November 5, 1998

MEMORANDUM FOR THE PRESIDENT

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SUBJECT: State of the Union/Budget Ideas

This memorandum provides a brief description of new ideas we are considering for the State of the Union. Some work has been done on fleshing them out, but many need additional work and further vetting through the interagency process. Most of these ideas involve increased spending, and you will have to make choices among them and/or scale them back as you consider the FY 2000 budget. Although our offices have worked together on many, if not most, of the ideas in this memo, we have noted, where possible, which of our offices has the lead role with respect to each proposal. Options relating to Social Security are not included in this memo.

EDUCATION AND TRAINING (DPC/NEC as specified)

1. Ending Social Promotion. Last year's budget proposal included $200 million for Education Opportunity Zones in districts that agreed to remove bad teachers, turn around failing schools, and end social promotions. The proposal required authorization, which Congress will never give us. For next year, we recommend a simpler approach that uses existing authority and focuses entirely on ending social promotion. We would like to expand our after-school program from $200 million to $700 million and give a disproportionate share of this money to districts that end social promotion. These school districts could use the money (as Chicago does) to provide extra help after school and mandatory summer school for students who need it. (Cost: $300 million above FY99 budget.) (DPC)

2. Teacher Quality and Recruitment. Now that we're on track to begin hiring 100,000 new teachers to reduce class size, we have an even greater responsibility to help communities attract talented new teachers to the profession. We envision a five-part strategy on teacher quality and recruitment: (1) a $100 million increase in the teacher recruitment scholarships we enacted this year in the Higher Education Act, which would put us on course to attract 60,000 new teachers at high-need schools over the next five years; (2) a $60 million initiative -- modeled after the successful Troops-to-Teachers program -- that would help states expand alternative certification routes and attract talented people from other professions, such as military personnel and employees in firms being downsized; (3) a nationwide crackdown on teacher education schools, including new regulations authorized by the Higher Education Act to require report cards for education schools; (4)

a $50 million increase in the Eisenhower program to send secondary school teachers who teach outside their field back to college to take additional courses in the subjects they're teaching, coupled with a new requirement that new secondary teachers pass competency tests in a subject before they can teach it; and (5) a high-profile effort to help states make the most of the 15 percent set-aside for teacher quality in the recently passed class size legislation. (Cost: about $210 million above FY99 budget). We are also exploring a politically interesting counter to private school choice: vouchers for private school teachers -- i.e., an incentive program to encourage private school teachers to teach in public schools. (DPC)

3. Work-Site Schools. One of the most promising new education ideas sprouting up around the country is the creation of public schools at work sites, designed primarily to serve employees' children. School districts provide the teachers and curriculum; companies provide facilities and upkeep. These schools-at-work serve a host of objectives at once, by (1) providing new facilities at no cost to the district; (2) increasing parental involvement in the schools and parental satisfaction in the workplace; (3) reducing employee turnover and absenteeism; and (4) increasing school diversity, because work sites are more diverse than residential neighborhoods. We propose a $100 million increase in an existing discretionary program to provide grants to 100 communities to launch work-site schools. We also could seek a stand-alone bill (like the charter school law) to advance this idea. In addition, we are working with Treasury to develop a tax credit for businesses that start on-site schools, similar to the Kohl business tax credit for on-site child care that is already in our budget. (Cost: $100 million for start-up grants. No estimate yet for tax credit, but it will be very small.) (DPC/NEC)

4. Public School Choice. As support grows for private school vouchers, we must continue our efforts to expand choices within the public schools. Charter schools are one answer, and we recommend a $20 million increase, to $120 million, to keep us on track to 3,000 charter schools by 2002. Work-site schools are another. We also recommend increased funding for (1) an existing grant program that helps urban and suburban school districts reduce racial isolation by forming interdistrict magnet programs; and (2) magnet schools on university campuses, especially in urban areas. (Cost: $25 million for interdistrict magnet programs; $15 million for 10 university-based schools.) (DPC)

5. School Leadership Academies. Research has shown that an effective principal is the single most important indicator of school success, yet little has been done at the national or state level to improve the management skills of principals. We propose a small initiative to create school leadership academies that would provide training in management, teacher evaluation, school discipline, and other areas to elementary school principals in high-poverty districts. (Cost: $50 million) (DPC)

6. Class size. To stay on course to reach 100,000 new teachers in seven years, we will ask for $1.3 billion in the FY2000 budget. We are planning an ambitious rollout of the class size initiative over the next year, as we award first-year funding, issue guidance to local districts on how the program works, and so on. We also will press Congress to restore the local matching requirement and strengthen the provisions to require competency testing of new teachers. (DPC)

7. Adult Literacy. According to the National Adult Literacy Survey, 44 million adults struggle with a job application, cannot read to their children, or are left on the welfare rolls because they lack basic skills. We are considering: (1) Workplace: a new tax credit and/or Federal grants to encourage employers to provide adult basic education classes at the worksite, and setting aside funds for work-based literacy projects within Welfare-to-Work competitive grants (se welfare section of this memo); (2) Community: expanding the infrastructure and funding for adult basic education through the Adult Education program, encouraging the development of programs focused on easing the transition to the U.S. for new immigrants (through ESL and civics classes), subsidizing the provision of child care on college campuses and other adult education sites, and launching a national information campaign to make people aware of the problem of functional illiteracy and of available services; and (3) Home: using the new *Learning Anytime Anywhere Partnerships* to create software for adult basic education using $200 computers (e.g., WebTV, game players) and subsidizing public housing projects that create computer literacy programs. (NEC)

8. National Campaign to Open Doors of College. Notwithstanding enormous strides we have made in reducing the financial barriers to college, too many families assume college is more expensive than it really is and are not aware of the aid that is available (Even among low-income youth with high test scores, one-fourth say they have not been able to get much information about financial aid for college). We are planning: (1) launching a major national public information campaign about college costs and financial aid (*e.g.* naming a national chairman such as Bill Cosby, having a national college visit day, etc.), (2) building on the authority in the new GEAR UP program, providing *every* middle school (e.g. 7th grade counselor) with the ability to give students a "21st Century Scholar Certificate," indicating the financial aid that they are eligible for, and (3) seeking to provide *every* high-poverty middle school with a college partner. This does not require any new investment, just some focus and creativity. (NEC)

9. Improving the College Success Rate. Getting people in the doors of college is not enough to close the racial and income opportunity gaps. For example, only 21% of African-American and 18% of Hispanic students who begin college complete a bachelor's degree within 5 years compared to 30% of White students. We are considering a package of policies, including: (1) a super-Pell grant for the lowest income families and/or to encourage a full-time focus on school in the first year of college (this would be expensive); (2) expanding successful mentoring and other support services in colleges (including those aimed at graduate school preparation); (3) promoting college course-taking while in high school; (4) improving articulation between two-year and four-year colleges; (5) encouraging partnerships between predominately minority-serving and predominately majority-serving institutions of higher education (particularly to promote graduate study); and (6) establishing a bridge fellowship program for graduate study in science and technology fields for minorities and women. (NEC)

10. School Modernization. The current assumption is that we will repeat this year's proposal for tax credits to build and renovate schools covering the interest on nearly $22 billion in bonds. We are, however, critically comparing our current proposal against other possible mechanisms to ensure we have the most effective approach. (NEC)

11. Further Expanding Junior ROTC. In response to the Los Angeles riots, Colin Powell proposed and Congress approved in 1992 an expansion of the high school-based JROTC. Since then, 1,000 units have been added primarily in urban areas, bringing the total to nearly 2,600 units with 400,000 participants. The budget increased over that period from $76 million to $166 million. There is a waiting list of more than 450 schools that would like to have a JROTC unit. Because DOD does not plan any further expansion, these 450 schools on the waiting list will not likely be added. We could propose adding another 900 units over the next few years, to reach the authorized maximum of 3,500. Cost: about $235 million. (NEC)

12. Training American Workers for Current and Future Skills Gaps. We should challenge the private sector to make specific commitments to train more American workers, which they pledged to do during the debate on H1-B visas. They could provide more college scholarships for women and minorities, partner with community colleges to develop cutting-edge curricula, and encourage their employees to serve as telementors for middle school students to get them excited about math and science. In addition, we are working on: (1) a program to foster partnerships ("Regional Skills Alliances") between industry and training providers to train both employed and unemployed workers; (2) competitive grants to encourage companies to develop programs in which they subsidize the training of individuals who they then commit to hire; (3) extensions and/or expansions of some of the current training tax provisions (such as the lifelong learning tax credit and Section 127);and (4) a major informational/media campaign by the Departments of Education and Labor to inform all Americans about available training opportunities, financial aid, and job search assistance to allow them to develop the skills required for employment opportunities around the country. (NEC)

13. Making Job Training Universal. We are considering an initiative to make job training more universal. The first component of this initiative would be to seek a significant increase in dislocated worker funding -- about $190 million -- so that we are on path to provide training to every dislocated worker who wants or needs it within five years. The second component would be to ensure that every unemployed person is eligible for core labor market services, e.g., job search assistance. The final component would be to take the steps necessary to ensure that every worker, regardless of where they live, would be able to have access to a One-Stop Career Center (where they can learn about job training, employment service activities, unemployment insurance, vocational rehabilitation, adult education, and other assistance.) (NEC)

14. Community Computing Centers. We have roughly 650 computing community centers, which empower low-income Americans in the Information Age by teaching them to type a cover letter and a resume, search for job vacancies on the Internet, or even start an Internet-related business. These efforts should be expanded. (NEC)

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School safety -- see CRIME section

SERVICE (DPC)

1. **AmeriCorps Seniors.** In the wake of John Glenn's return to space, we have an opportunity to give other senior citizens a mission. We propose adding $25 million to the current AmeriCorps program to create a senior corps of 10,000 volunteers to serve as tutors and mentors and in afterschool programs. We would build on a successful demonstration program that recruits seniors to serve 15-20 hours per week over a fixed period of time in schools and other community centers. In exchange, seniors would be eligible for small incentives, including awards to participate in senior learning programs. By inspiring responsibility among seniors, this initiative would provide an ideal complement to Social Security reform. John Glenn has expressed some interest in playing a role in AmeriCorps now that he's retired. We could invite him back to the State of the Union and place him in charge of a national effort to inspire seniors to serve. (Cost: $25 million)

2. **Expand AmeriCorps.** We propose expanding the AmeriCorps program from its current level of 50,000 members per year to approximately 70,000 per year, with the goal of reaching 100,000 per year by the end of this Administration. These additional members could be targeted to serve primarily in after-school and summer school programs. (Cost: $75 million)

3. **Expand Service Component of Work-Study Program.** Nearly 1 million students now receive federal work-study funding. Despite our efforts, colleges and universities are required to use only 7 percent of their work-study money for students employed in community service. The higher education lobby would object, but we could propose a substantial increase in that requirement -- e.g., phasing it up to 25 percent over the next 3 years.

HEALTH CARE (DPC/NEC as specified below)

1. **Long-Term Care Initiative.** This package could include: (1) a tax credit of up to $1,000 for people with three or more limitations in activities of daily living (ADL) or their caregivers, at a cost of about $6 billion over 5 years; (2) a plan for OPM to offer federal employees a choice of high-quality private long-term care insurance policies at lower-than-market prices; (3) a family caregiver support program, costing about $500 to $750 million over five years, that would provide grants to states for "one-stop shops" to assist families who care for severely impaired elderly relatives through counseling, training, and respite services; and (4) a nursing home quality initiative, costing about $500 to $750 million over five years, that would include new enforcement provisions (e.g., increased penalties), new funds for surveys of repeat offenders and improved surveyor training, and perhaps a new commission to oversee HCFA's nursing home enforcement efforts and to investigate other kinds of facilities where health care is offered (e.g., assisted living facilities). (DPC/NEC)

2. **Disability Proposals.** A health-related disabilities package could include: (1) the Jeffords-Kennedy Work Incentives Improvement Act, which enables people with disabilities to go back to work by giving them an option to buy into Medicaid and Medicare, at a cost of about $1.2 billion over 5 years; (2) a proposal, costing $50 million over five years, to promote the deinstitutionalization

of Medicaid beneficiaries by developing viable community-based care alternatives for people residing in nursing homes after a "date certain"; and (3) a proposal to make Medigap supplemental insurance ~~more accessible~~ to people with disabilities.

