious of it. Also, if all debt held by the public was included, not just the FHA debentures as currently, we would have to be more attentive and more formal in how we treat agency debt than we are now.

4. Social Security and Medicare Reform is linked to the budget process requirements of the Budget Enforcement Act and the Congressional Budget Act. We need to make these points:

- Budget Enforcement Act:

  - It currently expires for legislation enacted through 2002 (affecting PAYGO through 2006). It would need to be extended to continue to protect surpluses and to lock in cap increases.
  - The protections for Social Security (off-budget, exempt from sequestration) must be continued.
  - The discretionary caps should be increased, upon Social Security and Medicare reform.
  - The surplus needs to be defined, for BEA purposes, as excluding the Social Security and Medicare Lock-box transfers.
  - The PAYGO rules need to be waived on a one-time basis for the reform legislation so that the various related Administration initiatives (e.g., USA accounts) can be funded. The PAYGO rules would be extended for all other legislation.

- Congressional Budget Act:

  - Congressional rules protecting Social Security should be extended. For example, the Senate rules require 60 votes to override a point of order against any bill that would worsen the solvency of Social Security and against a reconciliation bill that would have any effect on Social Security.

  - The surplus needs to be defined, for CBA purposes, as excluding the Social Security and Medicare Lock-box transfers.

2-1-99

THE WHITE HOUSE

WASHINGTON

January 29, 1999

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MEMORANDUM FOR THE PRESIDENT

FROM: GENE SPERLING

SUBJECT: NEC WEEKLY REPORT

cc: JOHN PODESTA

Overall Economy: As you may know, this week a number of prominent individuals in financial sector issued statements that were very complimentary about the economy: John Williams, chief economist at Bankers' Trust in New York said: "If ever there has been a perfect economy, the United States seems to be it"; and Merrill Lynch said, "The U.S. economy is the wonder of the world . . . The latest round of economic data was mind-blowing."

Trade Hearings: You should know that the Finance Committee held three days of hearings Tuesday-Thursday (1/26-28) in an effort to lay the groundwork for a possible markup of a trade bill. Chairman Roth and others echoed the "new consensus" appeal in the SOTU. Sen. Lott explicitly urged the approval of fast track negotiating authority. The Administration witnesses (Rubin, Daley, Barshefsky, Browner and Herman) were well received. The only discordant notes were Sen. Rockefeller's statement that he might break with past practice and vote against fast track if further action on the steel problem were not forthcoming, and Sen. Graham's expression of frustration with reports that neither the Congressional leadership nor the Administration would support inclusion of Caribbean Basin Initiative NAFTA-parity legislation in the supplemental appropriations bill. Sen. Kerrey urged Chairman Roth to have the Finance Committee take it upon itself to develop a consensus bill that could pass in the House rather than wait for the Administration to issue a legislative proposal of its own. Roth was non-committal but signaled at various points in the week that he wanted to move ahead and, if necessary, away from last year's formulation somewhat if necessary. Finally, AFL-CIO President Sweeney delivered testimony sketching out a framework of principles within which we might well be able to structure our own approach (with perhaps one exception).

Bananas Update: NEC staff have continued to work closely with USTR and State to try to make progress on this dispute in a way that meets both our international and our Congressional obligations. Although several Member States have been pushing for a more moderate EU position, the Commission itself (and Leon Brittan in particular) have remained very inflexible. After a lot of procedural wrangling, the EU did allow the WTO meeting on our retaliation proposal to go forward and requested arbitration of our proposed damage amount. This means (per Bowles letter and USTR reading of WTO rules) that the retaliation deadline shifts from Feb 1 to March 3 (pending a 30 day arbitral review). We will continue to work with the agencies to explore avenues to get the EU to the table and negotiate a solution that meets US political requirements and is consistent with the WTO.

Stay Critical

2-1-99

Brazil Update: Brazil's economic outlook continues to be precarious, with the currency continuing its decline, the central bank continuing to raise interest rates, and with as yet no clear and comprehensive articulation of an overall framework (fiscal, monetary, privatization, structural change) in place. We will continue to work with NSC and coordinate the inter-agency communication and strategy regarding Brazil.

Closing the Skills Gap: You should know that we received very good press on the Closing the Skills Gap event in Action, VA last week. The *New York Times*, *Washington Post*, and *Washington Times* all had excellent stories describing how this comprehensive initiative would address a pressing issue and would have bipartisan appeal. In fact, Rep. Bill Goodling released a statement in which he said that your proposals have "merit" and that they "... appear to contain strong accountability measures, which Republicans have long sought in these types of federal programs." He added, "I hope the White House will quickly shape these proposals into legislation as soon as possible and move them to Congress for consideration. We will spar on a variety of education issues this year, but not these. What the President is talking about today should enjoy broad bipartisan support."

Social Security Rollout: This week, the NEC convened an organizational meeting with White House legislative, public liaison, intergovernmental, political, communications, and press offices, as well as staff from Treasury, OMB, and SSA, to discuss our strategy for moving forward on Social Security. We have divided into four sub-groups (legislative, outreach, communications, and policy development) to coordinate this effort, and have begun implementing our action plan. For example, along with Jack Lew, Larry Summers, Ken Apfel, Larry Stein, and others, I spent a significant amount of time on the Hill this week briefing members and staff, including Social Security Task Force Democratic members, Senate Finance Democratic staff, House Ways & Means Democratic staff, House and Senate Democratic leadership staff, House and Senate Democratic Budget staff, and Finance/Ways & Means Republican staff. In addition, I met with business leaders and members of the disability community to brief them on your Social Security plan on Tuesday (1/26) and Wednesday (1/27), respectively. On Friday (1/29), I spoke at the National Press Club on Social Security.

Medicare Commission: Last Tuesday (1/26), the Medicare Commission met to discuss reform plan laid out by Senator Breaux on January 22. The discussion, led primarily by your appointees, focused on some of the flaws in the plan (e.g., lack of a clearly defined guarantee of benefits; missing information on how premium support would work; only a placeholder for prescription drugs). Since your appointees are the "swing votes," the concerns raised by Dr. Laura Tyson and Stuart Altman were welcomed by the Democratic base, which is anxious that premium support is more a defined contribution than defined benefit. You should know that Senator Kennedy gave a speech vehemently opposing premium support at the Press Club Thursday (1/28). Senator Breaux has indicated that the next discussion of the plan will be Tuesday (2/9), and before then, he wants to work with us and the Congressional Democrats on a compromise. I will covene a principals meeting on Monday (2/1) with HHS, OMB, Treasury and key White House advisors to develop options around the Commission for your consideration. On a related note, in the shadow of the Social Security debate, your decision to

dedicate part of the surplus to Social Security is being widely embraced. At Thursday's (1/28) Finance Committee hearing, Mr. Greenspan said it is "probably wise to think in the broader context of not only Social Security, but Medicare ..." and that "when and if that [Social Security reform] is done, that the next issue of a very similar nature is Medicare...." We will continue to work to generate support for it in the Social Security and the Medicare Commission debates.

Need to keep up the work

Information Technology Initiative: Last Sunday (1/23), the Vice President unveiled more details on the long-term information technology research initiative that you announced in the State of the Union. Tom Kalil on my staff worked with Neil Lane to brief Silicon Valley executives, who are very supportive of the initiative. The initiative could lead to breakthroughs such as computers that can understand human speech and translate between languages in real-time, high-speed wireless networks that can bring telemedicine and distance learning to rural communities, and computers that are thousands of times faster than todays fastest supercomputer -- and can develop life-saving drugs and fuel-efficient engines more rapidly.

Union Membership Rises by 100,000 in 1998: Union membership rose by more than 100,000 in 1998, an increase over the previous year that the AFL-CIO attributed to more aggressive organizing. At the same time, the percentage of workers represented by organized labor slipped. The Labor Department reported Monday (1/25) that union membership grew from 16.1 million to 16.2 million last year. Furthermore, the share of the workforce belonging to unions declined from 14.1 percent to 13.9 percent, reflecting population growth and an overall expansion in the workforce. That is the least the percentage has fallen for the past five years. In 1994, there were 16.7 million union members, which reflected 15.5 percent of the workforce. The AFL-CIO said the raw increase in membership reflects membership drives such as those that brought United Airlines workers into the International Association of Machinists last July.

Pensions: While public attention has been focused on your proposals to reform Social Security and create USA Accounts to increase personal savings, we have not forgotten the third leg of retirement planning -- private pensions. An NEC-led working group has developed a package of new legislative proposals that, when coupled with your proposals from last year that have not been enacted, presents a comprehensive plan to: (1) expand private pension plan coverage, especially to small businesses; (2) increase the portability of private pension savings; (3) increase retirement security for women; (4) expand employees' and spouses' "rights-to-know" about their pensions; and (5) improves the security of the pension and pension guarantee systems. The Vice President is considering unveiling this package (otherwise hidden in the minutia of the budget) on Wednesday (2/10). The new portability provisions in our proposal stem largely from legislation introduced last year by Rep. Pomeroy.

We should draw more on

New Markets Initiative/Appalachia: This week, NEC staff briefed the Appalachian Regional Commission on the details of your New Markets initiative at their quarterly meeting. ARC Chairman Jesse White emphasized the significance of your references to Appalachia in the State of the Union, showed the Commission video clips from your remarks at Reverend Jackson's Wall Street Project, and expressed great excitement about the New Market proposals' potential impact on their region. The initiative was warmly received.

2-1-99

Digital Library Initiative: As part of a Millennium event the First Lady unveiled the digital library initiative ($30 million) that will begin the development of a national library of text, images, sound recordings, and other materials available to every school-child and every American with access to the Internet. It will include: hundreds of thousands of America's historical and cultural artifacts that are now only accessible to scholars visiting archives; hundreds of thousands of books and images of paintings; and leading-edge material to help America's children meet high academic standards in math and science. This initiative supports your Educational Technology Initiative by making unique historic, cultural, and scientific materials available to teachers, children, and parents. It also supports the goals of the White House Millennium Project by "honoring the past and imagining the future."