~~A~~ separate work-related disabilities package could include: a tax credit of $1,000 to $5,000 for working people with disabilities to assist them in paying for the costs associated with employment, ~~at~~ a cost of about $1 to 2 billion ~~over 5 years~~; a new competitive grant program, developed by your disabilities task force, to increase the employment rate of adults with disabilities; and efforts to ensure that new technologies are designed so as to be accessible to people with disabilities (see technology section). (DPC/NEC)

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3. Health Insurance Coverage Expansions. We could propose again, in somewhat new and improved forms: (1) an initiative to encourage small businesses to form purchasing cooperatives for health insurance, costing about $50 to 100 million over 5 years; (2) proposals to improve outreach for children's health insurance; and (3) a proposal, more limited than last year's, to provide a Medicare buy-in for certain people ages 55 to 65, benefiting about 30,000 people and costing $500 million over 5 years. (DPC/NEC)

4. Biomedical Research. We should again propose an increased investment in biomedical research -- perhaps (depending on how we treat tobacco money in the budget) between $500 million and $1 billion. (DPC)

5. Antibiotics (Super Bug) Initiative. Resistance to antibiotics is becoming a public health crisis, causing prolonged illnesses and even death. A new initiative, costing about $25 million each year, could address this problem through: (1) a major outreach and education campaign involving hospitals, health professionals, and managed care organizations; and (2) new research and surveillance efforts to understand where and why antibiotic resistance occurs and to develop effective responses. (DPC)

6. Bioterrorism Initiative. This initiative, costing $100-300 million each year, would: (1) train epidemic intelligence officers who can coordinate with state health departments to identify and respond to attacks; (2) develop a mass casualty emergency response system that includes primary care, emergency transportation, and decontamination abilities; (3) create and maintain a stockpile of pharmaceuticals; and (4) improve research to develop new vaccines and antibiotics to be used in the event of attack. (DPC)

7. Protecting beneficiaries from HMO withdrawals from Medicare. This year, a number of HMOs pulled out of Medicare with only a few months notice, leaving 50,000 beneficiaries with no plan options in their areas. You announced that the Administration would develop legislation to prevent this behavior in the future, and we are currently reviewing the best approaches. (DPC)

8. Redesigning and increasing enrollment in Medicare's premium assistance program. Over 3 million low-income Medicare beneficiaries are eligible but do not receive Medicaid coverage of their Medicare premiums and cost sharing. Many more may not get enough assistance through a new provision that is supposed to help higher income beneficiaries. We are developing a range of proposals, costing up to $500 million over five years, to use Social Security Offices to educate beneficiaries about this program, reduce administrative complexity for states, and give them incentives to engage in more aggressive outreach efforts. (DPC/NEC)

9. Prescription drug coverage for Medicare beneficiaries. We are considering a variety of proposals to address the lack of coverage for prescription drugs in Medicare, including a means-tested Medicaid option, an approach that would apply only in managed care, a traditional benefit for all beneficiaries, and an unsubsidized purchasing mechanism that uses Medicare's size as leverage for drug discounts for beneficiaries. If desirable, a proposal could be included in the budget or coordinated with the March release of the Medicare Commission's recommendations. The cost varies significantly depending on the proposal, ranging from $1 to 20 billion a year. (DPC/NEC)

10. Disease Initiatives. We are working on several initiatives designed to combat particular diseases. These initiatives, which you could choose to do individually or in combination, are: (1) an asthma initiative, which will curb recent steep increases in asthma cases especially among young children, by disseminating new treatment guidelines to state and local public health programs and encouraging them to work with schools, child care organizations, businesses, and other community organizations; (2) a mental illness initiative that will accompany a Surgeon General's report on this subject (and perhaps a White House Conference recommended by Mrs. Gore) and will include public-private partnerships to improve access to prevention and treatment, reforms in federal health programs to improve delivery of mental health services, and funding increases in the mental health block grant; and (3) a heart disease initiative, which could include: a new partnership with aging networks to evaluate and improve nutrition; efforts to measure successful prevention approaches and replicate them nationwide; and the creation of a network of educators, churches, and community-based organizations to launch a nationwide awareness campaign. In each of these initiatives, the public health efforts described above would supplement NIH funding of research projects. The estimated cost of these initiatives is $50 million for asthma, $100 million for mental illness, and $20 million for heart disease. (DPC)

11. Food Safety. We are working on a food safety initiative that will highlight safety standards and enforcement. Included in this initiative are: (1) a repackaged and somewhat modified legislative proposal giving the FDA and USDA additional enforcement powers (e.g., mandatory recalls and civil penalties); (2) additional food-specific regulations and/or guidelines (e.g., for certain fruits and vegetables); and (3) more extensive adoption of our model codes for restaurants and food service workers. In addition, we will focus on improving coordination with state and local agencies that regulate food safety in order to develop a wholly integrated national inspection system. (DPC)

TOBACCO (DPC)

1. State Menu. Our best vehicle for enacting tobacco legislation next year will be a legislative waiver of federal Medicaid claims to the states' expected $200 billion settlement with the tobacco companies. We will seek bipartisan agreement on a menu of uses for the federal share of state money, with tobacco control and child care as our top priorities. We will try to use this measure as a vehicle for other key elements of our tobacco policy, such as FDA jurisdiction and warning labels.

2. Price Increase. One of the most difficult budget decisions will be whether to assume a tobacco tax increase in our budget request, and if so, what to do with the money. There are strong arguments on each side of the question whether to include a tobacco tax increase in our budget. If we *do* assume tobacco revenue, the candidates for it include: (1) assistance to tobacco farmers (about $1 billion a year); (2) the long-term care tax credit (about $1 billion a year); (3) other tax cuts, such as a child care / stay-at-home tax credit and/or a reduction in the marriage penalty; (4) NIH research; (5) public health programs; and (6) the Medicare trust fund and/or a new prescription drug benefit for Medicare beneficiaries.

FAMILIES AND CHILDREN (DPC/NEC as specified)

1. Expansion of the Child Care and Development Block Grant (old policy). We propose to expand the Child Care and Development Block Grant as we did in the FY 1999 Budget. The block grant is the primary federal child care subsidy program, helping low-income working families to pay for child care. Currently, between one and two million children are served by the program, leaving roughly nine million children who are eligible but unserved. This proposal would cost at least $7.5 billion over five years. (DPC)

2. Tax Relief for Parents, Including Parents who Stay at Home. We are considering replacing our last year's proposal to expand the Child and Dependent Care Tax Credit with a new proposal to benefit <u>all</u> parents, including those who stay home. This change will address the criticism that our child care initiative did little for stay-at-home parents. We are reviewing proposals to (1) double the child tax credit to $1,000 per child for all children under the age of four, at a cost of about $12 billion over five years; (2) increase the standard deduction for each child under the age of three by $1,000, at a cost of about $3 billion over five years; or (3) expand the Child and Dependent Care Tax Credit as we did last year *and* extend its benefits to parents with children below age three by assuming minimum child care expenses of $150 each month, at a total cost of about $21 billion over five years. Each of these proposals can be dialed up or down by adjusting either the age threshold or the dollar amount. (DPC/NEC)

3. Tax Credit for Businesses Providing Child Care. We could again propose to provide a tax credit to businesses that provide child care services for their employees. The credit, which covers 25% of qualified costs but may not exceed $150,000 per year, costs $500 million over 5 years. To further build on this concept, we also propose to provide tax credits to businesses that provide on-site schools (see education section). (DPC/NEC)

4. Parent Paid Leave Plan. Many workers cannot afford to take unpaid leave following the birth or adoption of a child, even though they have access to an unpaid leave policy through FMLA or voluntary employer benefit plans. To address this problem, we are considering a proposal to provide eligible parents who already have access to unpaid leave with partial wage replacement for a set period of time. The cost of the program, which would be administered through the Unemployment Insurance System, varies according to the selected eligibility criteria. If we choose, for example, to give $200 per week for four weeks to new parents with median income (about $37,000) or below, the cost will be about $875 million for FY 2000 (including start-up and administrative expenses). (DPC)

5. FMLA Expansion to Businesses with 25 Workers (old but unarticulated policy). Under current law, workers are eligible for FMLA coverage only if they work at a business with *50 or more* employees and if they have worked at least twelve months and 1,250 hours for the employer. In your last State of the Union, you called for covering more workers under the FMLA, but did not fully articulate how you would do so. We could now advance a specific proposal to lower the FMLA threshold to 25 or more workers, which would expand coverage for up to ten million more American workers. (DPC/NEC)

6. Parent Education and Support Fund. We are considering proposals to create a competitive grant program administered by HHS to fund parent education and support programs, including home visitation programs and "second chance maternity homes" to support teen mothers and teach parenting skills. This fund could cost about $500 million over five years. (DPC)

7. Adoption Registry. We are working on plans to create an Internet-based adoption registry of foster care children waiting to be adopted, so that prospective adoptive parents can learn about these waiting children. Funding this registry would require very smally increase in HHS's Adoption Opportunities Grant Program. (DPC)

COMMUNITY EMPOWERMENT (DPC/NEC for all)

1. CDFI Tax Credit. We are looking at a proposal to extend tax incentives to encourage investment in CDFIs, which would leverage additional private investment in distressed areas and stimulate the economic revitalization of those areas. Under the proposal, $100 million in non-refundable tax credits would be made available to the CDFI Fund to allocate among equity investors in qualified CDFIs using a competitive process.

2. Microcredit Initiative. We are working to identify means to increase support for microenterprise finance, both domestically and internationally. We are examining whether to build on Senators Kennedy's and Domenici's PRIME legislation which would provide technical assistance to microenterprise. We are also looking at increased funding for CDFI initiatives specifically targeted to microenterprise. On the international side, we are looking at whether we can increase microenterprise funding through USAID or MDBs, especially to countries hardest hit by the financial crisis.

3. Clean Water, Parks, and Communities Bonds. We are examining three proposals to encourage "green" infrastructure projects. The first model uses the same financing mechanism as your school construction proposal for a menu of projects: protecting and improving water quality; cleanup of contaminated sediments; waterfront reclamation and revitalization; stormwater runoff control; purchasing of green spaces to prevent sprawl; park enhancements and revitalization, and brownfields cleanup. The second model, which provides a smaller incentive than the first model, would create new tax-exempt bond authority for these state and local areas to invest in clean water, parks, and communities. The advantage of this model is that it builds on the current system of bond finance. The final model would allocate tax credits (like the Low-Income Housing Tax Credit) to states and local areas to provide to the developers of these green infrastructure projects.

4. Employment Tax Credits. The Work Opportunity Tax Credit and the Welfare-To-Work Tax Credit encourage employers to hire and retain members of certain economically disadvantaged targeted groups. Both credits will expire on June 30, 1999. Under this proposal the two credits would be made permanent.

5. Re-Develop 10,000 Abandoned Buildings. Abandoned buildings are a symbol of urban blight, and an action plan to turn this around will be a powerful signal of change. We are examining different proposals to help re-develop 10,000 abandoned buildings, combining several existing programs or providing grants or tax incentives to spur private-sector redevelopment of these sites.

6. Low-Income Housing Tax Credit . Last year, you proposed a 40-percent expansion of the Low-Income Housing Tax Credit to spur the private sector to develop more affordable rental housing for low-income Americans. We recommend that you again ask Congress to take this action, which would restore the value of the credit to its 1986 level and help develop an additional 150,000-180,000 affordable housing units over the next five years. This proposal would cost $1.6 billion over five years.

7. Homeownership Tax Credit. We are examining two kinds of tax credits to promote homeownership among lower-income families, who generally do not benefit from the mortgage interest deduction. The first proposal would use the model of the Low-Income Housing Tax Credit to create a Low-Income Homeownership Tax Credit. Under this proposal, low-income families would receive a low- or zero-interest second mortgage, which would reduce their upfront costs (e.g., downpayment and closing costs) and investors would receive tax credits in return. The second proposal is a $5,000 tax credit for first-time homebuyers in Empowerment Zones or Enterprise Communities.

8. Housing for the Elderly Initiative. This proposal is designed to improve housing for elderly people and thereby provide an alternative to nursing home care. In addition to providing capital to improve and modify such housing to meet the needs of elderly residents, the initiative would provide housing vouchers for low income elderly who live in housing developed through the Low-Income Housing Tax Credit. Because the tax credit helps subsidize rent, this proposal would allow us to leverage our resources and provide more vouchers to the poor elderly.

9. Incremental Tenant-based Section 8 Vouchers. To build on our success in this past year's budget, we recommend seeking an additional 50,000 welfare-to-work housing vouchers and another 25,000 vouchers to meet the needs of the homeless, including elderly homeless and homeless veterans.

10. Homelessness. We are working on a three-part proposal that would: (1) assist the approximately 250,000 homeless veterans by increasing residential alternatives, community-based contracted care, job preparation activities, stand down activities (community-sponsored events that conduct one-stop service delivery programs for homeless veterans), the distribution of clothing, and long-term housing; (2) allow VA to sell surplus property with 10 percent of proceeds going to homeless veterans; and (3) start a demonstration project targeted to the chronically homeless to test the most promising models for moving the chronically homeless to self-sufficiency using a combination of permanent housing and links to mainstream services. Cost: $105 million -- $60 million for VA and $45 million for HUD demonstration project.

RURAL/AGRICULTURE (NEC/DPC as specified)

1. Strengthening the Safety Net. To help farmers suffering from the depressed export markets and natural disasters, we are considering various reforms of the crop insurance program and closing gaps in the emergency loan program. We are paying special attention to programs that will help small family farms. (NEC)

2. Bringing the knowledge of land grant colleges to every rural American: The USDA spends $1.6 billion on agricultural research, much of it at America's land grant colleges and universities. The government could provide grants to ensure that this information is available on the Internet and is well-organized --so that all rural Americans can easily access information on topics such as crops, livestock, rural development, natural resource conservation, and food safety. (NEC)

3. Emergency Medical Services in Rural Areas. The presence of viable emergency systems is critical for residents in rural areas, because of the high rates of injury associated with jobs in these areas and the long distances to health providers. This proposal, costing about $50 million, would provide funds to States and local communities to improve access to 911 services or alternative emergency systems. It also would fund programs to help rural communities train local citizens in CPR and first responder techniques and to recruit and retain emergency personnel. (DPC)

4. Rural Transportation. Transportation is crucial to the efforts of residents and businesses in rural America to improve the livability of their communities and expand their economic activities. We are developing a rural transportation initiative that will help those who live and work in rural areas by improving the ability of farms and businesses to obtain materials and move their products to markets, and by making it easier for small communities to attract additional commercial jet air service. (NEC/DPC)

New DPC

TECHNOLOGY (NEC)

1. Curbcuts on the Information Highway. We are looking at several options that would make information technology usable by people with disabilities in a manner that improves their lives: (1)

investing in R&D (e.g., text-to-speech, automatic captioning, speech recognition); (2) giving disabilities groups a seat at the table as the standards for new technologies are developed; (3) making the government a model "user" of accessible technology; and (4) explore opportunities for greater deployment. In addition, the tax credit for work-related impairment expenses for people with disabilities could be used to expand the market for assistive technology.

2. A Digital Library for Science, Math and Engineering. We need to get every young student and undergraduate excited about math, science and engineering. We are exploring creating a "digital library," which would contain lectures from Nobel Prize laureates, have an ability to track and replicate cutting-edge scientific experiments, and make it easier for students and teachers to locate the best instructional material on the Internet.

3. Information Technology Research Initiative. Increasing our investment in information technology research, which is currently about $1 billion of the federal research budget, could lead to the following breakthroughs: supercomputers that can more rapidly perform important functions, such as designing life-saving drugs and predicting severe weather systems; wireless networks that can bring telemedicine and distance learning to rural America; a device of the size of a paper that could monitor the vital signs of a senior citizen, send a "911" message in the event of a medical emergency, and provide an exact location using global positioning technology; new software tools that can help us cope with "information overload" by discovering patterns in huge quantities of data; and intelligent spacecraft that can explore the Solar System. Options have been developed at roughly $100, $200 and $400 million in FY2000; and $1, $2 and $3 billion over 5 years.

4. 21st Century Research Fund. One initiative that you announced in last year's budget that we think is important to continue is the 21st Century Research Fund -- which provided across-the-board support for civilian R&D at agencies such as NIH, NSF, and Energy. For FY99, Congress provided a 10 percent increase for basic research, so this is an area where bipartisan cooperation is possible. Currently, the FY2000 budget reflects only a 2% increase in civilian research.

CRIME (DPC)

1. Crime Bill II. The 1994 Crime Act will expire at the end of the FY 2000 budget cycle, guaranteeing that the next Congress will consider major crime legislation. We recommend that you get a jump on this debate by using your State of the Union and FY 2000 budget to challenge Congress to pass a new crime bill that builds on the core elements of the successful 1994 Act -- more police, smarter punishment, and more prevention. Most of the money required is already built into future budgets; continuation of the COPS program, however, will require new funds totaling about $1 billion. We believe that a new Crime Act should include the following elements:

- **Community-Oriented Policing and Prosecution Services (COPPS).** Your pledge to help fund 100,000 more police is likely to be fulfilled before the end of next summer. A new COPPS initiative (note the extra "P" for "Prosecution"), costing about $1.4 billion in the first year, could include funds to: (1) hire, redeploy, and retain an estimated 7,500 more police each year; (2) provide modern technology and equipment and support training in modern policing techniques, with a special emphasis on "hot spots" technology; (3) hire, train, and equip prosecutors to join local police in fighting crime on a more community-based, pro-active basis; and (4) support partnerships between law enforcement and community-based groups to prevent crime in their areas.

- **A new focus on probation supervision and coerced abstinence.** The punishment title of the crime bill now focuses largely on prison construction; we recommend shifting the focus to a new "Certainty of Punishment" initiative that will support the expanded use of probation supervision and of drug testing and treatment.

- **Gun initiatives.** A new crime bill should include your longstanding firearms priorities -- juvenile Brady, Brady II, federal CAP legislation and child safety locks. It also could include new proposals to: (1) close the loophole that exempts many firearms sales at gun shows and flea markets from Brady background checks; (2) expand the Youth Crime Gun Interdiction Initiative (YCGII) -- to trace all crime guns and investigate gun traffickers -- to an additional 20-40 cities; and (3) assemble gun strike forces -- teams of federal prosecutors and ATF agents, acting with local law enforcement -- to target cities with high levels of gun violence and crack down on gun traffickers.

- **Values-based crime prevention initiative.** In addition to other crime bill prevention programs, we could invest in promoting values-based crime and violence prevention efforts, such as those of Rev. Eugene Rivers. Funds from this program would go to comprehensive prevention programs run by faith-based and other institutions seking to instill and reinforce common sense values in troubled youth.

2. Safe, Disciplined, and Drug-Free Schools. At the White House Conference on School Safety, you announced that you would overhaul and strengthen the Safe and Drug-Free Schools Program. Under this proposed reform, funds will be appropriately targeted to schools with serious drug and crime problems, and schools will have to adopt rigorous, comprehensive school safety plans that include: tough but fair discipline policies, such as zero tolerance for guns and drugs; safe passage to and from schools; effective drug and violence policies and programs; annual school safety and drug use report cards; links to after school programs; efforts to involve parents; and crisis management plans. We also could include in this package (1) funds for states that adopt a policy of drug testing first-time applicants for drivers' licenses and (2) funds for school districts that adopt a policy of drug testing middle and high school students with parental consent. We believe that these reforms will require up to $450 million in new funding in FY 2000.

3. Parity for Substance Abuse Treatment. Appropriate substance abuse treatment remains unavailable to nearly half of the people who need it. To help fill this treatment gap, we could propose legislation to encourage parity between substance abuse treatment and other medical benefits. Similar to the Mental Health Parity Act signed into law in 1996, a current draft of this legislation would prohibit health care plans that provide a substance abuse benefit from setting annual or lifetime dollar limits on this benefit at a lower level than those for other medical and surgical benefits. At the same time, we would have to ensure that federal health programs provide parity between substance abuse treatment and other medical benefits; we are still exploring the cost of any necessary reforms to these programs.

4. Binge Drinking. We are working on a number of proposals regarding alcohol abuse, including (1) promoting a voluntary code for alcohol advertisements directed toward minors; (2) banning alcohol billboards near schools; (3) discouraging alcohol advertising on youth-oriented web sites; (4) and funding educational efforts about the dangers of alcohol consumption.

WELFARE REFORM, CHILD SUPPORT ENFORCEMENT, AND CHILD WELFARE (DPC)

1. Reauthorize the Welfare-to-Work Program. Congress authorized the Welfare-to-Work Program for only two years; if we wish to continue our current investment in the hardest-to-employ, we will have to propose a reauthorization of about $1.5 billion annually. Within this funding level, we propose several set-asides, totaling $500 million, for the following specific purposes: (1) work-based English-language literacy projects for immigrants and others; (2) work-based substance abuse testing and treatment programs; (3) employment services for welfare recipients with disabilities; and (4) a work-based program to promote responsible fatherhood, including efforts to increase low-income fathers' employment and earnings and ensure that they provide financial and other support to their children.

2. Child Support. One initiative, costing just a few million dollars each year, would increase the prosecution of egregious child support violators by establishing multi-agency teams, working with state and local law enforcement, to identify, analyze, and investigate cases for prosecution. A pilot project of this kind is already under way in five states; this proposal would put these units in place all across the nation within the next several years. A second initiative would seek legislation to exclude doctors and other health care providers who are delinquent in child support from the Medicare program or from programs offering health professional loans.

3. Children "Aging Out" of Foster Care. Each year, nearly 20,000 18-year-olds "age out" of the public child welfare system. Federal financial support for these young people ends just at the time they are making the critical transition to adulthood. Areas for increased investment for these young adults include: (1) expanding the independent living program, which provides services to foster care children in this age group; (2) expanding the transitional living program, a competitive grant program that funds community-based organizations that provide services to this population, including housing support; and (3) giving states the option of using Federal Medicaid dollars to provide health care coverage for this population. (Cost: roughly $150 million each year)

Welfare-to-Work Housing Vouchers and Tax Credit -- see COMMUNITY EMPOWERMENT Section

CIVIL RIGHTS AND WOMEN'S RIGHTS (DPC)

1. Equal Pay. We are working on a program to be run by the EEOC and DOL to increase outreach to businesses and employees about equal pay requirements, provide technical assistance to businesses seeking to comply, improve training for EEOC employees, and expand enforcement capabilities. In addition, the program will fund research on the nature and extent of wage discrimination, as well as a new Women in Non-Traditional Occupations Initiative designed to improve access of women into occupations such as construction and high technology. Cost: about $20 million for EEOC and $10 million for DOL.

2. Abortion Violence. We are working on a comprehensive initiative to address violence against providers of reproductive health services. This initiative may include: (1) a National Task Force established by the Department of Justice that will conduct investigations of abortion violence, collect and collate information related to clinic violence, and provide training to federal, state, and local law enforcement personnel on how to address this problem; (2) special security measures, including stepped-up U.S. Marshal support, at clinics identified to be at risk of violence; and (3) federal guarantees of loans taken out by clinics that must rebuild after they have been attacked. Cost: Unknown at this time.

TRANSPORTATION (NEC/DPC as specified)

Revised DR

1. Reauthorization of the FAA, with Focus on Modernization and Competition. A blue-ribbon bi-partisan panel concluded last year that the air transportation system faces "gridlock" within a decade without sweeping changes. We are considering various policy options to incorporate into the FAA reauthorization that you will propose in 1999 (it is a must pass this year) that will: (1) improve the efficiency and capacity of the nation's aviation system, and (2) enhance competition and service to rural areas. Some of the components of this initiative would include: centralizing the air traffic control services (ATS) in a performance-based organization (recommended by the bi-partisan panel); financing ATS for commercial aviation through cost-based user fees (supported by the major airlines); increasing Passenger Facility Charges (PFCs) to finance airport expansion nationwide (supported by state and local governments); modifying federal rules on how airports can use PFCs and other funds to encourage new airline entrants; and enhancing service to underserved areas.

We are also looking at ways to further competition in international aviation. The Administration has extended the benefits of competition by negotiating dozens of bilateral open-skies agreements. We could press our trading partners for World Wide Open Skies and explore lifting other restrictions on foreign aviation investment and operation on a reciprocal basis. (NEC)

2. Auto Safety. We are making headway on auto safety. Last year, the number and rate of auto fatalities declined. However, we still have a long way to go -- more than 40,000 Americans die in auto accidents each year, at a direct cost of $150 billion. The keys are seatbelts (more) and alcohol (less). We are working on a comprehensive initiative that would include: (1) meeting the President's goal of 85 percent seatbelt compliance by the year 2000, which would save 4,000 lives and nearly $7 billion; (2) promoting education initiatives like the Buckle-Up America campaign; (3) enforcing the TEA-21 requirement that states lower the legal blood alcohol content level from .10 to .08; and

(4) pushing a new Administration initiative on children's safety that will target auto accidents, among other problems, by promoting the use of child safety seats, booster seats (for children ages 4-8), and bicycle helmets. (NEC/DPC)

3. **Transportation Needs of the Aged.** With the number of Americans over 65 expected to grow by half by 2020, we should begin addressing the need to ensure their continued mobility, independence and safety in their later years. We are only beginning to look at this issue with DOT, which plans to hold six town meetings soon with senior citizens, medical experts, transportation safety specialists, and others to discuss the problems and challenges and identify best practices. The U.S. will host an international conference on this topic next year, in connection with the United Nation's Year of Older Persons. This may be combined with the long-term care and the housing for the elderly initiatives. (NEC)

Radio

4.**"Smart Growth" and Sustainable Development.** One of the biggest challenges facing America's communities is that "sprawl" development is threatening the long-term economic vitality and quality of life in America's urban, suburban and rural areas. Although land use decisions should remain the domain of state and local government, the federal government can be an effective partner. First, we will continue investing in sustainable transportation. TEA-21 authorizes a record $41 billion over the next six years for transit; increases tax-free transit benefits; and expands communities' ability to transfer funds from highway construction to transit, bicycle and pedestrian programs, telecommuting and other forms of transportation that reduce congestion and pollution. Second, we will provide incentives to make it easier for communities to pursue smart growth policies, by exploring ways cities can capture the air quality benefits of sustainable development and by supporting a private sector initiative that would encourage mortgage lenders to consider the savings from "location efficiency"in making mortgage determinations for homebuyers . (NEC)

ENERGY (NEC)

1. **Electricity Restructuring.** You could call on Congress to enact legislation, to make the electricity industry more competitive and to provide more choices for industrial, commercial and residential customers. The Administration's Comprehensive Electricity Competition Act will save consumers $20 billion a year. Retail competition will not only improve efficiency, but also reduce the two-thirds waste of energy currently associated with fossil-fuel generation of electricity, thereby cutting greenhouse gas emissions. Prominent Republicans have included electricity restructuring on their list of priorities for 1999.

Rad.

2. **Distributed Generation ("Micropower").** To increase the consumer savings and environmental benefits from electricity competition, the Administration will pursue legislation to eliminate obstacles to the use of small, clean efficient generation technologies (e.g., fuel cells and photovoltaics) that can be installed at or near the electricity user's site. Moving from large, central-station generation of electricity to distributed generation by small, clean sources is analogous to the move from mainframe computers to personal computers.

PENSIONS (NEC)

1. Expanded Private Pension Plan Coverage: Last year, you announced several initiatives to expand pension plan coverage which were not enacted, but which we continue to believe are important and have substantial support on the Hill. We should again call for legislation that: authorizes a simplified plan for small businesses that combines the best features of a defined benefit and defined contribution plan (SMART), costing $313 million over five years; provides a three-year tax credit to encourage small businesses to set up retirement programs, costing $508 million over five years; and authorizes payroll deductions for IRAs. We are exploring ways to expand coverage for moderate and lower-income workers. Consideration is also being given to ways of enabling multiple small businesses to pool together for pension plan administration.

2. Women's Retirement Security: To underscore the importance of pensions for women's retirement security, you would call for legislation enacting the two initiatives you announced in late October -- namely, that time taken under FMLA should count toward retirement plan vesting requirements and mandating that employer plans offer an option that pays less while the retired employee is living but pays a survivor benefit equal to at least 75 percent of the benefit the couple received while both were alive.

3. Pension Portability: You could renew your call for reducing vesting requirements from five years to three years for employer matching contributions to 401(k) and other plans to reflect an increasingly mobile workforce, and more workers moving in and out of the workforce over a lifetime. We are also exploring various options that would increase pension portability and facilitate the movement of retirement savings between plans, where this can be done without encouraging "leakage" or loss of worker protections -- e.g., providing that federal employees can roll over retirement savings from private sector qualified plans into the federal Thrift Savings Plan.