Community Reinvestment Act (CRA): NEC, DPC, Leg Affairs, and Treasury staff have been working with Senate Banking Committee Democratic staff to prepare for assaults on CRA during this Congress. As the new Banking Committee Chair, Senator Gramm has indicated a strong interest in "CRA reform." He has advanced two proposals. First, in the context of Financial Modernization reform, he proposes "neutrality" on CRA, making an institution's CRA record irrelevant to any approval for new bank powers. Second, under the guise of preventing extortion of banks by activists, he proposes separate legislation to: (1) give a "safe harbor" from CRA scrutiny for bank mergers if the institution had a satisfactory CRA rating at its last review; and (2) make it a felony for a bank to make a financial commitment to a community with the intent of influencing what any group might say about its CRA record. As drafted, these changes could significantly limit CRA's effectiveness. Senator Sarbanes and his staff are very pleased with your recent statements (and those of the Vice President and Secretary Rubin) about the importance of protecting CRA. At Senator Sarbanes' request, Larry Stein and Treasury and WH staff provided a briefing this week on CRA for Banking Committee Democratic staff. Senator Sarbanes' staff made a plea for Democratic unity and Larry asked that Democratic Senators work with us before signing on to any seemingly innocuous reform proposals from Senator Gramm.

FAA Reauthorization: NEC has been deeply involved in efforts to complete and clear the Administration's FAA reauthorization bill, so that we can roll it out late next week. Congress did not enact an FAA bill last year because of disagreements over proposed changes in access to Reagan National Airport; thus, our bill will in most respects be identical to what we proposed a year ago. Although our bill is still in clearance, it will likely call for a) creating a performance-based organization to manage air traffic control services, and b) financing air traffic control services with a cost-based user's fee -- in keeping with the recommendations of two blue-ribbon panels on aviation safety and competition. Our bill also will propose c) lifting the $3 cap on the Passenger Facility Charges that local airports can charge -- something the major airlines will oppose but local governments will embrace. This proposal, combined with our budget request for the FAA's airport grants program, mean that we will be requesting record levels of investment in airport infrastructure. Finally, the bill will contain d) provisions to promote competition and enhance service to rural areas.

WHY THE DOUBLE COUNTING CRITIQUE IS INVALID

A number of people have questioned the economic plan laid out in the President's State of the Union Address on the grounds that it "double counts" Social Security payroll revenue by crediting the Social Security and Medicare trust funds with a portion of the unified budget surplus even though the unified budget surpluses are in part due to Social Security surpluses.

We believe that this is not the right way to think about the economic impact of the plan.

- Currently, the government as a whole is running a surplus -- it is bringing in more in revenue than it is paying out.

- The fundamental question for our budget policy is what to do with the excess.

- The President is proposing that most of it be set aside to pay for future retirement and health needs stemming from the aging of America. This will add to national savings and improve the country's wealth. This is in contrast to those who propose using the surplus for tax cuts or immediate spending needs.

- The President's plan sets aside these funds to help meet our future obligations to Social Security and Medicare in two ways.

  -- First, with 21 percent of the surpluses that are allocated to Social Security (21 percent of the 62 percent), we propose to purchase private equities. Then when the time comes to pay benefits, we will sell the equities.

  -- Second, with 79 percent of the surpluses allocated to Social Security (29 percent of the 62 percent), and with all of the surpluses transferred to Medicare, we are proposing to buy back government debt (Treasury bills and bonds) held by the public and to give bonds of equal value to the OASDI and HI trust fund.

How Paying Off Debt Helps Meet the Financial Challenges Facing America in the Future

- Paying off debt means that the government owes less money to private individuals. Thus, it improves the government's net worth. We are projecting that under our plan, the debt to GDP ratio (where debt is measured as the debt held by the public) will fall from 44 percent today to around 7 percent in 2014, and it is expected to continue to drop after that.

  -- Paying off debt reduces debt servicing costs -- thereby increasing future budget surpluses and freeing up additional resources for other uses.

January 29, 1999

BUDGET TREATMENT OF SURPLUS TRANSFERS TO SOCIAL SECURITY AND MEDICARE (HI)

1. How should the budget show the transfer of the designated amounts to the Social Security and Medicare trust funds?

- Treasury would increase the assets of the Social Security and Medicare (HI) trust funds by designated amounts. The reform legislation would need to require Treasury to transfer the funds from the General Fund to the trust funds. Since these funds are not spent, they are available for and will be used by Treasury to retire publicly held debt as a matter of course under current law.

- Treasury would increase the assets in the trust funds by transferring funds from the general fund to the trust funds in the same manner that payroll taxes are now transferred. The budget would record general fund outlays and trust fund receipts, as it does now for the transfer of payroll taxes.

- The proposed law—by modifying the BEA, the Congressional Budget Act, and Title 31 as it pertains to the President's budget—would reduce the amount of the surplus by the amount of the transfers. The budget would refer to the transfers as "Social Security and Medicare Lock-box Transfers" (or "Lock-box Transfers" for short in tables).

- This would have the following effects on the presentation of budget totals (see the attached table, "Proposed Budget Presentation of Social Security Reform"):

  - Wherever the unified budget totals are struck, the budget would show "Lock-box transfers" on a separate line. The surplus amount would be reduced by this amount.

  - Wherever the surplus is shown by itself, the amount would be the reduced amount.

  - Where on- and off-budget surpluses or deficits are shown, the budget would show "Lock-box transfers" on a separate line. The on-budget surplus or deficit plus the off-budget surplus, less the Lock-box transfers would equal the unified budget surplus.

  - All of the tables in the budget on outlays and receipts would show the outlays and receipts of the transfer as normal.

- As with other receipts to the trust funds, these receipts would be invested until needed to pay benefits.

2. How will these receipts be invested?

- The Social Security trust fund managers would be authorized to invest up to 21% of the amounts in the two Social Security lock-boxes (14.6% of the trust funds' invested assets) in private equities.

- They would invest the remainder according to current law. In practice, this has been in special non-marketable Treasury securities.

- The Medicare trust fund managers would invest the receipts in the Medicare lock-box according to current law. In practice, this has been in special non-marketable Treasury securities.

- Concurrent with the Social Security reform proposal, we propose to make a conceptual change in budget scoring for the purchase of privates securities, in consultation with the Congressional scorekeepers.

  Under current budget scoring rules, purchases of private securities would be treated like the purchase of any asset—the budget would record an outlay. When the equities were sold, the budget would record a receipt. In contrast, investments in U.S. securities are treated as asset exchanges—no outlay is recorded when they are purchased and no receipt is recorded when they are sold, except to the extent of earnings or losses. Conceptually, there is no basis for treating investments in private securities (debt and equity) for the same purpose differently from investments in U.S. securities, provided that they are "qualifying investments" as defined below.

  Therefore, we propose to no longer score outlays or receipts for purchase and sales of these securities, under the criteria detailed below. Instead, we would treat them as asset exchanges. (If we did not make this change, the Lock-box transfers to the surplus would have to exclude the amount of the transfers that we estimate will be invested in private securities. This is because the private investments would count as outlays and reduce the surplus by that means.)

- The revised budget treatment would apply to any qualifying investment, not just those of the Social Security and Medicare trust funds. To qualify, investments would have to meet the following criteria (this list may be refined later) in order to ensure that the Government was not using the investment as a "costless" way to provide subsidies or allocate resources for an industrial or social policy:

  - Investments in equities must be authorized in law.
  - They must be for investment purposes, not for the acquisition of assets to be used in carrying out Government programs.
  - Investments must be limited to indexed funds.

- Investments must be managed by an independent board.
- The Government must have no say in the affairs of any corporation in whose equities Government funds are invested.

- Under the revised rule, we must consider how the budget should record capital gains and losses. There are four options:

  - **When realized.** The budget would record gains and losses when realized—that is, whenever the equity is sold, even if the proceeds are immediately reinvested.

  - **When liquidated.** The budget would record gains and losses when any part of the investment portfolio (stocks and bonds) as a whole is liquidated to pay benefits.

  - **Continuously.** The portfolio would be marked to market on a daily basis. The budget would record cumulative gains and losses for the year.

  - **Hybrid.** Book a yield equal to that on Treasuries continuously, with additional gain or loss booked upon realization, or upon ultimate liquidation.

3. What should we do about the debt subject to statutory limit?

- Investments by the trust funds count under the current statutory limit. We estimate that the increased investments we propose for the Social Security and Medicare trust funds (together with the other effects of the proposal) would require a debt limit increase by the end of FY 2001. (Absent the proposal, no increase in the limit would be required in the foreseeable future.) The attached table, "Debt Subject to Limit with Social Security Reform," provides estimates of debt pending and with Social Security reform. The estimates for debt with Social Security reform reflect various options for redefining debt subject to limit, which are included in some of the options below.

- Our options are:

  - **Do nothing now.** We could simply wait until the increase is needed in the summer of 2001. This would avoid strapping the reform proposal with additional baggage, but it would require the next Administration to deal with the "must pass" legislation.

  - **Increase the limit in the reform legislation.** Increasing the debt limit as part of the reform proposal would allow us to more clearly justify the increase as necessary to save Social Security and Medicare.

  - **Redefine debt subject to limit in the reform legislation to exclude debt resulting from investing the transfers.** Rather than increase the limit, this option would define the increase in debt resulting from the transfers out from under the limit. It

could be justified as a special exemption needed to save the trust funds. On the other hand, it would difficult to explain why debt resulting from transfers was excluded but debt resulting from the investment of normal receipts was not.

- **Redefine debt subject to limit in the reform legislation to include only debt held by the public.** This would remove debt held by these trust funds and other Government accounts from under the debt limit. We would point out that it makes no sense for Congress to subject these investments to limit while simultaneously causing them to increase.

  Furthermore, most budget experts agree that debt held by the public is the more meaningful measure of debt and, if there must be a limit, that it should limit this debt. We could point to the fact that the nearly-passed resolutions for a balanced budget Constitutional amendment would have constrained debt held by the public, not debt held by Government accounts.

  On the other hand, some will not understand the proposed change and will be suspicious of it. Also, if all debt held by the public was included, not just the FHA debentures as currently, we would have to be more attentive and more formal in how we treat agency debt than we are now.