4. Expand Pension Right to Know Provisions: You could call for a pension right to know package that provides for both workers and their spouses general information relating to retirement needs and their benefits under employer retirement plans. In addition, an employee's spouse should have the same rights to get information as the employee, before waiving the statutorily provided survivor protection. You should call for a Pension Right to Know package that provides information for both workers and their spouses. We are also working on an employee education program that would provide employees with the tools they need to work with their employers to provide pension plans, and are thinking about how to encourage courses in high schools on the importance of savings and other general investment education (which can be combined with the Consumer Literacy and Education campaign described below). Consideration is also being given to a savings stamp book program in the schools (sell savings stamps in very small amounts; when the book is full, turn it in for a U.S. savings bond) to help educate the young about how to reach savings goals.

5. Increase Retirement Security: To promote security, we are continuing to work on the pension audit bill, changes to the multi employer (collectively bargained) plan rules, and expansion of PBGC's missing participant program.

FINANCIAL SERVICES (NEC/DPC as specified)

1. Consumer Financial Literacy and Education. We are currently developing a set of proposals to promote consumer financial awareness and enhance consumer credit literacy, ranging from a public awareness campaign to establishing an educational clearinghouse to disseminate quality curricula to high school students. We are also working on a study to identify what the biggest problems are with how Americans use consumer credit, and what basic banking services and steps they can take to help themselves (this may be very important if bankruptcy reform is a live item next year). Part of our focus is on reaching out to low-income households, building on (and expanding) two existing government programs -- Treasury's Electronic Funds Transfer program that was a first step in helping the "unbanked" enter into electronic commerce and a USDA extension program that is providing some (limited) services to rural low-income families. This proposal would cost $5-10 million. (NEC)

2. Consumer Financial Bill of Rights. In order to respond to the outrage consumers feel about ATM surcharges, without supporting economically questionable regulation of ATM fees, we are considering a proposal either for the government or for financial institutions voluntarily to make publicly available a list of basic banking services and fees on an individual or geographic basis to be published periodically over the Internet. The services profiled would include, but would not be limited to, charges for access to ATMs. We are also considering the adequacy of current credit card disclosure requirements (again, relevant to bankruptcy reform) and other areas where information about financial service arrangements would be helpful to consumers. This would cost $3-5 million. (NEC/DPC)

THE WHITE HOUSE

WASHINGTON

MEETING ON CONGRESSIONAL AND THINK-TANK SOCIAL SECURITY REFORM APPROACHES

Cabinet Room

November 12, 1998

11:20 AM

AGENDA

I. PLANS THAT TRANSFER SURPLUSES TO TRUST FUND

II. PLANS THAT USE SURPLUSES TO FUND INDIVIDUAL ACCOUNTS

III. PLANS THAT USE SURPLUSES BOTH TO STRENGTHEN THE TRUST FUND AND ESTABLISH INDIVIDUAL ACCOUNTS

A Basic Typology of Plans

We will be discussing six forms of Social Security plans. All of these plans use the surplus in one way or another, and all could be designed to do so to a greater or lesser extent.

Title	Description
A. Plans That Use the Surplus to Shore up the Trust Fund	
1. Bond-only plans	Maintain current policy of holding only Treasury securities.
2. Equities in the Trust Fund	Introduce equities into the system, but hold them collectively.
B. Plans That Use the Surplus in Creating Individual Accounts	
3. Add-on individual accounts	Continue to use all of the current 12.4 percent payroll tax to fund traditional Social Security benefits; make sufficient adjustments to the system (benefit cuts, revenue increases) to bring it into balance. Establish individual accounts in addition to the current system.
4. Carve-out individual accounts	Divert some of the current 12.4 percent payroll tax into individual accounts. Individual accounts *replace* part of the current system, and could potentially be described as a tax cut. Relatively large surplus transfers and/or cuts to the traditional Social Security benefit would be necessary to restore solvency. So far, most carve-out plans have been "fiscally conservative" with significant cuts through such provisions as raising the retirement age. With more use of the surplus, the cuts could be softened.
C. Plans That Use the Surplus Both to Shore up the Trust Fund and to Fund Individual Accounts	
5. Integrative plans	Use surplus to establish individual accounts. At retirement, part of the proceeds of the accounts are used to finance traditional benefits, while part provide an add-on individual account.
6. Hybrid plans	Contribute part of the surplus directly into the Trust Fund, as under (1) or (2), and part into individual accounts as under (3).

THREE BASIC REFORMS

At this point, we want our discussion to focus on fundamental issues of plan design that could impact our short-term strategy for achieving reform, and to avoid spending too much time on details that can be worked out at a later date.

- <u>Many of our plans contain three basic provisions that are meant as place holders for benefit cuts and/or revenue increases to be determined later.</u> The three provisions we happen to have chosen close 44 percent of the 75-year actuarial imbalance. There would be many other ways to achieve similar solvency effects.

  -- **Raise the taxable maximum for the OASDI payroll tax so that 90 percent of earnings are taxed by 2010.** This would return the percentage of earnings that are covered to where it was in 1982 and 1983. In 1998 dollars, it would be equivalent to raising the taxable maximum from \$68,400 to \$95,100. It would raise taxes by up to \$1,655 (on both workers and employers) for the six percent of workers with earnings above \$68,400. We are exploring ways to raise revenues without having such a large effect.

  -- **Cover state and local government new hires beginning in 2011.**

  -- **Increase the number of years used in calculating Social Security benefits from 35 to 38.**

- <u>These proposals could be replaced with an across-the-board benefit cut of 10 percent.</u> While all three of these proposals are likely to run into serious political opposition, it is important to note that only one of these three provisions results in a reduction in Social Security benefits for future retirees, and that the reduction equals only 3 percent of current-law benefits. Replacing these provisions with an across-the-board benefit cut would require a 10-percent cut in benefits in 2015 and later (or 20 percent by 2040 if the cuts were phased in more slowly). Such benefit cuts may be even less palatable than these three basic provisions.

I. Plans that Transfer Surplus to the Trust Fund

TRANSFER UNIFIED BUDGET SURPLUSES TO SOCIAL SECURITY TRUST FUND AND INVEST IN BONDS ONLY

- Transfer **91 percent** of the *currently projected* unified budget surpluses to the Trust Fund for as long as they last (2033), and continue to invest the Trust Fund in government bonds only.

- Do not include common set of reforms.

KEY ATTRACTIONS OF THIS APPROACH

- Continues the program on a completely defined benefit basis, avoiding potentially costly and risky alternative approaches.

- Preserves benefits at current law levels.

- Prevents nearly all of the surplus from being used for other purposes.

- Very consistent with our message of the past year that surpluses have been reserved pending Social Security reform.

KEY DISADVANTAGES OF THIS APPROACH

- See box on next page.

IMPACT ON 75-YEAR ACTUARIAL BALANCE

Common set of reforms	NA
General revenue transfer to Trust Fund	+2.22
Remaining Actuarial Balance	+0.03

IMPACT ON BENEFITS IN 2030
PERCENT OF CURRENT LAW BENEFITS

	Low Earner ($12,000)	Average Earner ($27,000)	High Earner ($43,000)
Total	+0.0	+0.0	+0.0

ALTERNATIVE VERSION WITH 3 COMMON REFORMS:

- Transfer **55 percent** of the *currently projected* UB surplus to Trust Fund for as long as they last (2031), and continue to invest the Trust Fund only in government bonds.

- 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).

KEY CHALLENGES ASSOCIATED WITH BONDS ONLY PLANS

- **Will Transfers of the Surplus Help Us Prepare for the Future?** Transfers of the budget surplus to the Trust Fund do not reduce the mismatch between annual tax revenues and benefit obligations in the out years. However, to the extent that transfers allow us to use the surplus to pay off debt (or purchase private securities), they will leave us in a stronger financial position when the demographic challenges arrive.

- **Will Transfers Succeed in Removing Surpluses from the Books?** Under current budget scoring rules, transfers used to purchase government bonds would not remove any unified budget surplus from the books, and therefore would not prevent the surplus from being used for tax cuts or new spending. However, allocating the surpluses for Social Security could lead to a change in scoring rules.

- **The Double Counting Problem.** The Trust Fund has already been credited with the excess of Social Security taxes over benefits. The current unified budget surplus is entirely due to the Social Security surplus. Under OMB projections, 89 percent of unified budget surpluses over the next 10 years are due to Social Security (under CBO projections, 98 percent are due to Social Security). If we were to transfer the surplus to Social Security, some might complain that we were crediting the Trust Fund twice. Indeed, some people already argue that the Trust Fund is not "real" and that we are "raiding" the Social Security Trust Fund to mask non-Social Security deficits.

- **Maintains and Expands Social Security Trust Fund Structure.** Many Democrats and Republicans do not support the trust fund structure, saying that it does not truly set aside money for Social Security and does not prevent the funds from being spent. By transferring additional funds to the trust fund, this type of plan would expand Social Security's reliance on the trust fund structure.

- **Sustaining Transfers If Surpluses Do Not Materialize.** If the full projected surpluses do not materialize and transfers are scored as outlays, then the transfers could result in budget deficits. To the extent that these deficits are financed by issuing debt, then we will not have done anything to improve the long run fiscal situation. In addition, it may appear strange to be transferring amounts based on projections of surpluses from many years ago.

TRANSFER SURPLUS TO TRUST FUND AND INVEST IN EQUITIES

- Transfer **68 percent** of the *currently projected* unified budget surpluses to the Trust Fund for **1999-2032** to purchase equities. Limit the share of the Trust Fund invested in equities to 25 percent.

KEY ATTRACTIONS OF THIS APPROACH

- Continues the program on a completely defined benefit basis.
- Achieves higher returns with low administrative costs while spreading risk across the population and over time.
- Preserves benefits at current law levels.

KEY DISADVANTAGES OF THIS APPROACH

- The government would own between 5 and 11 percent of the stock market depending on the methodology used. See the box on the next page for details

IMPACT ON 75-YEAR ACTUARIAL BALANCE

Common set of reforms	NA
General revenue transfer to Trust Fund	+2.20
Across the board cuts to achieve solvency	NA
Remaining Actuarial Balance	+0.01

IMPACT ON BENEFITS IN 2030
PERCENT OF CURRENT LAW BENEFITS

	Low Earner ($12,000)	Average Earner ($27,000)	High Earner ($43,000)
Total	+0.0	+0.0	+0.0

ALTERNATIVE VERSION WITH COMMON SET OF REFORMS:

- Transfer **50 percent** of the currently projected UB surpluses to the Trust Fund for **1999-2008** to purchase equities. Limit the share of the Trust Fund invested in equities to 25 percent.
- 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).
- Make across the board benefit cuts of 6 percent to achieve solvency.

SUBOPTION: SAVE SOCIAL SECURITY WITH SOCIAL SECURITY PLUS ACCOUNT
• It would be possible to use the surplus remaining after achieving actuarial balance to fund individual accounts that are truly in addition to the traditional benefit. The equities in the trust fund would be preserving the traditional structure, and the individual accounts would be on top of the full traditional benefit. Therefore, doubts about sustainability and risk of the individual accounts would not threaten the traditional Social Security program. However, the plan would rely on essentially all of the currently projected surpluses for 30 years. Thereafter, this plan could create demands for deficit funding on the individual accounts.

ISSUES ARISING FROM INVESTING THE TRUST FUND IN EQUITIES

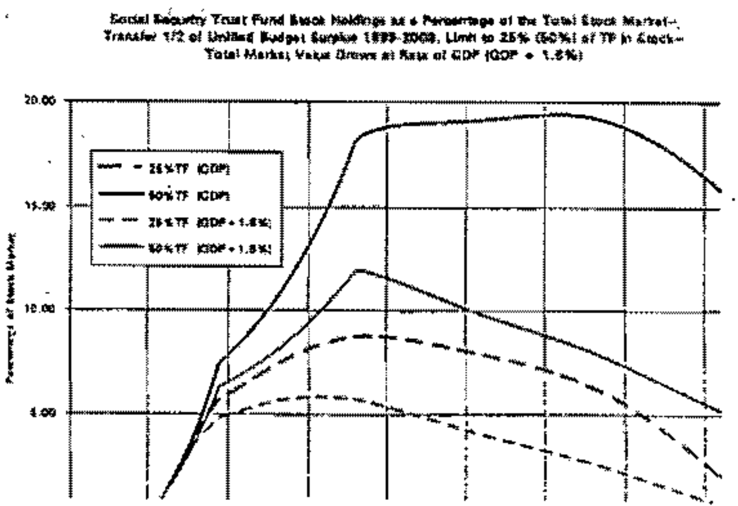
- **Government Ownership of Private Securities.** In the plans shown on the previous page, the government would eventually hold between 5 and 11 percent of the overall stock market. This raises three important concerns:

  1. Largest Shareholder. If the Trust Fund owned 10 percent of the stock market, the government would be the largest shareholder in at least 70 percent of U.S. publicly traded corporations.

  2. Political Influence on Investment Choices. Congress could legislate restrictions on what the funds could invest in (e.g. no tobacco stocks).

  3. Corporate Governance Issues. For example, how would government-owned shares be voted at stockholder meetings?

There are different methodologies for projecting the future size of the stock market. Depending on the methodology chosen, one obtains different estimates of the share of the total stock market held by the trust fund. The chart below shows the share of the stock market held by the trust fund for two different reform plans under two different assumptions about the future growth rate of the stock market.



The Pervasiveness of Corporate Governance Issues

- While issues of government ownership of private securities do not arise in the case of individual accounts, issues of political influence over investment choices and of corporate governance could still be large, especially if investment choices were limited to a few government-authorized index funds.

What Happens If the Stock Market Performs Poorly?

- If the stock market performs worse than is projected, the balance in the trust fund will be lower than projected, creating pressure for additional revenue sources or benefit cuts. This is a common feature of plans that depend on stock market returns to fund traditional Social Security benefits.

II. PLANS THAT USE THE SURPLUS TO FUND INDIVIDUAL ACCOUNTS

Five Key Issues Concerning Individual Accounts

Key Issue #1: Perceptions of Benefit Levels

- People might perceive that the individual account is part of the total Social Security benefit, and has more than made up for the reduction in the traditional benefit.

- Alternatively, people might perceive their individual account as risky and uncertain, and perceive that they received a 16-percent reduction in their Social Security benefit.

- Plans which guarantee benefit levels or which integrate the individual account and the defined benefit may be more successful in getting people to look at their total benefit.

Example: Impact on Benefits (Percentage of Current Law)

Change in traditional benefit	-16.3 percent
<u>Annuity from individual account</u>	<u>+20.8 percent</u>
Total	+4.5 percent

Key Issue #2: Benefit Guarantees

Because individual accounts expose individuals to more risk, it might be desirable to shift some of that risk to society as a whole.

- <u>**Providing a Safe Investment Option.**</u> One way to do this would be to offer a safe investment option -- for example, Treasury Inflation Protected Securities -- and to design a reform package to ensure that workers who chose this safe investment option have a reasonable level of benefits.

  -- The downside of this approach is that it might encourage individuals -- particularly low-income individuals -- to take too little risk.

- <u>**Guaranteeing Current-law Benefits.**</u> Another option would be to let people invest however they choose, but to guarantee that the combined benefit from traditional Social Security and the individual account would at least equal the current-law traditional Social Security benefit (Sen. Gramm's plan adopts this approach).

  -- A guaranteed benefit might encourage workers to take too much risk, since they would receive the upside gains, while the government would protect them on the downside. However, some argue that many investors do not take on enough risk. Moreover, if the portfolio choices were limited to basic index funds, the extent of this "moral hazard" problem would probably be minimal.

  -- A guarantee shifts risk away from individuals and onto the unified budget. We are currently trying to quantify the extent of this risk.

KEY ISSUE #3: FISCAL SUSTAINABILITY

For How Long Can We Afford to Fund Individual Accounts Out of the Surplus?

- If remaining surpluses are spent, 2 percent individual accounts can be afforded until around 2023.
- Once the surpluses have run out we could continue to fund the individual accounts out of general revenues (this would cost around 0.8 percent of GDP), or we could trigger in traditional reforms to pay for the individual accounts.
- It might also be possible to set aside some of the extra surpluses in the early years to prefund individual account contributions in later years. We present a plan like this later in the packet.

KEY ISSUE #4: DESIGNING A PACKAGE WITH "WINS" FOR BOTH PARTIES

- **Individual accounts can be provided in a way that is more progressive than the current defined benefit Social Security system.** We could propose a negotiating principle that the traditional benefit must remain as progressive as it currently is, and that any individual accounts must be *more* progressive.
- **Our reform package could include initiatives to reduce elderly poverty, particularly among widows, and to help other needy populations.** We are developing a list of policy options in this area. For example, if progressive individual accounts were at least partially bequeathable, low-income families with short life expectancies could potentially benefit more from the progressivity of the individual accounts than they do from the progressivity of the current system.

KEY ISSUE #5: FEASIBILITY AND COST OF INDIVIDUAL ACCOUNTS

- **Individual accounts in foreign countries have proven very costly.** In both the U.K. and Chile, administrative costs absorb 20 percent or more of account accumulations under their systems of individual accounts.

- **Lower costs might be achievable by limiting choice.** At the cost of severely limiting choices, it may be possible to keep costs down significantly. Our benefit numbers assume a very low administrative cost of 10 basis points per year. This would correspond to a reduction in account accumulation of only 2 percent.

- **Low-cost plans would also be low-service plans.** The level of services associated with a plan this cheap wold be very low, and in particular would compare unfavorably with the level of services offered through most 401(k) plans. Specifically, a bare-bones plan might offer annual reporting rather than monthly or even daily reporting, a much narrower range of asset choice, and a far lesser ability to switch among available assets.

- **Contributions would lag earnings.** For individual account funding approaches that are tied to past earnings, the delays in making contributions into accounts could be perceived to be very long. Under current procedures, workers' earnings for the prior year are not verified until November in the current year. Thus, if a system of this type were in force currently, workers' last recorded contribution as of today might be for 1996; or workers might just have received their contributions for 1997.

- **Funding out of the surplus might alleviate the perception problem.** It might be argued that since the funding of these accounts was coming from the surplus, individuals would not perceive the contributions to be tied to their earnings, and therefore not see it as arriving late.

- **Other approaches might be possible.** It is also possible, though not yet fully verified, that some acceleration of contributions could be achieved through a change in procedures.

FLAT-DOLLAR ADD-ON INDIVIDUAL ACCOUNT WITH ACROSS THE BOARD BENEFIT CUTS TO RESTORE SOLVENCY

- Fund $580 per worker individual accounts out of general revenue. Assume these funds are invested 50-50 in stocks and bonds.
- 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).
- Make additional across the board benefit cuts by revising the benefit formula, but keep disability benefits at current-law levels.

KEY ATTRACTIONS OF THIS APPROACH

- Gives individuals control over their retirement savings. Could be described as building wealth.
- Achieves higher returns while avoiding government ownership of private securities.

KEY DISADVANTAGES OF THIS APPROACH

- Surpluses are not sufficient to fund individual accounts forever.

IMPACT ON 75-YEAR ACTUARIAL BALANCE

Common set of reforms	+0.97
Across the board cuts to achieve solvency	+1.22
Remaining Actuarial Balance	+0.01

IMPACT ON BENEFITS IN 2030 PERCENT OF CURRENT LAW BENEFITS

	Low Earner ($12,000)	Average Earner ($27,000)	High Earner ($43,000)
Common Set of Reforms	-3.0%	-3.0%	-3.0%
Across-the-Board Cuts Implied by Remaining Shortfall	-13.3	-13.3	-13.3
Annuity provided by Individual Account	+34.4	+20.8	+15.8
Total	+18.1	+4.5	-0.5

Partially Voluntary Individual Accounts

- Fund $290 per worker individual accounts out of general revenue. Assume these funds are invested 50-50 in stocks and bonds. ***Allow workers to voluntarily contribute an additional 1 percent of earnings to their accounts.***

- Make common set of reforms.

- Make additional across the board benefit cuts by revising the benefit formula, but keep disability benefits at current-law levels.

Key Attractions of This Approach
• Cuts in half the long-term fiscal obligation of the government to finance individual accounts.
• Preserves benefit levels for low-income workers even if they do not make voluntary contributions.

Key Disadvantages of This Approach
• Some may feel they are being asked to add an additional one percent of payroll taxes simply to maintain their existing Social Security benefit level.

Impact on Benefits in 2030 Percent of Current Law Benefits			
	Low Earner ($12,000)	**Average Earner ($27,000)**	**High Earner ($43,000)**
Common Set of Reforms	-3.0%	-3.0%	-3.0%
Across-the-Board Cuts Implied by Remaining Shortfall	-13.3	-13.3	-13.3
Annuity provided by Individual Account	+17.2	+10.4	+7.9
Total without voluntary contribution	+0.9	-5.9	-8.4
Maximum annuity provided by voluntary Individual Account	+8.1	+10.8	+13.1
Total	+9.0	+4.9	+4.7
Under current law, annual benefit levels are $6,010 for the low earner, $9,925 for the average earner, and $13,112 for the high earner.			

III. Plans that Use the Surplus Both to Shore up the Trust Fund and to Fund Individual Accounts

Hybrid Plans: Individual Accounts and Trust Fund Equity Investments

- Create $290 per worker individual accounts funded out of general revenue.
- Invest Trust Fund assets worth 1 percent of payroll in stocks. Limit the share of the Trust Fund invested in stocks to 25 percent.
- Make common set of reforms.
- Make additional across the board cut in benefits to achieve solvency.

Key Attractions of This Approach

- Provides wins for both sides. Shores up traditional Social Security and establishes individual accounts.
- Because individual accounts are small, sustaining them in the out years will not create much pressure on other programs.
- Because transfers to the trust fund are modest, the peak share of the stock market owned by the trust fund will between 3.7 and 5.7 percent.

Key Disadvantages of This Approach

- Has the downsides of both individual accounts and trust fund investments: the high administrative costs of small individual accounts and the problems of government ownership of private securities.

Impact on 75-Year Actuarial Balance

Common set of reforms	+0.97
Tax indiv. accounts like OASDI	+0.06
Redeem TF assets to buy stocks	+0.58
Across the board cuts to achieve solvency	+0.73
Remaining Actuarial Balance	+0.00

Impact on Benefits in 2030
Percent of Current Law Benefits

	Low Earner ($12,000)	Average Earner ($27,000)	High Earner ($43,000)
Common Set of Reforms	-3.0%	-3.0%	-3.0%
Across-the-Board Cuts Implied by Remaining Shortfall	-8.0	-8.0	-8.0
Annuity provided by Individual Account	+17.2	+10.4	+7.9
Total	+6.2	-0.6	-3.1

ARE THERE WAYS TO REDUCE GOVERNMENT OWNERSHIP CONCERNS?

- <u>Trust Fund investments could be allocated according to investment choices of individuals in their individual accounts.</u> In plans that combine Trust Fund investments with individual accounts, it might be possible to have the Trust Fund allocate its investments according to the aggregate investment behavior of individuals in their individual accounts. This idea -- and other ideas like it -- could allow defenders of government investment to say that it was millions of individual choices and not a government board that was allocating funds.

PHASED IN 2 PERCENT INDIVIDUAL ACCOUNTS WITH SHORT-TERM TRANSFER TO TRUST FUND FOR STOCKS

- Create $145 per worker plus 0.5 percent of earnings individual accounts for 2000-2009, $290 plus 1 percent thereafter funded out of general revenue.
- Transfer ½ of projected unified budget surplus to Social Security Trust Fund and invest in stocks. Limit the share of the Trust Fund invested in stocks to 25 percent.
- Make common set of reforms.
- Make additional adjustments in traditional Social Security to achieve solvency.

KEY ATTRACTIONS OF THIS APPROACH

- Ultimately creates 2 percent of payroll individual accounts while strengthening traditional Social Security as well.

KEY DISADVANTAGES OF THIS APPROACH

- The 2 percent of payroll individual account will need to be funded even after the surpluses run out.
- Government would eventually own between 5.3 and 8.0 percent of the stock market depending on methodology used.

IMPACT ON 75-YEAR ACTUARIAL BALANCE

Common set of reforms	+0.97
Tax indiv. accounts like ordinary income	+0.17
General revenue transfer to TF and buy stocks	+1.01
Across the board cuts to achieve solvency	+0.07
Remaining Actuarial Balance	+0.00

IMPACT ON BENEFITS IN 2030
PERCENT OF CURRENT LAW BENEFITS

	Low Earner ($12,000)	Average Earner ($27,000)	High Earner ($43,000)
Common Set of Reforms	-3.0%	-3.0%	-3.0%
Across-the-Board Cuts Implied by Remaining Shortfall	-1.1	-1.1	-1.1
Annuity provided by Individual Account	+20.4	+17.1	+16.8
Total	**+16.3**	**+13.0**	**+12.7**

Add-on Individual Account with Escrow Account to Sustain Individual Accounts

- Fund $580 per worker individual accounts out of general revenue. Assume these funds are invested 50-50 in stocks and bonds.
- After funding individual accounts, place 70 percent of remaining surpluses in an escrow account invested 50-50 in stocks and bonds. Use the escrow account to fund individual account contributions after the unified budget surplus runs out.
- 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).
- Make additional across the board benefit cuts by revising the benefit formula, but keep disability benefits at current-law levels.

Key Attractions of This Approach

- Sustains individual accounts even after surpluses run out, thereby avoiding pressure to cut other programs to fund the new individual account "entitlement."

Key Disadvantages of This Approach

- Has same disadvantages as other plans that combine individual accounts and government investment in private securities.
- Some may find this proposal unusual and therefore not sound because it uses the escrow account to prefund individual account contributions rather than retirement benefits -- a type of prefunding that people are more accustomed to in their pension plans.

Impact on 75-Year Actuarial Balance

Common set of reforms	+0.97
Across the board cuts to achieve solvency	+1.22
Remaining Actuarial Balance	+0.01

Impact on Benefits in 2030
Percent of Current Law Benefits

	Low Earner ($12,000)	Average Earner ($27,000)	High Earner ($43,000)
Common Set of Reforms	-3.0%	-3.0%	-3.0%
Across-the-Board Cuts Implied by Remaining Shortfall	-13.3	-13.3	-13.3
Annuity provided by Individual Account	+34.4	+20.8	+15.8
Total	+18.1	+4.5	-0.5

FLAT-DOLLAR ADD-ON IA WITH 50 PERCENT INTEGRATION

- Fund $580 per worker individual accounts out of general revenue. Assume these funds are invested 50-50 stocks and bonds.
- Use 50 percent of individual accounts to fund traditional Social Security benefit. Tax other half of retirement income from individual accounts like Social Security
- Make common set of reforms.
- Make additional adjustments to traditional Social Security program to restore solvency.

KEY ATTRACTIONS OF THIS APPROACH

- Creates individual accounts and strengthens traditional Social Security without government ownership of private securities.
- Integration of the benefit may make people more likely to perceive that their individual account is added together to their traditional benefit in providing their overall benefit.