4. Social Security and Medicare Reform is linked to the budget process requirements of the Budget Enforcement Act and the Congressional Budget Act. We need to make these points:

- Budget Enforcement Act:

  - It currently expires for legislation enacted through 2002 (affecting PAYGO through 2006). It would need to be extended to continue to protect surpluses and to lock in cap increases.
  - The protections for Social Security (off-budget, exempt from sequestration) must be continued.
  - The discretionary caps should be increased, upon Social Security and Medicare reform.
  - The surplus needs to be defined, for BEA purposes, as excluding the Social Security and Medicare Lock-box transfers.
  - The PAYGO rules need to be waived on a one-time basis for the reform legislation so that the various related Administration initiatives (e.g., USA accounts) can be funded. The PAYGO rules would be extended for all other legislation.

- Congressional Budget Act:

  - Congressional rules protecting Social Security should be extended. For example, the Senate rules require 60 votes to override a point of order against any bill that would worsen the solvency of Social Security and against a reconciliation bill that would have any effect on Social Security.

  - The surplus needs to be defined, for CBA purposes, as excluding the Social Security and Medicare Lock-box transfers.

PRESIDENT CLINTON'S FRAMEWORK FOR SOCIAL SECURITY AND MEDICARE REFORM WHILE MAINTAINING FISCAL DISCIPLINE

- Overview Talking Points — Page 1
- One-Pager on the President's Proposal — Page 2
- Chart: the President's Proposal — Page 3
- One-Pager on Benefits of Debt Reduction — Page 4
- Chart: Interest Payments Due on Debt — Page 5
- Chart: Publicly Held Debt, 1980-2014 — Page 6
- David Broder, *The Greatest Gift to our Kids* — Page 7
- One-Page on Support for the President's Proposal — Page 8
- *Wall Street Journal*, "Greenspan Backs Clinton's Plan For the Surplus: Diverting General Revenues Toward Social Security Will Cut Debt" — Page 9
- Talking Points on Double Counting Issue — Page 10
- Jonathan Chait, *Washington Diarist: Doubletalk* — Pages 11-12
- The Case for Investing in Equities — Pages 13-16

FEBRUARY 1999

TALKING POINTS:
PRESIDENT CLINTON'S FRAMEWORK FOR SOCIAL SECURITY AND MEDICARE REFORM, WHILE MAINTAINING FISCAL DISCIPLINE

- **Investing the Surplus for Tomorrow: The President's Plan Reserves Nearly 90% of Surplus To Meet Long-Term Retirement Challenge.**

  - Rather than consuming the surplus for today, President Clinton's proposal reserves nearly 90 percent of the projected budget surpluses -- almost $4 trillion -- over the 15 years to meet our long-term retirement challenge.

  - President Clinton's proposal will pay down nearly $3 trillion of our national debt. As a result, the publicly held debt will be cut by more than two-thirds and, as a share of GDP, will fall from 44 percent today to 7.1 percent in 2014 -- its lowest level since 1917.

- **Continuing A Pro-Growth Strategy That is Working vs. Returning To The Failed Policies of Debt and Deficit: The President's Proposal Creates a Debt Reduction Lock-Box for Social Security and Medicare.**

  - In 1993, President Clinton and Congressional Democrats cut the deficit, helping create the longest peacetime economic expansion in history. President Clinton's plan will create a debt reduction lock-box for Social Security and Medicare. This is a pro-growth strategy -- maintaining fiscal discipline by cutting the national debt, which will result in higher national savings, lower interest rates, higher private-sector investment, and higher economic growth. We should <u>not</u> return to the failed policies of the 1980s that quadrupled the national debt and led to the highest deficit in the history of our country.

- **President Clinton Believes We Must Meet Obligations To Future Generations <u>First</u> -- By Reserving 77% of Surpluses for Saving Social Security and Strengthening Medicare.**

  - Republicans and Democrats agree that investing 62 percent of the surplus to strengthen Social Security is the right thing to do. Some -- even those who agree we should save Social Security -- would use the rest of the surplus for tax cuts. President Clinton believes we must meet our obligations to future generations first -- that is why must reserve 77 percent of the projected surpluses to save Social Security and strengthen Medicare. The President believes that anyone who hopes to spend the surplus -- on tax cuts or spending initiatives -- has an obligation to first tell America's families how they plan to preserve and extend the Medicare trust fund into the next century.

- **After We Save Social Security and Strengthen Medicare, We Should Provide Tax Relief for America's Families: President Clinton's Plan To Give Tax Credits for Retirement Savings in USA Accounts Will Mean Larger Tax Relief for Average Families Than The Republican Plan.**

  - The Republican tax scheme would disproportionately help the rich. According to the Citizens for Tax Justice, for the one percent of taxpayers making more than $301,000, the average tax cut would be $20,697 annually. But, for taxpayers making less than $38,000, a group that includes 60% of all taxpayers, the average tax cut under the Republican proposal would be $99 a year -- far less than the hundreds of dollars for average working families the President's USA Account proposal would provide.

SAVING SOCIAL SECURITY NOW, WHILE MEETING AMERICA'S CHALLENGES FOR THE 21st CENTURY

In His State of the Union Address, President Clinton Put Forward His Framework To Save Social Security and Strengthen Medicare, While Meeting America's Challenges for the 21st Century. The President and Vice President's framework strengthens Social Security and Medicare by:

- **Using The Budget Surplus To Help Save Social Security And Invest A Portion In the Stock Market To Seek Higher Returns.** The President proposes to transfer 62 percent of the projected budget surpluses over the next 15 years -- $2.8 trillion -- to the Social Security system. The President proposes to invest less than one-quarter of the transferred surpluses in the private sector to achieve higher returns for Social Security -- just as any state or local government, or private pension does -- after working with Congress to devise a mechanism to ensure that the investments are made independently and without political interference by private-sector managers with minimum administrative costs.

- **This Framework Will Save Social Security Until 2055 -- And the President Will Work With Congress To Save It Until At Least 2075.** Transferring over 60 percent of the surpluses to Social Security and investing a portion in the market will keep Social Security solvent until 2055. The President believes we must work on a bipartisan basis to make the hard-headed but sensible and achievable choices to save Social Security until at least 2075. As part of this effort, President Clinton believes that we must:

  (1) ***Reduce Poverty Among Single Women.*** Reduce poverty among elderly women -- particularly widows, who have a poverty rate nearly twice the overall poverty rate for older Americans; and

  (2) ***Eliminate The Earnings Test.*** Eliminate the confusing and out-dated earnings test so that we stop discouraging work and earnings among older Americans.

- **Strengthen Medicare for the 21st Century.** The President's framework reserves 15 percent of the projected surpluses for Medicare, securing Medicare until 2020. The President believes that the new resources should be utilized to achieve broader, bipartisan reforms that modernize Medicare, make it more efficient, provide for a long-overdue prescription drug benefit, and keep Medicare safe until 2020.

After Social Security and Medicare Reform Are Secured, President Clinton Proposes To:

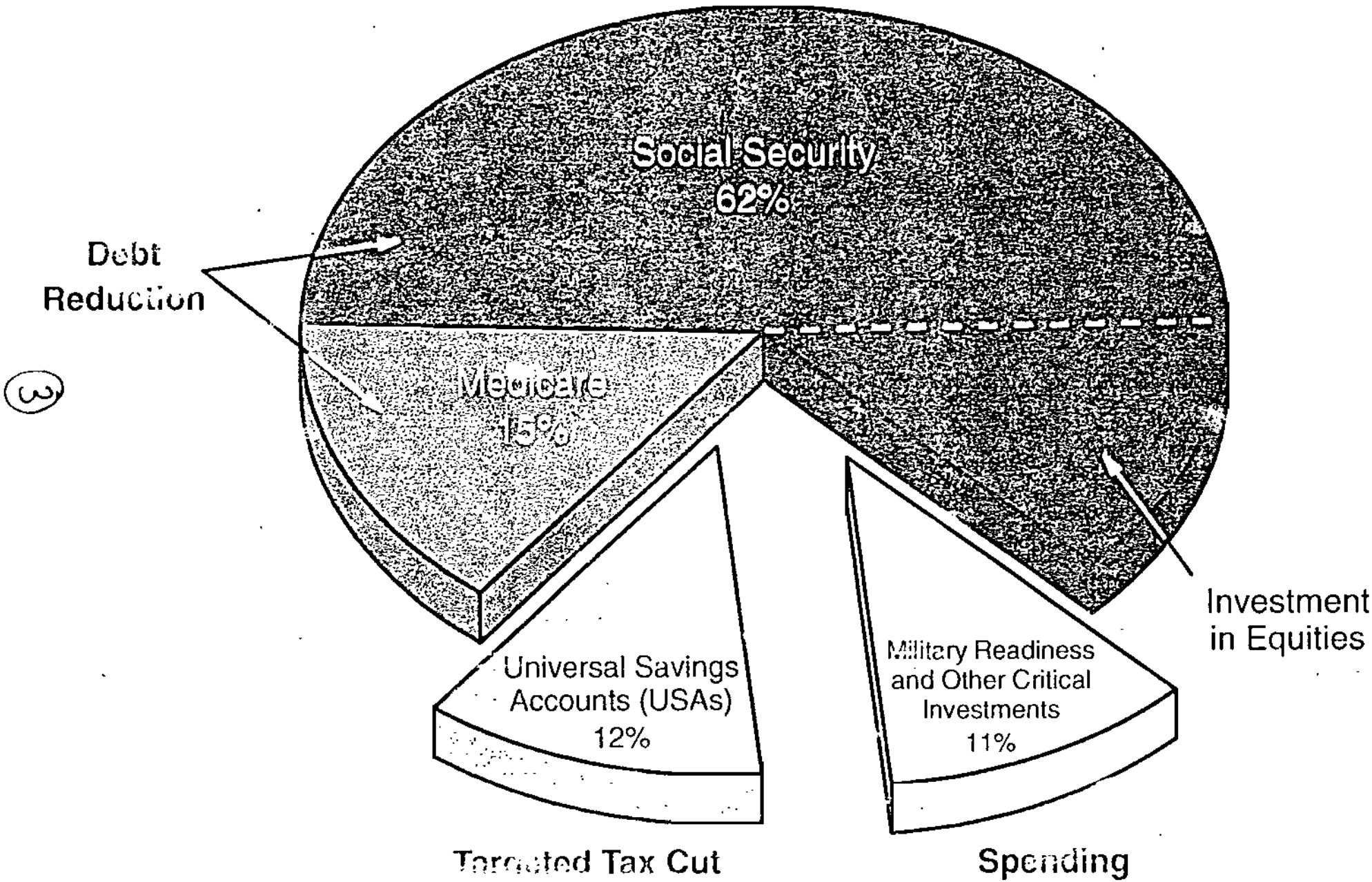
- **Provide $536 Billion in Tax Credits to Create New Universal Savings Accounts -- USA Accounts.** The President's framework will reserve 12 percent of the projected surpluses to create new Universal Savings Accounts (USAs) so working Americans can build wealth to meet their retirement needs. To help Americans save, we would provide Americans a flat tax credit to make contributions into their USA account. In addition, we would provide additional tax credits to match a portion of an individual's savings -- with more help for lower-income workers.

- **Prepare America for the Challenges of the Future.** The President's framework will reserve 11 percent of the projected surpluses for military readiness and other pressing domestic priorities.

A FISCALLY RESPONSIBLE PROPOSAL: PUBLICLY HELD DEBT FALLS TO LOWEST LEVEL SINCE 1917

- **Debt-to-GDP Ratio Will Fall to Lowest Level Since 1917.** As a share of the economy, the publicly held debt increased from 26% in 1981 to 50% in 1993. Since President Clinton took office, the publicly held debt as a share of GDP has dropped to 44%. And under the President's framework, the publicly held debt will be cut by more than two thirds, and, as a share of GDP, will fall from 44% today to 7.1% in 2014 -- its lowest level since 1917.

Framework for Social Security and Medicare Reform with Long-Term Fiscal Discipline



PRESIDENT CLINTON PRO-GROWTH STRATEGY: CUTTING THE FEDERAL DEBT TO ITS LOWEST LEVEL SINCE 1917

In the 1980s, The Federal Debt Quadrupled. Under Presidents Reagan and Bush, the debt held by the public quadrupled. As a share of GDP, the publicly held debt increased from 26 percent in 1981 to 50 percent in 1993. When the President took office, the debt-to-GDP ratio was projected to rise to nearly 80 percent by 2003.

Under President Clinton, America's Fiscal House Is Now In Order. Instead of sticking with the failed policies of debt and deficit, President Clinton put in place a bold, new economic strategy to cut the deficit, lower interest rates and spur economic growth. Today, we have the first budget surplus in a generation.

President Clinton's Proposal Will Cut Debt To Lowest Level Since 1917. As a result of President Clinton's fiscal discipline, the publicly held debt as a share of GDP has dropped from 50 percent in 1993 to 44 percent in 1998. Under the President's framework, the publicly held debt will be cut by more than two thirds and, as a share of GDP, will fall from 44 percent to 7.1 percent in 2014 -- its lowest level since 1917.

President Clinton's Strategy To Cut the Debt Will Help Strengthen the Economy, Cut Interest Payments, and Ensure that We Do Not Leave A Legacy of Debt to Our Children:

- **President Clinton's Strategy Is A Pro-Growth Strategy.** President Clinton's framework will cut the federal debt, thereby raising national savings by nearly 2 percent of GDP; Universal Savings Accounts will encourage saving even more. Higher national savings will mean lower interest rates, higher private-sector investment, and thus, higher economic growth in the future.

- **President Clinton's Strategy Will Cut Interest Payments on the Federal Debt.** When President Clinton took office, interest payments on the federal debt were projected to eat up 27 cents of every budget dollar by the year 2014. That would have made it almost impossible for future generations to make basic decisions about how the government should spend their money. Today, interest payments on the debt take up about 13 cents of every tax dollar. *Under the President's proposal, interest payments would shrink to just 2 cents on every dollar by 2014.*

- **President Clinton's Strategy Will Ensure That We Do Not Leave a Legacy of Debt to Our Children.** President Clinton's proposal would cut the debt held by the public, as a share of the economy, to 7.1 percent in 2014. This would mean that instead of leaving a mountain of debt for our children, we would completely eliminate the national debt by 2018.

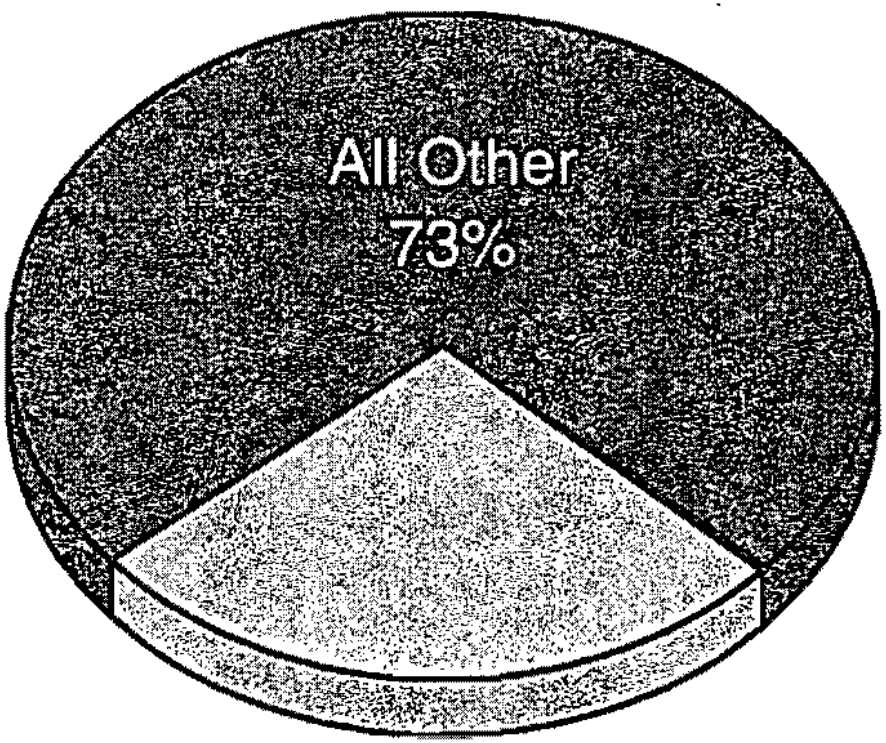
CUTTING THE NATIONAL DEBT IS RIGHT FOR AMERICA

- **Alan Greenspan, Federal Reserve Chairman, January 28, 1999:** "[I]ncreasing our national saving is critical. The President's approach to Social Security reform supports a large unified budget surplus. This is a major step in the right direction in that it would ensure that the current rise in government's positive contribution to national saving is sustained."

- **David Broder, "The Greatest Gift to our Children," *Washington Post*, February 7, 1999:** "[Saving on interest payments due on the national debt] illustrates the single biggest achievement -- and the most important virtue -- of the fiscal policy this government has pursued over the past six years, a policy which Clinton is wisely recommending be continued for the foreseeable future. Thanks to the budget decisions he has made -- some fiercely resisted by Republicans and others urged or embraced by them -- we have gone from confronting deficits as far as the eye could see to the prospect of large budget surpluses. This is a huge gain for ourselves and our children."

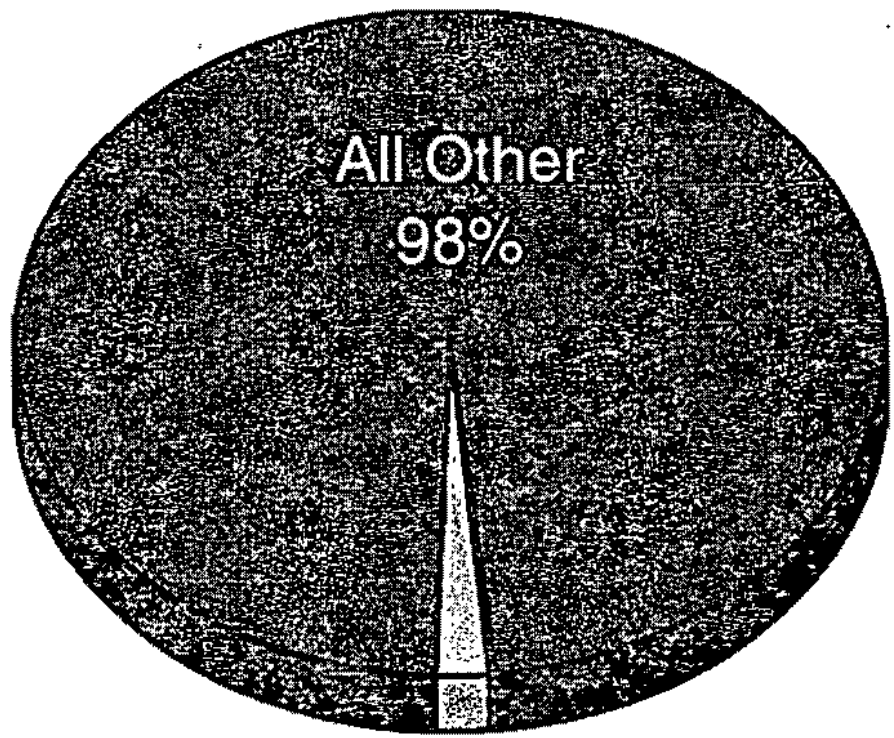
Interest as a Percent of Outlays in 2014