KEY DISADVANTAGES OF THIS APPROACH

- When the government uses 50 percent of the individual account to fund the traditional benefit, people may feel that they are losing half of their account rather than understanding all along that the account had two parts -- one part which funds the traditional benefit and another part that provides additional retirement income.
- May be perceived as complicated.
- The individual accounts would represent between 6.7 and 12.5 percent of the stock market.

IMPACT ON 75-YEAR ACTUARIAL BALANCE

Common set of reforms	+0.97
Tax individual accounts like OASDI	+0.06
50 percent clawback of indiv. accounts	+0.90
Across the board cuts to achieve solvency	+0.26
Remaining Actuarial Balance	+0.00

IMPACT ON BENEFITS IN 2030
PERCENT OF CURRENT LAW BENEFITS

	Low Earner ($12,000)	Average Earner ($27,000)	High Earner ($43,000)
Common Set of Reforms	-3.0%	-3.0%	-3.0%
Across-the-Board Cuts Implied by Remaining Shortfall	-3.2	-3.2	-3.2
Annuity provided by Individual Account	+17.2	+10.4	+7.9
Total	+11.0	+4.2	+1.7

Plans That Fund Individual Accounts Out of the Existing 12.4 Percent Social Security Payroll Tax

Breaux-Gregg-Kolbe-Stenholm Plan

- Use 2 percent of the existing 12.4 percent Social Security payroll tax to fund 2 percent of payroll individual accounts.

- Make reforms to traditional Social Security program:
  - -- Reduce second and third bend points by 2 percent per year for 20 years.
  - -- Reduce COLA by 0.5 percentage points.
  - -- Increase normal retirement age by 2 months per year until it reaches 70, then index.
  - -- Cover new state and local workers.
  - -- Reduce spouse benefits from 50 to 33 percent of PIA.
  - -- Increase computation period to 40 years, but count all earnings.
  - -- Eliminate earnings test.
  - -- Credit all taxation of Social Security benefits to OASDI.
  - -- Create new minimum benefit.

Key Attractions of This Approach

- Plan is fiscally responsible

Key Disadvantages of This Approach

- Reduces benefits compared to present law (though not compared to the 72 percent of benefits that are affordable in 2032 if no changes are made).

Impact on 75-year Actuarial Balance

Remaining Actuarial Balance	+0.00

Impact on Benefits in 2030
Percent of Current Law Benefits

	Low Earner ($12,000)	Average Earner ($27,000)	High Earner ($43,000)
Change in Traditional Benefits	-25.1%	-39.5%	-42.2%
Annuity provided by Individual Account	+16.2	+21.6	+26.2
Total	-8.9	-17.9	-16.0

A Kinder and Gentler Carve-out Plan

- A carve-out plan does not have to result in large benefit cuts. If general revenues are used to the same extent as in the add-on individual account (but are transferred to the trust fund instead of being used to finance individual accounts, the benefit levels would be the same. It may be harder to sustain general fund transfers to Social Security once surpluses run out than it would be to sustain transfers to individual accounts.

THE WHITE HOUSE

WASHINGTON

MEETING ON CONGRESSIONAL AND THINK-TANK SOCIAL SECURITY REFORM APPROACHES

PART II

Cabinet Room
November 24, 1998
3:05 p.m.

AGENDA

III. PLANS THAT USE SURPLUSES BOTH TO STRENGTHEN THE TRUST FUND AND ESTABLISH INDIVIDUAL ACCOUNTS

Discussed Last Time:

I. PLANS THAT TRANSFER SURPLUSES TO TRUST FUND

II. PLANS THAT USE SURPLUSES TO FUND INDIVIDUAL ACCOUNTS

A Basic Typology of Plans

We will be discussing six forms of Social Security plans. All of these plans use the surplus in one way or another, and all could be designed to do so to a greater or lesser extent.

Title	Description
A. Plans That Use the Surplus to Shore up the Trust Fund	
1. Bond-only plans	Maintain current policy of holding only Treasury securities.
2. Equities in the Trust Fund	Introduce equities into the system, but hold them collectively.
B. Plans That Use the Surplus in Creating Individual Accounts	
3. Add-on individual accounts	Continue to use all of the current 12.4 percent payroll tax to fund traditional Social Security benefits; make sufficient adjustments to the system (benefit cuts, revenue increases) to bring it into balance. Establish individual accounts in addition to the current system.
4. Carve-out individual accounts	Divert some of the current 12.4 percent payroll tax into individual accounts. Individual accounts *replace* part of the current system, and could potentially be described as a tax cut. Relatively large surplus transfers and/or cuts to the traditional Social Security benefit would be necessary to restore solvency. So far, most carve-out plans have been "fiscally conservative" with significant cuts through such provisions as raising the retirement age. With more use of the surplus, the cuts could be softened.
C. Plans That Use the Surplus Both to Shore up the Trust Fund and to Fund Individual Accounts	
5. Integrative plans	Use surplus to establish individual accounts. At retirement, part of the proceeds of the accounts are used to finance traditional benefits, while part provide an add-on individual account.
6. Hybrid plans	Contribute part of the surplus directly into the Trust Fund, as under (1) or (2), and part into individual accounts as under (3) or (4).

THREE BASIC REFORMS

At this point, we want our discussion to focus on fundamental issues of plan design that could impact our short-term strategy for achieving reform, and to avoid spending too much time on details that can be worked out at a later date.

- Many of our plans contain three basic provisions that are meant as place holders for benefit cuts and/or revenue increases to be determined later. The three provisions we happen to have chosen close 44 percent of the 75-year actuarial imbalance. There would be many other ways to achieve similar solvency effects.

  -- **Raise the taxable maximum for the OASDI payroll tax so that 90 percent of earnings are taxed by 2010:** This would return the percentage of earnings that are covered to where it was in 1982 and 1983. In 1998 dollars, it would be equivalent to raising the taxable maximum from $68,400 to $95,100. It would raise taxes by up to $1,655 (each for workers and employers) for the six percent of workers with earnings above $68,400. We are exploring ways to raise revenues without having such a large effect.

  -- **Cover state and local government new hires beginning in 2011.**

  -- **Increase the number of years used in calculating Social Security benefits from 35 to 38.**

- These proposals could be replaced with an across-the-board benefit cut of 10 percent. While all three of these proposals are likely to run into serious political opposition, it is important to note that only one of these three provisions results in a reduction in Social Security benefits for future retirees, and that the reduction equals only 3 percent of current-law benefits. Replacing these provisions with an across-the-board benefit cut would require a 10-percent cut in benefits for 2015 and later (or 20 percent by 2040 if the cuts were phased in more slowly). Such benefit cuts may be even less palatable than these three basic provisions.

I. Plans that Transfer Surplus to the Trust Fund

Transfer Unified Budget Surpluses To Social Security Trust Fund and Invest in Bonds Only

- Transfer 91 **percent** of the *currently projected* unified budget surpluses to the Trust Fund for as long as they last (2033), and continue to invest the Trust Fund in government bonds only.

- Do not include common set of reforms.

Key Attractions of This Approach
• Continues the program on a completely defined benefit basis, avoiding potentially costly and risky alternative approaches.
• Preserves benefits at current law levels.
• Prevents nearly all of the surplus from being used for other purposes.
• Very consistent with our message of the past year that surpluses have been reserved pending Social Security reform.

Key Disadvantages of this Approach
• See box on next page.

Impact on 75-year Actuarial Balance (current balance is -2.19)	
Common set of reforms	NA
General revenue transfer to Trust Fund	+2.22
Remaining Actuarial Balance	+0.03

Impact on Benefits in 2030 Percent of Current Law Benefits			
	Low Earner ($12,000)	Average Earner ($27,000)	High Earner ($43,000)
Total	+0.0	+0.0	+0.0

Alternative Version with 3 Common Reforms:

- Transfer **55 percent** of the *currently projected* UB surplus to Trust Fund for as long as they last (2031), and continue to invest the Trust Fund only in government bonds.

- 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).

KEY CHALLENGES ASSOCIATED WITH BONDS ONLY PLANS

- **Will Transfers of the Surplus Help Us Prepare for the Future?** Transfers of the budget surplus to the Trust Fund do not reduce the mismatch between annual tax revenues and benefit obligations in the out years. However, to the extent that transfers allow us to use the surplus to pay off debt (or purchase private securities), they will leave us in a stronger financial position when the demographic challenges arrive.

- **Will Transfers Succeed in Removing Surpluses from the Books?** Under current budget scoring rules, transfers used to purchase government bonds would not remove any unified budget surplus from the books, and therefore would not prevent the surplus from being used for tax cuts or new spending. However, allocating the surpluses for Social Security could lead to a change in scoring rules.

- **The Double Counting Problem.** The Trust Fund has already been credited with the excess of Social Security taxes over benefits. The current unified budget surplus is entirely due to the Social Security surplus. Under OMB projections, 89 percent of unified budget surpluses over the next 10 years are due to Social Security (under CBO projections, 98 percent are due to SS). If we were to transfer the surplus to Social Security, some might complain that we were crediting the Trust Fund twice. Indeed, some people already argue that the Trust Fund is not "real" and that we are "raiding" the Social Security Trust Fund to mask non-Social Security deficits.

- **Maintains and Expands Social Security Trust Fund Structure.** Many Democrats and Republicans do not support the trust fund structure, saying that it does not truly set aside money for Social Security and does not prevent the funds from being spent. By transferring additional funds to the trust fund, this type of plan would expand Social Security's reliance on the trust fund structure.

- **Sustaining Transfers If Surpluses Do Not Materialize.** If the full projected surpluses do not materialize and transfers are scored as outlays, then the transfers could result in budget deficits. To the extent that these deficits are financed by issuing debt, then we will not have done anything to improve the long run fiscal situation. In addition, it the future it may appear strange to be transferring amounts based on projections of surpluses from many years before.

Transfer Surplus to Trust Fund and Invest in Equities

- Transfer **68 percent** of the *currently projected* unified budget surpluses to the Trust Fund for **1999-2032** to purchase equities. Limit the share of the Trust Fund invested in equities to 25 percent.

Key Attractions of This Approach
• Continues the program on a completely defined benefit basis.
• Achieves higher returns with low administrative costs while spreading risk across the population and over time.
• Preserves benefits at current law levels.

Key Disadvantages of This Approach
• The government would own between 5 and 11 percent of the stock market depending on the methodology used. See the box on the next page for details

Impact on 75-Year Actuarial Balance (current balance is -2.19)	
Common set of reforms	NA
General revenue transfer to Trust Fund	+2.20
Across the board cuts to achieve solvency	NA
Remaining Actuarial Balance	+0.01

Impact on Benefits in 2030
Percent of Current Law Benefits

	Low Earner ($12,000)	Average Earner ($27,000)	High Earner ($43,000)
Total	+0.0	+0.0	+0.0

Alternative Version with Common Set of Reforms:

- Transfer **50 percent** of the currently projected UB surpluses to the Trust Fund for **1999-2008** to purchase equities. Limit the share of the Trust Fund invested in equities to 25 percent.

- 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).

- Make across the board benefit cuts of 6 percent to achieve solvency.

SUBOPTION:
SAVE SOCIAL SECURITY WITH SOCIAL SECURITY PLUS ACCOUNT

- It would be possible to use the surplus remaining after achieving actuarial balance to fund individual accounts that are truly in addition to the traditional benefit. The equities in the trust fund would be preserving the traditional structure, and the individual accounts would be on top of the full traditional benefit. Therefore, doubts about sustainability and risk of the individual accounts would not threaten the traditional Social Security program. However, the plan would rely on essentially all of the currently projected surpluses for 30 years. Thereafter, this plan could create demands for deficit funding of the individual accounts.

ISSUES ARISING FROM INVESTING THE TRUST FUND IN EQUITIES

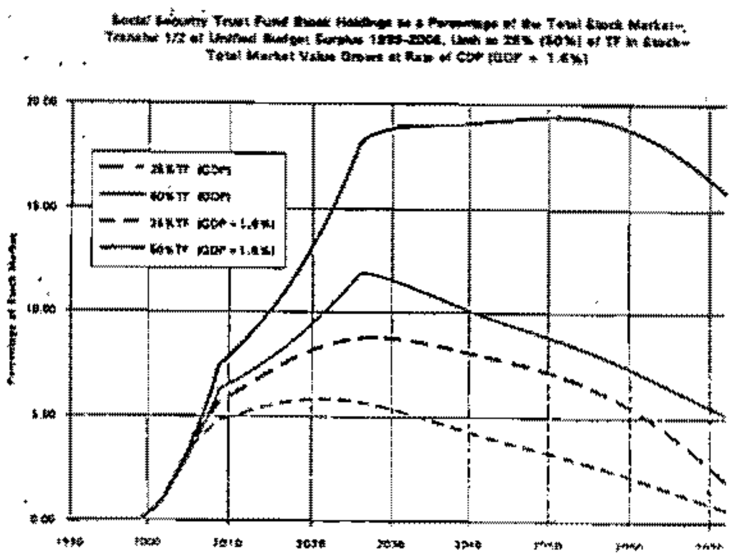
- **Government Ownership of Private Securities.** In the plans shown on the previous page, the government would eventually hold between 5 and 11 percent of the overall stock market. This raises three important concerns:

  1. **Largest Shareholder.** If the Trust Fund owned 10 percent of the stock market, the government would be the largest shareholder in at least 70 percent of U.S. publicly traded corporations.

  2. **Political Influence on Investment Choices.** Congress could legislate restrictions on what the funds could invest in (e.g. no tobacco stocks).

  3. **Corporate Governance Issues.** For example, how would government-owned shares be voted at stockholder meetings?