Pre-1993 Baseline



Interest
27%

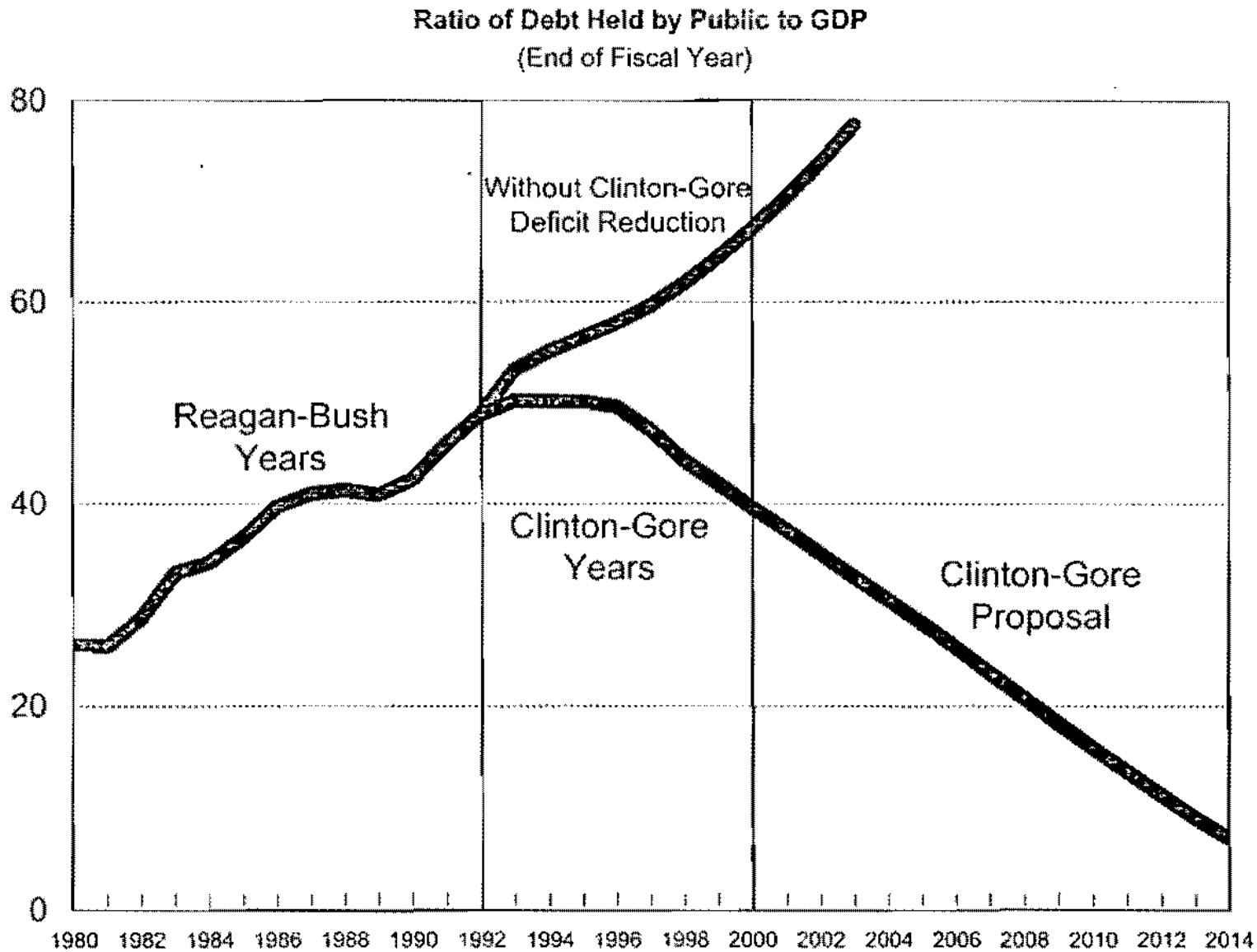
President's Proposal



Interest
2%

5

Investing The Surplus For Our Future: Cutting the Debt By More Than Two-Thirds



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David S. Broder

The Greatest Gift to Our Kids

A year ago, when President Clinton offered his federal budget, the estimate of fiscal 1999 interest payments on the national debt was a bit under $242 billion. Last week, one-third of the way through that fiscal year, the new budget estimated interest payments at just over $227 billion.

The almost $15 billion saving resulted from two things: a marvelous economy that generated more revenues for Uncle Sam than had seemed likely. And, second, the decision—urged by Clinton and endorsed last year by Congress—to save about 80 percent of the resulting budget surplus and use it to pay down the national debt, thereby reducing interest payments.

Now, saving $15 billion may not seem like much in a budget of $1.7 trillion. But let me tell you, it is equal to the whole 1999 budget of the National Institutes of Health, our pre-eminent medical research facility. It is more than the federal government will spend this year on Head Start and the main program of assistance to elementary and secondary schools. It is more than is budgeted for all of the environmental, conservation and land management programs of the government.

This illustrates the single biggest achievement—and the most important virtue—of the fiscal policy this government has pursued over the past six years, a policy which Clinton is wisely recommending be continued for the foreseeable future.

Thanks to the budget decisions he has made—some fiercely resisted by Republicans and others urged or embraced by them—we have gone from confronting deficits as far as the eye could see to the prospect of large budget surpluses.

This is a huge gain for ourselves and our children. In a time of rampant cynicism about government and politicians, this is one achievement for which Washington can take a bow. To be sure, the real heros and heroines are in the private economy, but politicians made hard decisions to restrain spending and resist huge tax cuts, without which these numbers would not have appeared.

For years, I wrote each February about "the fastest-growing item in the federal budget—interest payments on the national debt." I argued that this was the most wasteful of all expenditures, because those interest payments, drawn from current taxes, bought us not a single weapon or school lunch. It was money down the drain—or, more accurately, into the pockets of the bondholders, foreign and domestic.

And I often quoted Sen. Pat Moynihan of New York, who regularly warned that as long as these deficits piled on each other, year after year, interest costs would "rise geometrically," threatening the well-being of future generations.

But now we have broken out of that destructive pattern and entered into what Jack Lew, the director of the Office of Management and Budget, calls "a virtuous cycle." By saving the surplus and paying down the accumulated national debt, we reduce annual interest charges at an accelerating rate.

Here's an example. The budget submitted a year ago estimated interest costs for the following five years (fiscal '99 through '03) at $1.159 trillion. The new budget estimates interest charges for the next five years (fiscal '00 through '04) at $977 billion—a difference of $182 billion. That's enough to pay the salaries of everyone in the military for half that five-year period.

In the first year, the saving is $26 billion; in the fifth year, almost twice that, $48 billion. And it will continue to grow each year.

Now, I am not confident of long-term projections, because no one knows when we will hit an economic squall. But Lew told the Senate Budget Committee that if we stayed the course for 15 years, the national debt would shrink from half the size of the whole economy— which it was in 1992—to about 7 percent of the economy's size. Freeing them of the burden of debt would be, he rightly said, "one of the greatest gifts that we could ever give our children."

The Republican response is to divert much of the surplus into a 10 percent, across-the-board tax cut. Sen. William Roth of Delaware, the chairman of the Finance Committee, told Treasury Secretary Robert Rubin, "I find it incomprehensible that the president's plan would not allow for a wide-gauge tax cut in the next 15 years."

Rubin replied that the Treasury estimates that 35 percent of the benefits of such a tax cut would go to the top 1 percent of earners and two-thirds of the benefits to the top 20 percent—"the upper-income people who are, in all other respects, doing best in our society."

That's the essence of the budget debate: Save the surplus for our kids or let the rich spend more on themselves.

The Washington Post
Sunday, February 7, 1999

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SUPPORT FOR KEY ASPECTS OF PRESIDENT CLINTON'S PROPOSAL

- **Henry Aaron, Brookings Institution, January 27, 1999:** "The purpose of this note is to explain how the president's proposal would work from an accounting perspective. The message is simple: the double-counting issue is bogus. The president's address outlined a bold plan that stands in striking contrast to alternative proposals that would use the projected budget surpluses to justify large tax cuts or spending increases. Faced with a once in-a-generation choice about how to spend large and unanticipated surpluses, the nation should confront the big issue "save the surplus or spend it" and not get mired in accounting pettifoggery."

- **Alan Greenspan, Federal Reserve Chairman, January 28, 1999:** "In this light, increasing our national saving is critical. The President's approach to social security reform supports a large unified budget surplus. This is a major step in the right direction in that it would ensure that the current rise in government's positive contribution to national saving is sustained."

- ***Wall Street Journal*, "Greenspan Backs Clinton's Plan For the Surplus: Diverting General Revenues Toward Social Security Will Cut Debt," January 29, 1999:** "Federal Reserve Chairman Alan Greenspan defended President Clinton's plan to divert general revenues into Social Security suggesting that it may be the only politically possible way to use growing budget surpluses to pay down the national debt.... Mr. Greenspan called Mr. Clinton's plan for the surplus 'a major step in the right direction.'"

- ***New York Times*, "In the Red. No, Black. Debate Over Social Security Proposal Misfires in Focus on Double Counting," January 30, 1999:** "[T]he real difference between the President's plan and that of his critics is not double counting. Some critics want to use the surplus to cut taxes. Many Republicans want to use it to create individual retirement accounts.... The President wants instead to drive down the Federal debt, now about $4 trillion."

- ***Washington Post*, "Saving Budget," February 2, 1999:** "The government's long-run obligations continue to be much greater than the foreseeable revenues. The mostly conservative fiscal position that the president has staked out is correct."

- **Jonathan Chait, "Who's Fiscally Responsible Now," *New York Times*, January 25, 1999:** "The political genius of Mr. Clinton's plan is that it marries good policy with good politics. This used to be what Republicans called responsible budgeting. How sad that they now see it as unacceptable."

Greenspan Backs Clinton's Plan For the Surplus

Diverting General Revenues Toward Social Security Will Cut Debt, He Says

By JACOB M. SCHLESINGER
Staff Reporter of THE WALL STREET JOURNAL

WASHINGTON—Federal Reserve Chairman Alan Greenspan defended President Clinton's plan to divert general revenues into Social Security, suggesting that it may be the only politically possible way to use growing budget surpluses to pay down the national debt.

Republicans have stepped up criticism of the White House Social Security plan in recent days, focusing on its reliance on a massive transfusion of new tax revenues to extend the Social Security trust fund by 23 years to 2055. Currently, Social Security is funded by payroll taxes.

Internet Exuberance?

Fed Chairman Greenspan told Congress that Internet-stock mania is like buying lottery tickets. Article on page C1.

At a Senate Budget Committee hearing, Chairman Pete Domenici of New Mexico blasted Mr. Clinton's plan as "an elaborate game" of "accounting shifts" that will "undercut efforts to achieve real reform." Mr. Domenici noted that in prior bipartisan studies of the retirement program, one of the few points of consensus was opposition to using general revenues.

But Mr. Domenici and other Republicans were unsuccessful in repeated attempts to draw Mr. Greenspan into attacking Mr. Clinton's plan. Mr. Greenspan has in the past opposed using general revenues to fund Social Security and indicated yesterday that he wasn't happy about the idea now. But he implied that Mr. Clinton's plan—which essentially marries future Social Security commitments to current budget surpluses—may be the best political means to an end that Mr. Greenspan strongly supports: paying down the national debt of $3.8 trillion held by the public.

The notion that Congress could rally enough support to pay down debt without such a gimmick "may be totally unrealistic," Mr. Greenspan said, adding that Mr. Clinton's approach may be a "second-best" way to accomplish that goal.

The heart of the complex debate is what Washington should—and can—do with budget surpluses that the White House estimates will total $4.4 trillion in the next 15 years.

Many economists, most notably Mr. Greenspan, feel the money should be used to pay down debt, which they say will lower interest rates, raise national savings and investment, and boost long-term growth rates. Mr. Greenspan called Mr. Clinton's plan for the surplus "a major step in the right direction."

Republicans don't necessarily disagree. But they contend it is unrealistic to expect Washington to sit on surpluses for many years without boosting spending or cutting taxes. "If I look out there and look at Congress, they are going to spend it," Sen. Domenici said. So, he and other Republicans prefer a big tax cut. On that point, they won Mr. Greenspan's qualified endorsement. He repeated his oft-stated view that if the government can't protect surpluses, it is better to cut taxes than increase spending.

Republicans are increasingly vocal in opposing the complex way that Mr. Clinton does pay down the debt. The Clinton plan would use about $2.5 trillion to pay down debt. For every dollar of debt paid down, Mr. Clinton would give an extra dollar of IOUs to the Social Security trust fund to pay for benefits from 2032 to 2055. Under that scenario, those benefits would essentially be paid out of general revenues.

Despite his praise for parts of Mr. Clinton's Social Security plan, Mr. Greenspan agreed with critics that it doesn't do much to solve the long-term cost problems. Mr. Clinton's proposals avoid any painful changes, and Mr. Greenspan said that ultimately, "in all likelihood . . . taxes will have to be raised, or benefits cut." Mr. Greenspan also cautioned against assuming that the White House's rosy estimates for surpluses will actually materialize.

In his testimony, Mr. Greenspan also reiterated his opposition to another portion of the Clinton Social Security plan that drew the most attention when the package was first unveiled last week: investing some of the trust fund in the stock market. "Even with Herculean efforts, I doubt it would be feasible to insulate, over the long run, the trust funds from political pressures," the Fed chairman said.

THE WALL STREET JOURNAL

FRIDAY, JANUARY 29, 1999

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TALKING POINTS ON DOUBLE COUNTING AND DEBT

- **When You Strip Away All of the Accounting Rhetoric, the President's Plan Does Two Things:**

  (1) Between now and 2014, the President's plan will cut the publicly held debt by more than two thirds, increasing national savings and strengthening our economy to make it easier for us to meet our retirement challenge and other national priorities.

  (2) It gives Social Security first claim on the benefits of debt reduction (by giving new bonds to the trust fund).

- **That Is Why Fed Chairman Alan Greenspan and Top Experts Support the President's Approach to Debt Reduction:**

  - **Henry Aaron, Brookings Institution, January 27, 1999:** "The message is simple: the double-counting issue is bogus. The president's address outlined a bold plan that stands in striking contrast to alternative proposals that would use the projected budget surpluses to justify large tax cuts or spending increases."

  - **Alan Greenspan, Federal Reserve Chairman, January 28, 1999:** "In this light, increasing our national saving is critical. The President's approach to social security reform supports a large unified budget surplus. This is a major step in the right direction in that it would ensure that the current rise in government's positive contribution to national saving is sustained."

- **The President's Plan Takes Advantage of Our Current Good Times to Set Aside Resources So That We Can Meet Our Existing Obligations.** We already have an obligation to current workers to pay them benefits when they retire, even if they retire in years after 2032. The President's plan does not increases these commitments. Instead, it sets aside resources so that we can meet our existing obligations.

- **Under the President's Plan, We Have the Ability to Pay Benefits Through 2032 and Beyond:** When President Clinton took office in 1993, deficits were exploding and there were serious concerns about how we were going to be able to pay back the Social Security trust fund when it began redeeming its bonds. Because of the fiscal discipline and tough choices of the past six years, the Clinton Administration is projecting budget surpluses, <u>even after paying back Social Security</u>, until the middle of the next century.

- **The President's Plan Follows the Same Accounting That Has Been Used by Every U.S. Administration since the Johnson Administration.** Since the Johnson Administration, the Social Security surplus has been part of the unified budget surplus, and has been used a second time, almost always for new spending. Many Republicans have called for the surplus to be used a second time for tax cuts, to fund individual accounts, or to pay for the transition to an individual account system. The President's plan uses the surpluses for debt reduction, and to extend the life of the Social Security and Medicare trust funds.

- **The Bottom Line Is Clear: The President's Plan Will Cut the Debt and Keep America's Economy Strong.** Regardless of any claims offered by opponents, the President's plan will cut the debt held by the public by more than two thirds, and as a share of the economy it will fall to its lowest level since 1917. This will raise national savings, lower interest rates, and help keep America's economy strong. The President's plan will lower the burden faced by our children and grandchildren, and leave the country better able to meet the challenges of an aging population.

THE NEW REPUBLIC

A Weekly Journal of Opinion

February 22, 1999

Washington Diarist: Doubletalk

By Jonathan Chait

The most irritating thing about newspapers is their convention of presenting disagreements on matters of fact as nothing more than differences of opinion. Recently, a city official here resigned because he used the word "niggardly." A Washington Post story reported that the word "means different things to different people." Most of the Washingtonians quoted felt it could be taken as a slur, but others did not. And who is the Post to say which side is right? The same day, another Post story reported that President Clinton's Social Security plan is in trouble; it is widely thought to be a "budgetary sleight-of-hand that actually has the effect of counting twice the money that would have gone into the program anyway." Now, it is either double-counting or it isn't, but the article did not delve into the merits of the accusation. Instead it focused on the fact that "serious questions are surfacing."

The question surfaced, among other places, in an article in last week's tnr by Matthew Miller. For those who missed it, Miller assumes the following scenario: The budget surplus is $150 billion, of which $100 billion comes from the leftover Social Security taxes that weren't used to pay for current benefits. That $100 billion goes into the Social Security trust fund. Then Clinton takes 60 percent of the total budget surplus--$90 billion--and gives it to the trust fund. That means the trust fund gets a total of $190 billion. Since this is more than the total value of the budget surplus, Miller concludes that Clinton's plan "double-counts" and is also a "scam," "legerdemain," and a good dozen other synonyms.

I admit it looks strange. But there's a perfectly decent explanation. Suppose that I loan you a dollar, and you promise to pay me back with interest. The Chait trust fund is now worth one dollar. Then, out of the goodness of your heart, you decide to give me back the same dollar as a gift. Now I am worth two dollars: the dollar I have, plus the dollar you still owe me. Clinton's proposal works the same way. Social Security brings in an extra dollar that it doesn't need this year. It loans the dollar to the rest of the federal budget, and in return the federal government deposits an IOU for one dollar in Social Security's trust fund. (The trust fund is an accounting device to keep track of all the dollars Social Security has loaned out.) Now the extra dollar belongs to the non-Social Security budget, and the government can spend it any way it wants. Clinton proposes giving that dollar-- 60 cents of that dollar, actually, but let's keep it simple--back to the Social Security trust fund. Then the trust fund takes the dollar and purchases a $1 federal bond from the general public. Hence, it has increased its value by more than the value of the budget surplus.

In case it sounds like I'm trying to pull a fast one, let's ponder those two transactions in turn. The first part simply involves lending the Social Security surplus to the general budget. This resembles double-counting in the sense that the money credited to the trust fund can also be used for other purposes. Yet, while the outcry in the press might make you think that Clinton invented this tactic, every federal budget has done this for decades. Indeed, the very same Republicans who are denouncing Clinton--including self-proclaimed budget hawks such as John Kasich and Pete Domenici--have themselves proposed using the budget surplus, made up largely of Social Security funds, to pay for new tax cuts or private retirement accounts.

The only new element is what Clinton proposes to do with the money after Social Security lends it to the general budget. The general budget gives most of the money right back to the

trust fund as a grant, not a loan. The trust fund takes about 15 percent of the money and gives it to an independent board to invest in stock indexes. (This part is also controversial, but I won't get into it right now.) It invests the rest of the money in Treasury bills, thus reducing the national debt. Again, this might appear suspicious--how can you use the same dollar to reduce the national debt and bolster the Social Security trust fund? The answer is that it has the same economic effect as reducing the national debt. Right now there are millions of Americans who own federal bonds--IOUs for money they've lent to Uncle Sam. When the trust fund buys up some of those bonds, the public then can use the money to spend or invest in the private sector. To the extent the money is invested in efficient new productive capacity, it strengthens the economy over the long run. Also, by reducing the debt it owes to the public, the government increases its ability to borrow in the future. The only twist is that Clinton's plan guarantees that the benefits of this saving accrue to Social Security. If this still strikes you funny, consider an alternative scenario. If Clinton took the Social Security portion of the budget surplus and spent it all on tax credits or child care or wild parties in the Oval Office, the money would still be credited to the trust fund. So, if he instead saves the money for Social Security, shouldn't the trust fund reflect the difference?

One common objection is that bolstering the trust fund cannot work because it accumulates nothing but IOUs. But the debtor on those IOUs is the United States government, the safest credit risk in the history of civilization. And the creditors are future Social Security recipients, who demonstrate roughly the same level of forgiveness toward missed payments as a loan shark from the Gambino family. Anyway, this isn't a reason to oppose Clinton's plan, which boosts the government's capacity to make good on future debts.

But Miller doesn't claim the trust fund won't be there. Instead he argues that Clinton is simply pulling money out of the sky. The "logical extension" of the Clinton plan, he writes, is "to use the same accounting trick to boost the trust fund a few extra trillion and announce that Clinton had put the Social Security problem behind us altogether." He's arguing, in other words, that Clinton's plan would have allowed him to add as much money as he wanted to the trust fund. But this is simply not the case. The most Clinton could have put into the trust fund is twice the surplus. This is a fact, not an opinion.