There are different methodologies for projecting the future size of the stock market. Depending on the methodology chosen, one obtains different estimates of the share of the total stock market held by the trust fund. The chart below shows the share of the stock market held by the trust fund for two different reform plans under two different assumptions about the future growth rate of the stock market.



The Pervasiveness of Corporate Governance Issues

- While issues of government ownership of private securities do not arise in the case of individual accounts, issues of political influence over investment choices and of corporate governance could still be large, especially if investment choices were limited to a few government-authorized index funds.

What Happens If the Stock Market Performs Poorly?

- If the stock market performs worse than is projected, the balance in the trust fund will be lower than projected, creating pressure for additional revenue sources or benefit cuts. This is a common feature of plans that depend on stock market returns to fund traditional Social Security benefits.

II. Plans That Use the Surplus to Fund Individual Accounts

FIVE KEY ISSUES CONCERNING INDIVIDUAL ACCOUNTS

KEY ISSUE #1: PERCEPTIONS OF BENEFIT LEVELS

- People might perceive that the individual account is part of the total Social Security benefit, and has more than made up for the reduction in the traditional benefit.

- Alternatively, people might think of their individual account as risky and uncertain, and perceive that they received a 16-percent reduction in their Social Security benefit.

- Plans which guarantee benefit levels or which integrate the individual account and the defined benefit may be more successful in getting people to look at their total benefit.

Example: Impact on Benefits (Percentage of current law benefits)

Change in traditional benefit	-16.3 percent
<u>Annuity from individual account</u>	<u>+20.8 percent</u>
Total	+4.5 percent

KEY ISSUE #2: BENEFIT GUARANTEES

Because individual accounts expose individuals to more risk, it might be desirable to shift some of that risk to society as a whole.

- <u>**Providing a Safe Investment Option.**</u> One way to do this would be to offer a safe investment option -- for example, Treasury Inflation Protected Securities -- and to design a reform package to ensure that workers who chose this safe investment option have a reasonable level of benefits.

  -- The downside of this approach is that it might encourage individuals -- particularly low-income individuals -- to take too little risk.

- <u>**Guaranteeing Current-law Benefits.**</u> Another option would be to let people invest however they choose, but to guarantee that the combined benefit from traditional Social Security and the individual account would at least equal the current-law traditional Social Security benefit (Sen. Gramm's plan adopts this approach).

  -- A guaranteed benefit might encourage workers to take too much risk, since they would receive the upside gains, while the government would protect them on the downside. However, some argue that many investors do not take on enough risk. Moreover, if the portfolio choices were limited to basic index funds, the extent of this "moral hazard" problem would probably be minimal.

  -- A guarantee shifts risk away from individuals and onto the unified budget. We are currently trying to quantify the extent of this risk.

Key Issue #3: Fiscal Sustainability

For How Long Can We Afford to Fund Individual Accounts Out of the Surplus?

- If remaining surpluses are spent, 2 percent individual accounts can be afforded until around 2023.
- Once the surpluses have run out we could continue to fund the individual accounts out of general revenues (this would cost around 0.8 percent of GDP), or we could trigger in traditional reforms to pay for the individual accounts.
- It might also be possible to set aside some of the extra surpluses in the early years to prefund individual account contributions in later years. We present a plan like this later in the packet.

Key Issue #4: Designing a Package with "Wins" for Both Parties

- **Individual accounts can be provided in a way that is more progressive than the current defined benefit Social Security system.** We could propose a negotiating principle that the traditional benefit must remain as progressive as it currently is, and that any individual accounts must be *more* progressive.
- **Our reform package could include initiatives to reduce elderly poverty, particularly among widows, and to help other needy populations.** We are developing a list of policy options in this area. For example, if progressive individual accounts were at least partially bequeathable, low-income families with short life expectancies could potentially benefit more from the progressivity of the individual accounts than they do from the progressivity of the current system.

Key Issue #5: Feasibility and Cost of Individual Accounts

- **Individual accounts in foreign countries have proven very costly.** In both the U.K. and Chile, administrative costs absorb 20 percent or more of account accumulations under their systems of individual accounts.

- **Lower costs might be achievable by limiting choice.** At the cost of severely limiting choices, it may be possible to keep costs down significantly. Our benefit numbers assume a very low administrative cost of 10 basis points per year. This would correspond to a reduction in account accumulation of only 2 percent.

- **Low-cost plans would also be low-service plans.** The level of services associated with a plan this cheap would be very low, and in particular would compare unfavorably with the level of services offered through most 401(k) plans. Specifically, a bare-bones plan might offer annual reporting rather than monthly or even daily reporting, a much narrower range of asset choice, and a far lesser ability to switch among available assets.

- **Contributions would lag earnings.** For individual account funding approaches that are tied to past earnings, the delays in making contributions into accounts could be perceived to be very long. Under current procedures, workers' earnings for the prior year are not verified until November in the current year. Thus, if a system of this type were in force currently, workers' last recorded contribution as of today might be for 1996; or workers might just have received their contributions for 1997.

- **Funding out of the surplus might alleviate the perception problem.** It might be argued that since the funding of these accounts was coming from the surplus, individuals would not perceive the contributions to be tied to their earnings, and therefore not see it as arriving late.

- **Other approaches might be possible.** It is also possible, though not yet fully verified, that some acceleration of contributions could be achieved through a change in procedures.

Flat-Dollar Add-on Individual Account with Across the Board Benefit Cuts to Restore Solvency

- Fund $580 per worker individual accounts out of general revenue. Assume these funds are invested 50-50 in stocks and bonds.
- 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).
- Make additional across the board benefit cuts by revising the benefit formula, but keep disability benefits at current-law levels.

Key Attractions of This Approach

- Gives individuals control over their retirement savings. Could be described as building wealth.
- Achieves higher returns while avoiding government ownership of private securities.

Key Disadvantages of This Approach

- Surpluses are not sufficient to fund individual accounts forever.

Impact on 75-Year Actuarial Balance (current balance is -2.19)

Common set of reforms	+0.97
Across the board cuts to achieve solvency	+1.22
Remaining Actuarial Balance	+0.01

Impact on Benefits in 2030
Percent of Current Law Benefits

	Low Earner ($12,000)	Average Earner ($27,000)	High Earner ($43,000)
Common Set of Reforms	-3.0%	-3.0%	-3.0%
Across-the-Board Cuts Implied by Remaining Shortfall	-13.3	-13.3	-13.3
Annuity provided by Individual Account	+34.4	+20.8	+15.8
Total	+18.1	+4.5	-0.5

PARTIALLY VOLUNTARY INDIVIDUAL ACCOUNTS

- Fund $290 per worker individual accounts out of general revenue. Assume these funds are invested 50-50 in stocks and bonds. ***Allow workers to voluntarily contribute an additional 1 percent of earnings to their accounts.***

- Make common set of reforms.

- Make additional across the board benefit cuts by revising the benefit formula, but keep disability benefits at current-law levels.

KEY ATTRACTIONS OF THIS APPROACH

- Cuts in half the long-term fiscal obligation of the government to finance individual accounts.

- Preserves benefit levels for low-income workers even if they do not make voluntary contributions.

KEY DISADVANTAGES OF THIS APPROACH

- Some may feel they are being asked to add an additional one percent of payroll taxes simply to maintain their existing Social Security benefit level.

IMPACT ON BENEFITS IN 2030
PERCENT OF CURRENT LAW BENEFITS

	Low Earner ($12,000)	Average Earner ($27,000)	High Earner ($43,000)
Common Set of Reforms	-3.0%	-3.0%	-3.0%
Across-the-Board Cuts Implied by Remaining Shortfall	-13.3	-13.3	-13.3
Annuity provided by Individual Account	+17.2	+10.4	+7.9
Total without voluntary contribution	+0.9	-5.9	-8.4
Maximum annuity provided by voluntary Individual Account	+8.1	+10.8	+13.1
Total	+9.0	+4.9	+4.7

Under current law, annual benefit levels are $6010 for the low earner, $9925 for the average earner, and $13,112 for the high earner.

III. Plans that Use the Surplus Both to Shore up the Trust Fund and to Fund Individual Accounts

HYBRID PLANS:
INDIVIDUAL ACCOUNTS AND TRUST FUND EQUITY INVESTMENTS

- Create $290 per worker individual accounts funded out of general revenue.
- Invest Trust Fund assets worth 1 percent of payroll in stocks. Limit the share of the Trust Fund invested in stocks to 25 percent.
- Make common set of reforms.
- Make additional across the board cut in benefits to achieve solvency.

KEY ATTRACTIONS OF THIS APPROACH

- Provides wins for both sides. Shores up traditional Social Security and establishes individual accounts.
- Because individual accounts are small, sustaining them in the out years will not create much pressure on other programs.
- Because transfers to the trust fund are modest, the peak share of the stock market owned by the trust fund will be between 3.7 and 5.7 percent.

KEY DISADVANTAGES OF THIS APPROACH

- Has the downsides of both individual accounts and trust fund investments: the high administrative costs of small individual accounts and the problems of government ownership of private securities.

IMPACT ON 75-YEAR ACTUARIAL BALANCE (current balance is -2.19)

Common set of reforms	+0.97
Tax indiv. accounts like OASDI	+0.06
Redeem TF assets to buy stocks	+0.58
Across the board cuts to achieve solvency	+0.73
Remaining Actuarial Balance	+0.00

IMPACT ON BENEFITS IN 2030
PERCENT OF CURRENT LAW BENEFITS

	Low Earner ($12,000)	Average Earner ($27,000)	High Earner ($43,000)
Common Set of Reforms	-3.0%	-3.0%	-3.0%
Across-the-Board Cuts Implied by Remaining Shortfall	-8.0	-8.0	-8.0
Annuity provided by Individual Account	+17.2	+10.4	+7.9
Total	+6.2	-0.6	-3.1

ARE THERE WAYS TO REDUCE GOVERNMENT OWNERSHIP CONCERNS?

- **Trust Fund investments could be allocated according to investment choices of individuals in their individual accounts.** In plans that combine Trust Fund investments with individual accounts, it might be possible to have the Trust Fund allocate its investments according to the aggregate investment behavior of individuals in their individual accounts. This idea -- and other ideas like it -- could allow defenders of government investment to say that it was millions of individual choices and not a government board that was allocating funds.

- **Many of the fundamental issues of corporate governance continue to arise in this approach.** Because the individual accounts being "mirrored" by the trust fund investments are presumed to be invested TSP-style, in government-authorized funds, issues of political influence over investment choices and of corporate governance could still be large.

Add-on Individual Account with Escrow Account to Sustain Individual Accounts

- Fund $580 per worker individual accounts out of general revenue. Assume these funds are invested 50-50 in stocks and bonds.
- After funding individual accounts, place 70 percent of remaining surpluses in an escrow account invested 50-50 in stocks and bonds. Use the escrow account to fund individual account contributions after the unified budget surplus runs out.
- 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).
- Make additional across the board benefit cuts by revising the benefit formula, but keep disability benefits at current-law levels.

Key Attractions of This Approach

- Sustains individual accounts even after surpluses run out, thereby avoiding pressure to cut other programs to fund the new individual account "entitlement."

Key Disadvantages of This Approach

- Has same disadvantages as other plans that combine individual accounts and government investment in private securities.
- Some may find this proposal unusual and therefore not sound because it uses the escrow account to prefund individual account contributions rather than retirement benefits. People are used to the idea of prefunding pension benefits, but it would be novel to prefund pension contributions.

Impact on 75-Year Actuarial Balance (current balance is -2.19)

Common set of reforms	+0.97
Across the board cuts to achieve solvency	+1.22
Remaining Actuarial Balance	+0.01

Impact on Benefits in 2030, Percent of Current Law Benefits

	Low Earner ($12,000)	Average Earner ($27,000)	High Earner ($43,000)
Common Set of Reforms	-3.0%	-3.0%	-3.0%
Across-the-Board Cuts Implied by Remaining Shortfall	-13.3	-13.3	-13.3
Annuity provided by Individual Account	+34.4	+20.8	+15.8
Total	+18.1	+4.5	-0.5

Flat-Dollar Add-on IA with 50 percent Integration

- Fund $580 per worker individual accounts out of general revenue. Assume these funds are invested 50-50 stocks and bonds.
- Use 50 percent of individual accounts to fund traditional Social Security benefit. Tax other half of retirement income from individual accounts like Social Security
- Make common set of reforms and additional adjustments to traditional Social Security program to restore solvency.

Key Attractions of This Approach

- Traditional benefits (after six percent reduction) are guaranteed regardless of how the market performs.
- Achieves nearly the same outcome as a trust fund investment in equities plan without creating perception of government ownership of private securities. Indeed, some prominent Republicans have embraced this approach.
- Integration of the benefit may make people more likely to perceive that their individual account is added together to their traditional benefit in providing their overall benefit.

Key Disadvantages of This Approach

- When the government uses 50 percent of the individual account to fund the traditional benefit, people may feel that they are losing half of their account rather than understanding all along that the account has two parts -- one part which funds the traditional benefit and another part that provides additional retirement income.
- May be perceived as complicated.