The president's idea might not be in so much trouble, then, if Congress and the media actually understood it. But, then again, maybe it wouldn't matter. Upon hearing that "niggardly" derives from Middle English and Scandinavian dialects, one offendee shrugged: "Do we really know where the Norwegians got the word?" Yes, maybe they anticipated that, centuries hence, the word "nigger" would become a slur in English and then subsequently become socially unacceptable, so they preemptively sneaked a similar-sounding word into the language. All I know for sure is that serious questions are surfacing.

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THE CASE FOR INVESTING PART OF THE UNIFIED SURPLUSES IN EQUITIES

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

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

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

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

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

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

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

WHY INVEST PART OF THE SURPLUSES IN EQUITIES?

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

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

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

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

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

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

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

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

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

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

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

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

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

- Management fees are extremely important in determining the buildup of assets. A fee of one basis point paid every year for 40 years would reduce the accumulated balance by only about 0.4 percent. By contrast, a fee of 100 basis points would reduce the accumulated balance by about 33 percent.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

THE WHITE HOUSE

WASHINGTON

February 3, 1999

SPEECH TO AARP NATIONAL LEGISLATIVE COUNCIL

DATE:	February 3, 1999
LOCATION:	The Willard Hotel
BRIEFING TIME:	1:00 pm - 1:25 pm
EVENT TIME:	1:40 pm - 2:30 pm
FROM:	Gene Sperling Ben Johnson

I. PURPOSE

To underline the importance of investing the surplus to meet America's long-term challenges. In particular, Republicans in Congress have essentially acceded to your demand that we reserve 62% of the surplus for Social Security. While they continue to press for more military spending, they have allocated virtually the entire 38% of the surplus for an across-the-board tax cut. You will speak to AARP about why it is important that we dedicate some of that surplus to Medicare. Without new funding, the changes we need to make to restore Medicare's solvency would be severe. That is why we should balance our need for tax cuts (USA accounts) with the need to do more to strengthen and protect Medicare.

II. BACKGROUND

AARP, the largest and most influential senior organization, is convening its annual National Legislative Council in Washington this week. AARP's National Legislative Council, composed of 43 volunteer leaders from across the country, meets annually to establish the Association's public policies for the coming year. The group's recommendations will be reviewed and approved by the AARP Board of Directors. Social Security and Medicare have dominated most of the Council's discussion.

AARP continues to maintain a non-partisan posture on many issues. AARP says the Administration's budget proposal contains several intriguing proposals to address the future retirement security needs of the boomers:

- They look forward to seeing and exploring the all-important details of the Social Security proposal, especially its effect on reducing the public debt.

- On our Medicare proposal, they say the reductions should be scrutinized to ensure that they will not jeopardize beneficiaries.

- They support your USA accounts proposal as a creative approach that merits further discussion. They are pleased with our Long Term Care Proposal as an important first step.

AARP President Joseph Perkins will thank you for participating in their National Legislative Council, reaffirm AARP's support to continue a national dialogue on Social Security and Medicare, and to strengthen the prospects for a healthy and financially secure retirement.

At this week's annual meeting (February 1-5), AARP's Council has been addressed by Janet Yellen, Representatives Richard Gephardt, Jim McDermott, Bill Archer and Bill Thomas, and Senators Phil Gram and John Breaux, among others.

You have spoken to AARP national Legislative council in 1993, 1996, and 1997. Vice President Gore addressed the Council last year.

III. PARTICIPANTS

Pre Brief Participants
Gene Sperling
Chris Jennings
Barbara Woolley

Event Participants
YOU
John McManus, Chairman, AARP National Legislative Council
Joe Perkins, President, AARP
Tess Canja
Margaret Dixon
John Rother
Judith Kenyon
Kevin Donnellan
Grant Midgley
Marcy Creque
Walter Young
Ben Cook
Virginia Tierney
Hyman Kuntz
Mary Evanson
Oliver Coleman
Ross Webb
Pete Kelley
Irv Howards
Ray Stomer
Barbara Dickman
Donnis Thompson

Peter Szego
Mary Jane Phillipe
Otto Shultz
John Herman
Ruth Blacker
Bart Fields
Bill Iuto
Marle Sonderman
Gene Forrester
Wilma Cosper
David Stucki
Jane Baumgarten
Nellie Fox-Edwards
Jack Albert
Erma Cunningham
Bill Mikell
Ann Weber
Jose Gandert
Phyllis Baritz
Keith Campbell
Elda Davila
Dot Grames
Ken Huff
Mary Jane O'Gara
Mary Scott
Maury Weiner

IV. PRESS PLAN

Open Press.

V. SEQUENCE OF EVENTS

- **YOU** will be greeted by John McManus, Chairman, National Legislative Council; Joseph Perkins, President; Esther Canja, President-Elect; Horace Deets, Executive Director; Margaret Dixon, Immediate Past President; Kevin Donnellan, Director, Advocacy and Management.

- Off-stage announcement of **YOU** accompanied by John McManus and Joseph Perkins.

- John McManus, Chairman, AARP National Legislative Council, proceeds to the podium, welcomes and introduces Joseph Perkins.

- Joseph Perkins, President, AARP, makes remarks and introduces **YOU**.

- **YOU** will make remarks and depart.

VI. REMARKS

Provided by Speech writing.

VII. ATTACHMENTS

- Medicare principles fact sheet
- Seating Chart
- Bio on Joseph Perkins, President, AARP
- Bio on John McManus, Chairman, AARP National Legislative Council

DRAFT: PROPOSAL TO DEDICATE THE SURPLUS TO MEDICARE AND PRINCIPLES FOR MEDICARE REFORM

February 2, 1999

- **Highlight the need for the surplus for Medicare.** In a speech to the American Association of Retired Persons (AARP), you will underscored the need to dedicate 15 percent of the surplus to secure the Medicare Trust Fund until 2020 and to contribute to broader reforms that further strengthen the program.

  - **Competition, efficiency and traditional savings alone cannot secure Medicare.** If reductions in growth alone were relied on to extend the life of the Medicare Trust Fund, spending growth per beneficiary would have to be reduced to 2.8 percent per year -- in every year -- to get to 2020. This rate is over 60 percent below projected private health insurance spending per person (7.3 percent). This would represent a real cut, since this growth rate is below general inflation; the value of Medicare spending per beneficiary would erode, and be 10 percent below today's spending level by 2020. This explains why every independent health analyst agrees that Medicare cannot be strengthened without adding new revenues such as the surplus

- **Principles for Medicare reform.** You will also underscore the intention that the surplus be part of a broader reform package. Such a reform package should:

  - **Dedicate Surplus to Secure Medicare until 2020.** One of the fundamental goals of Medicare reform is to put this program on firmer financial footing to better prepare it for the demographic and health challenges of the next century. These challenges cannot be addressed solely by program efficiencies, transferring current liabilities out of the Trust Fund, or increased beneficiary payments. The President proposes to use 15 percent of the projected surpluses over the next 15 years to secure the Medicare Trust Fund until 2020 and to contribute to broader reforms that further strengthen the program.

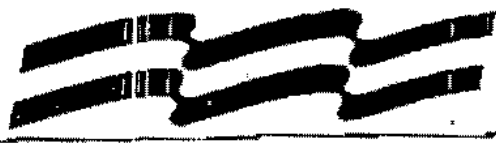
  - **Modernize Medicare and Make It More Competitive.** Medicare should adopt the best management, payment, clinical and competitive practices used by the private sector, to help maintain high-quality services and keep spending growth in line with the private spending. Strong and effective Federal administration of Medicare should be assured.

  - **Guarantee Defined Set of Benefits Without Excessive New Costs to Beneficiaries.** The entitlement to an adequate set of health benefits should be maintained. A modernized, well-defined benefits package is needed for informed competition among Medicare's health plan options. Reforms should also guarantee that current low-income protections are maintained or strengthened, and that any new cost burden is not excessive.

  - **Use Savings from Reform to Help Fund a Prescription Drug Benefit.** Additional savings from making Medicare more efficient should be used to help finance a long-overdue prescription drug benefit. Millions of Medicare beneficiaries have no or inadequate coverage for their medications, limiting their access to needed treatments. Prescription drugs have become an essential part of treatments and cures, and are expected to play an even greater role in health care in the next century.

	Peter Szego	Mary Jane Phillipe	Otto Shultz	John Herman	Ruth Blecker	Bart Fields	Bill Ido	Marie Sonderman	Gene Forrester	Wilma Cosper	David Stuckl	Jane Baumgarten
Dennis Thompson												Nellie Fox-Edwards
Barbara Dickman												Jack Albert
Ray Stomer												Erma Cunningham
Irv Howards												Bill Mikell
Pete Kelley												Ann Weber
Ross Webb												Jose Candert
Oliver Coleman												Phyllis Bartlz
Mary Evanson												Keith Campbell
Hyman Kurtz												Elida Davila
Virginia Tierney												Dot Grames
Ben Cook												Ken Kuff
Walter Young												Mary Jane O'Cara
Marcy Creque												Mary Scott
Grant Midgley												Maury Weiner
			John Bother	Margaret Olson	Joe Perkins	Tess Canja	podium	John McManus	Judith Kenyon	Kevin Donnellan		

AARP NEWS



For further inquiry, contact AARP Communications
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(202) 434-2560 • Fax: (202) 434-2588 • www.aarp.org

BIOGRAPHIC SKETCH

* MR. PERKINS WILL INTRODUCE THE PRESIDENT

JOSEPH S. PERKINS

PRESIDENT
AMERICAN ASSOCIATION OF RETIRED PERSONS

Joseph S. Perkins of Danvers, MA, was elected Vice President of AARP at the 1994 Biennial Convention. He succeeded automatically to the position of President-elect in 1996 and became President at the 1998 Convention. In addition to his responsibilities as President, Mr. Perkins serves on the Board Finance Committee and the National Legislative Council. He also is a member of the AARP Andrus Foundation Board of Trustees and the AARP Business Partnerships Advisory Council.

As President-elect, Mr. Perkins served on the AARP Executive Committee, the Board Finance Committee, and the Board Committee on Human Resources. He also was a member of the National Legislative Council and vice chair of the AARP Andrus Foundation Board of Trustees. During his term as Vice President, Mr. Perkins served on the board of trustees of the AARP investment program from Scudder and the board of councilors of the Ethel Percy Andrus Gerontology Center at the University of Southern California. He was a trustee of the AARP Group Health Insurance Trust, a board observer of the AARP Pension/Welfare Trust, and a member of the AARP Business Partnerships Advisory Council.

Mr. Perkins currently serves on the board for Operation ABLE (Abilities Based on Long Experience) and the Advisory Council of the Foster Grandparent Program for Greater Boston.

-MORE-

He recently completed a four-year term on the Pension Benefit Guaranty Corporation Advisory Committee and on the national board of directors of the Alzheimer's Association. He also served on the board of directors of the International Society for Retirement Planning, was a founding member and president of the New England Retirement Planners Council, and volunteered for Project RAP, a crisis-intervention counseling service for four years.

Mr. Perkins retired in 1994 as the corporate retirement manager for Polaroid Corporation. Prior to entering this field, he was a practicing industrial engineer.

AARP is the nation's leading organization for people 50 and over. It serves their needs and interests through legislative advocacy, research, informative programs, and community services provided by a network of local chapters and experienced volunteers throughout the country. The organization also offers members a wide range of special membership benefits, including Modern Maturity magazine and the monthly Bulletin.

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Editors: Photos of Mr. Perkins and further information on AARP are available from Communications (202) 434-2560.

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Podesta

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THE WHITE HOUSE

WASHINGTON

February 5, 1999

THE PRESIDENT HAS SEEN
2-7-99

MEMORANDUM FOR THE PRESIDENT

FROM: GENE SPERLING

SUBJECT: NEC WEEKLY REPORT

cc: JOHN PODESTA

Steel Update: Last week, Commerce released December 1998 steel import data -- 20 days earlier than the normal release date. The new numbers provide strong evidence that our strategy of vigorous enforcement of our trade laws and strong bilateral pressure is working. Imports of steel from all countries *decreased* 32 percent in December. Imports of hot-rolled steel from all countries declined 67 percent in December, while imports of these products from Japan and Russia decreased 77 percent and 90 percent respectively. You should know that Commerce is expected to release preliminary dumping determinations next Friday and they are finalizing suspension agreement negotiations with Russia at about the same time. We are honing strategies to prevent surges in other steel products and from other major exporting nations, including Korea. John Podesta and I will chair a principals meeting on this and our overall steel strategy on Tuesday. You should know that the industry plans to file a dumping case on steel plate, another major steel product, against Japan, Korea, and several other nations within two weeks -- this information is not public and is market sensitive.

Community Reinvestment Act: Your strong comments on CRA to the U.S. Conference of Mayors last Friday provoked a letter from Senator Gramm. "Mr. President," he wrote, "CRA is not under attack; bribery is." Gramm complains of "an unsavory practice in which protestors file official complaints . . . and pursue them until they are paid by the banks to stop protesting." His solution: make it a felony to make payments or commitments in connection with a CRA complaint. His amendment is so broad that it could chill bona fide relationships between banks and community groups by frightening banks that their community commitments could result in criminal liability. We are working with the DPC and Treasury on a response. In addition, it seems as though Gramm is working on a series of CRA amendments he wants to address in either Financial Modernization legislation or a stand-alone CRA "reform" bill. The NEC and DPC will send you a background memorandum on these issues shortly.

Social Security Update: On Monday (2/1), Larry Stein and I met with Senator Conrad to discuss your Social Security plan. Karen Tramontano and I also met with Alan Reuther of the UAW and Gerry Shea from AFL-CIO. On Tuesday (2/2), I hosted a principals meeting where we discussed USA accounts. On Wednesday (2/3), Ken Apfel, Larry Summers and I briefed the House Democratic Budget group and I also spoke at the AFL-CIO's social policy committee meeting. On Thursday (2/4), Robert Rubin and I met with Bob Denham, former Chairman of Solomon Brothers Smith Barney to discuss your balanced budget and your Social Security

reform plan. As you may recall, Bob was one of the 12 CEOs who endorsed your 1993 budget early on. On Friday (2/5), Larry Stein and I met with Senator Grassley on Social Security. I also met with House and Senate leadership, Chiefs of Staff and Policy staff to discuss message ideas and strategy. In addition, I met with representatives from a number of women's groups to discuss your Social Security plan. Next week, they will be sending me a list of their key issues and concerns on Social Security reform.

We are continuing an active outreach strategy for validators and have been encouraging experts to write op-ed pieces supporting your plan. In addition, we are collecting names of economists supporting your plan, including 5 Nobel prize winners. This week, the Social Security working group continued to develop a legislative version of your Social Security package and USA accounts.

Agriculture: Following up on your pledge in the State of the Union to work on crop insurance reform, Secretary Glickman announced -- as part of his budget roll-out Monday, 2/1 -- several principles that any crop insurance legislative proposal would have to meet: maximize participation in the program, comprehensive coverage, flexibility, use of market mechanisms; and lowest cost to both farmers and taxpayers. He also provided preliminary proposals -- in very general terms -- to meet these objectives; these had been approved at a deputies level inter-agency meeting chaired last summer by Sally Katzen. Secretary Glickman's announcement was well received. The next step is to announce a series of regional forums around the country for us to listen to farmers and ranchers; we will first clear the schedule with interested members in Congress. Meanwhile, the NEC-led interagency group is continuing its work on concentration and alleged anti-competitive practices in the pork industry; we expect to have a report with recommendations by the end of next week.

School Construction and Davis-Bacon: As you know, last year's school construction proposal was silent on Davis-Bacon and our position was that it would not apply. You were asked to take another look at this issue, and Karen Tramontano has asked Sally Katzen to lead an NEC process to do so. Adding Davis-Bacon raises a range of difficult issues, such as administrative feasibility, tax policy precedent, and the impact on the probability of passing your school construction proposal. We are working on these issues to inform your decision. In the mean time, there are a number of bills being introduced that do not include Davis-Bacon. In response to inquires, for now we will take a neutral position.

Internet Tax Commission: You should know that the commission created as a result of the Internet Tax Freedom Act has not met because of the controversy over its composition. Because appointments were made by House and Senate leadership without coordination, they are not consistent with the statutory requirements for a balance between industry and state and local representatives. The "Big Seven" groups are very concerned about the imbalance -- which is in industry's favor -- and that many of the state and local representatives that were chosen are opposed to Internet taxation (e.g. Governor Gilmore). NEC, OVP, and IGA will continue working with the Big Seven, industry, and House and Senate leadership to see if this can be resolved.

THE PRESIDENT HAS SEEN
2-7-99

Medicare Commission Update: The public meeting scheduled for Tuesday (2/9) has been indefinitely postponed, in part because Senator Breaux is trying to decide on next steps. It has become apparent that the plan that he put out on January 22 does not have the 11 votes needed for passage. This is largely due to its vagueness. On Tuesday (2/2), Congressman Dingell sent a letter to Senator Breaux, signed by all Democratic appointees except Kerrey, expressing concerns about its lack of details and the need for analysis. It also pointed out the importance of making the plan consistent with Democratic principles, similar to those you outlined at AARP on Wednesday. All of your Commission appointees and the Democrats -- including Senator Breaux -- were grateful for your remarks, since they help ground the debate. As the Commission's March 1 deadline approaches, we will keep you apprised of developments and seek your guidance on how to proceed.

Hearing on Disability Bill: On Thursday (2/4), there was a hearing on the Jeffords-Kennedy-Roth-Moynihan Work Incentives Improvement Act that you included in your budget. There is growing bipartisan support for the bill, which was introduced last Thursday (1/28) with 40 co-sponsors, including about a *dozen* Republicans. Senator Kennedy, in his remarks, thanked you for your support of the legislation, your mention of this important issue in the State of the Union, and your other disability initiatives (tax credit, assistive technology increase, and long-term care initiative). Senator Dole, who also testified, made an appeal to the Republicans. He said that this is about "big government, but good government" in response to the prevalent criticism that this is an entitlement expansion. Tommy Thompson's Secretary of Health also testified in strong support of the bill. The bill is slated for a mark-up in the Finance Committee in early Spring, and we believe that Nancy Johnson and Ben Cardin will introduce it in the House.

Y2K Liability Reform: A coalition of industry groups (including high tech and insurance companies, the National Association of Manufacturers and the U.S. Chamber of Commerce) announced this week they have developed a consensus legislative proposal to limit legal liability stemming from Y2K computer problems. The bill includes caps on punitive damages and attorneys fees, limits on joint and several liability, and other elements familiar from product liability battles. The plaintiffs' bar and consumer groups will strongly oppose the measure. The high-tech industry is already signaling to us that they care only about the more "moderate" elements of the bill and could sacrifice portions driven by their colleagues' ideological views on tort reform. However, it is possible that some of the "moderate" elements of the bill will be difficult for us to support. The NEC is leading a working group with DoJ, Commerce, WH Counsel, OVP, and the Y2K Council to develop an Administration approach to these issues.

Strategic Petroleum Reserve: The Department of Energy (DOE) recently developed a proposal to replenish the 28 million barrels sold from the strategic petroleum reserve (SPR) in recent non-emergency sales. Initially, several economic agencies, including CEA and Treasury, expressed concern that the proposal might be presented or perceived as an attempt to support the oil industry by trying to raise the price of oil. Ron Minsk, of my staff, led an interagency process. The consensus view was that we should support Energy's proposal, but should characterize it as an opportunity to demonstrate good management and stewardship of the SPR by replacing oil supplies while prices are low. Energy will explicitly acknowledge that the decision is neither intended nor expected to have any effect on prices, and that this action will enhance our national/energy security. I plan to phone Secretary Richardson (and Senator Bingaman) over the weekend to convey the decision, and expect that Energy will make a public announcement soon.

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Trade Legislation -- Africa: The House Ways and Means Subcommittee on Trade approved the Africa Growth and Opportunity Act by a unanimous vote. Secretary Daley testified. Full committee action may occur as early as next week. At the hearing, Rep. Jesse Jackson, Jr. outlined an alternative bill which emphasized deep debt relief and a reallocation of part of China's textile and apparel import quota bill to Sub-Saharan African countries. In response to questions about the Jackson bill, our position has been to reiterate our strong support for the Rangel-Crane bill, but to say that we are open to working with everyone -- including Jackson -- who wants to assist in Africa's economic development.