Impact on 75-Year Actuarial Balance (current balance is -2.19)

Common set of reforms	+0.97
Tax individual accounts like OASDI	+0.06
50 percent clawback of indiv. accounts	+0.90
Across the board cuts to achieve solvency	+0.26
Remaining Actuarial Balance	+0.00

Impact on Benefits in 2030
Percent of Current Law Benefits

	Low Earner ($12,000)	Average Earner ($27,000)	High Earner ($43,000)
Common Set of Reforms	-3.0%	-3.0%	-3.0%
Across-the-Board Cuts Implied by Remaining Shortfall	-3.2	-3.2	-3.2
Annuity provided by Individual Account	+17.2	+10.4	+7.9
Total	+11.0	+4.2	+1.7

Plans That Fund Individual Accounts Out of the Existing 12.4 Percent Social Security Payroll Tax

BREAUX-GREGG-KOLBE-STENHOLM PLAN

- Use 2 percent of the existing 12.4 percent Social Security payroll tax to fund 2 percent of payroll individual accounts.
- Make reforms to traditional Social Security program:
  -- Reduce second and third bend points by 2 percent per year for 20 years.
  -- Reduce COLA by 0.5 percentage points.
  -- Increase normal retirement age by 2 months per year until it reaches 70, then index.
  -- Cover new state and local workers.
  -- Reduce spouse benefits from 50 to 33 percent of PIA.
  -- Increase computation period to 40 years, but count all earnings.
  -- Eliminate earnings test.
  -- Credit all taxation of Social Security benefits to OASDI.
  -- Create new minimum benefit.

KEY ATTRACTIONS OF THIS APPROACH

- Plan is fiscally responsible.

KEY DISADVANTAGES OF THIS APPROACH

- Reduces benefits compared to present law (though not compared to the 72 percent of benefits that are affordable in 2032 if no changes are made).

IMPACT ON 75-YEAR ACTUARIAL BALANCE (current balance is -2.19)	
Remaining Actuarial Balance	+0.00

IMPACT ON BENEFITS IN 2030
PERCENT OF CURRENT LAW BENEFITS

	Low Earner ($12,000)	Average Earner ($27,000)	High Earner ($43,000)
Change in Traditional Benefits	-25.1%	-39.5%	-42.2%
Annuity provided by Individual Account	16.2	21.6	26.2
Total	-8.9	-17.9	-16.0

2 Percent Carve-out for 2 Percent Individual Accounts with Transfer of Remaining Surplus for Bonds

- Redirect 2 percent of OASDI payroll tax beginning in 2000 to fund 2 percent of payroll individual accounts. Assume these funds are invested 50-50 in stocks and bonds. Transfer remaining *currently projected* surpluses to the trust fund and invest them in bonds.

- 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).

- Make additional across the board cuts by revising the benefit formula.

Key Attractions of This Approach

- Plan is fiscally responsible and would reduce long-term budget deficits and increase national savings even compared with the baseline that uses the surplus to pay off debt.

- The combined retirement income from individual accounts and traditional benefit would be close to currently promised benefit levels.

Key Disadvantages of This Approach

- In the long run, the individual account would be providing roughly 40 percent of the total benefit. Benefit levels would depend heavily on stock market performance.

- Because it uses some of the current payroll tax to fund individual accounts, this plan could be perceived as the first step toward total privatization.

Impact on 75-Year Actuarial Balance (current balance is -2.19)

Common set of reforms	+0.97	
Two percent carve-out	-1.92	
Transfer of remaining surpluses to OASDI		+1.45
Across the board cuts to achieve solvency		+1.71
Remaining Actuarial Balance	+0.03	

Impact on Benefits in 2030
Percent of Current Law Benefits

	Low Earner ($12,000)	Average Earner ($27,000)	High Earner ($43,000)
Common Set of Reforms	-3.0%	-3.0%	-3.0%
Across-the-Board Cuts Implied by Remaining Shortfall	-18.7	-18.7	-18.7
Annuity provided by Individual Account	+16.2	+21.6	+26.2
Total	-5.5	-0.1	+4.5

Note: if individual accounts were funded more progressively, the total benefits for low earners could exceed currently promised levels.

STRATEGIC DISCUSSION OF A PLAN THAT INVESTS EQUITIES IN THE TRUST FUND

Many of the fundamental decisions related to Social Security reform can be framed by examining a plan that relies exclusively on prefunding and equity investment.

BASE PLAN
• Transfer 60 **percent** of the *currently projected* unified budget surpluses to the Trust Fund for **1999-2032** to purchase equities. Limit the share of the Trust Fund invested in equities to 33 percent.
• Spend one quarter of the remaining surpluses on discretionary spending and three quarters on Medicare or debt reduction. Roughly $500 billion would be available over 10 years.

This plan would command substantial support because it preserves the current structure of the system, and it avoids making any cuts in benefits. However there are three key critiques of this approach:

- Fiscal responsibility
- Raises corporate governance concerns
- Lacks individual accounts

ALTERNATIVE A: DO SOME TRADITIONAL REFORMS AS WELL
• Include 3 basic provisions (increase computation years, cover state and local workers, increase taxable maximum). Do additional 3 percent across the board cut in benefits.
• Transfer 50 percent of the currently projected surpluses to trust fund to purchase equities for only ten years (1999-2008). Limit trust fund to 25 percent equities. Alternatively, could transfer 35 percent of the surplus for as long as it lasts.

ALTERNATIVE B: SOCIAL SECURITY PLUS ACCOUNT
• Spend three-quarters of remaining surpluses on individual account and one quarter on discretionary spending. Account could be flat dollar or it could provide matches for voluntary contributions. Could afford approximately $200 per worker contributions for about 20 years (there would be shortfalls in early years).

FISCAL DISCIPLINE

Critiques of this approach:

- **Allocates additional resources to the elderly.** For those who feel that society is spending too much on the elderly already, this approach directs additional resources to the elderly in order to maintain all of currently promised benefits.

- **Depending on surpluses and stock returns is risky.** This plan relies completely on 30 years of budget surpluses and on equity returns. Both components are uncertain. If budget surpluses do not materialize, then continuing general fund transfers to OASDI may result in pressure to cut other spending programs. If equity returns are lower than projected, then we will need to do Social Security reform again at a later date.

- **Does not directly address long-run funding gap.** This plan does not close any of the gap between current year tax revenue and benefit payments, and it has a trust fund that is declining at the end of the 75-year window.

- **Uses general fund transfers.** Because the plan relies on substantial general revenue transfers, it precludes the use of these funds for other purposes (including Medicare financing, education spending, etc.), and it exposes the plan to criticism for crediting the trust fund with the Social Security surplus a second time.

Rejoinders:

- **Why do pain if there are surpluses available?** Those who argue that we should rely less on surpluses and higher returns and that we should rely more on traditional benefit cuts and revenue increases must explain why we should make painful adjustments to Social Security when the surpluses are otherwise likely to go for defense spending and tax cuts for the rich.

- **Plan allows for additional spending.** The surpluses remaining after this plan is enacted could be used for a combination of individual accounts, tax cuts, and discretionary spending.

- **Uses Social Security surpluses for Social Security.** Since most of the surpluses are due to Social Security, it makes sense to use them to strengthen Social Security. If the surpluses are used for other things, we could be attacked for using Social Security tax revenue for non-Social Security purposes.

- **Tax cuts would make long run fiscal situation even worse.** If we fail to achieve Social Security reform and the surpluses are used for permanent tax cuts, the long run fiscal situation will be even worse when we finally do get around to fixing Social Security.

GOVERNMENT OWNERSHIP OF PRIVATE SECURITIES

Critiques of this approach

- **Government ownership.**

  -- Government would own at least 5 percent of the stock market and perhaps as much as 11 percent. Critics could potentially use a methodology that produced estimates that are even higher.

  -- If the government owned 10 percent of the market, it would be the largest shareholder in more than 70 percent of U.S. publicly traded corporations.

  -- People would question why we were encouraging other countries to move toward private markets when our government was acquiring shares in private companies.

- **Political influence on investment decisions.** There might be pressure for the government to invest in socially desirable activities such as affordable housing that may have lower rates of return and to divest from companies in unpopular but profitable industries.

- **Corporate Governance.** Government voting of shares would likely be perceived as interference, but government abstinence from voting might give too much influence to remaining shareholders or management. Any structure of investment, no matter how independent could be altered by Congress and the President at any time in the future.

Rejoinders

- **Independent structures like the Federal Reserve System have proved resilient.** Could create an independent organization like the Federal Reserve with trustees who were appointed to long terms, and who could not be removed until the end of their term. In addition, funding for the independent body could come out of the system's own

GOVERNMENT INVESTMENT IN EQUITIES

Critiques of this approach

- **Stock market could perform poorly.** In real terms, the Dow Jones did not rebound to its 1968 peak until 1987. On three occasions during the past 70 years, the S&P 500 index has declined over two years by more than 35 percent. Japan's Nikkei has fallen by 60 percent since 1989.

- **Individual does not get sense of control or of accomplishing personal saving.** Much of the appeal of individual accounts is the perceived opportunity to build wealth. In the collective approach to investments, individuals will not have investment choices, see their accounts accumulate, or be able to bequeath part of their accounts.

- **People seem to like IRAs, why be paternalistic and enforce collective investment?**

Rejoinders

- **Market risk is accepted in private pension plans, why not in Social Security?**

- **If the economy performs poorly over long periods of time it doesn't matter what type of Social Security system we have, it will be hard to pay full benefits.**

- **Collective investing permits risk-pooling both within and across cohorts.** During the 20th century in the US, even large stock market declines have been more than made up by subsequent rebounds. For example, a portfolio of a worker who lived through the 1929 crash would have fully recovered by the end of 1936. By pooling risk, the trust fund approach removes the sensitivity of worker's retirement income to the particular year in which they reached retirement.

- **Collective investing provides high returns with low administrative costs.** Wall Street won't receive 20 percent of people's retirement income as it might in a moderately expensive individual account plan.

- **Over 40 year periods, risk of stock market may not be so great**

ALTERNATIVE A: DO SOME TRADITIONAL REFORMS AS WELL

- Include 3 basic provisions (increase computation years, cover state and local workers, increase taxable maximum). Do additional 3 percent across the board cut in benefits.
- Transfer 50 percent of the currently projected surpluses to trust fund to purchase equities for only ten years (1999-2008). Limit trust fund to 25 percent equities. Alternatively, could transfer 35 percent of the surplus for as long as it lasts.

Advantages:

- More fiscally responsible. Closes some of the long run imbalance between taxes and benefits. Potentially relies on only 10 years of surpluses.
- Frees up more of the long-run surpluses for Medicare and discretionary spending. People might be willing to tolerate small cuts in Social Security if the savings were allocated to Medicare.

Disadvantages:

- May not be able to prevent surpluses from being spent on tax cuts for the rich.
- Will have to compete with Republican individual account initiatives that promise no reductions in benefits.
- Preserving surpluses for Medicare may not be a viable strategy since there is unlikely to be a significant Medicare agreement this year.
- This plan has no individual accounts and no tax cuts. It is hard to see how such a plan results in a bipartisan consensus.

ALTERNATIVE B: SOCIAL SECURITY PLUS ACCOUNT
• Spend three-quarters of remaining surpluses on individual account and one quarter on discretionary spending. Account could be flat dollar or it could provide matches for voluntary contributions. Could afford approximately $200 per worker contributions for about 20 years (there would be shortfalls in early years).

Advantages:

- **Provides best of both worlds: saves Social Security and also provides individual accounts.**

- **Because the individual accounts are strictly in addition to the current law Social Security benefit, it is less essential that they be funded forever.** This reduces the "Stockman risk" of needing to fund them once surpluses run out.

- **Solidifies traditional Social Security while offering options for compromise with individual account supporters.**

Disadvantages:

- Individual accounts will be very small and therefore administrative costs will absorb a larger fraction of investment returns.

- While small individual accounts may be a valuable new benefit for low-income workers, it may be perceived is just one more tax preferred savings vehicle by upper-income workers.

- Even though the individual accounts will be small and are not essential to the total Social Security benefit, there may be some pressure to continue to fund them even after the surpluses run out, thereby creating pressure on other government programs.

THE WHITE HOUSE

WASHINGTON

Big Chall for 21st C [illegible]

1 Aging → SS/MC → LTC, elderly

2 Children → Ed, [illegible], Afterschl, Tobacco

3 Families [illegible] [illegible] work

December 3, 1998

4 Environ →

5 Econ → Empowerment → [illegible], [illegible] → WTO → Trade [illegible]

6 Security → [illegible] → [illegible]: [illegible] [illegible] [illegible] [illegible] [illegible]

MEMORANDUM FOR THE PRESIDENT

CC: JOHN PODESTA

THROUGH: MARIA ECHAVESTE

FROM: MICHAEL WALDMAN MW 7 Community → [illegible] [illegible] [illegible]
STATE OF THE UNION PLANNING GROUP

SUBJECT: HIGHLIGHTS OF DOMESTIC AND ECONOMIC POLICY MEMOS

You have been sent several memos from the policy councils, suggesting an array of new possible policies – some big, some small. The purpose of this memorandum is to identify what we believe are the most significant of these new policy proposals, so you can begin to see the shape of a possible State of the Union and budget.

This is not an exclusive list. In addition, it does not include many of the smaller proposals -- many of which were included in the memoranda to you from the policy councils -- which will undoubtedly be a part of the final speech. It reflects discussion among Bruce Reed, Elena Kagan, Gene Sperling, Sally Katzen, Maria Echaveste, Paul Begala, Jack Lew, Mark Penn, Lael Brainard and Doug Sosnik, among others.

Social Security. At this moment we don't have anything further to add to the ongoing discussions about what to say on Social Security -- except to reaffirm that, given the central place of Social Security in the speech last year, there will be enormous pressure to show some specificity in this address.

Long-Term Care Initiative. As you know, this is politically very powerful, and speaks to a real source of deep anxiety for typical families. The most important new proposal would be for a tax credit of up to $1,000 for disabled elderly or their caregivers (at a cost of about $6 billion over 5 years). In addition, the package could include a nursing home quality initiative; respite services, training and counseling for families who care for severely impaired elderly relatives; and new long-term care options for federal employees.

In addition to Social Security and long-term care, the policy councils are developing a full agenda of issues of particular concern to elderly Americans – including measures to fight fraud and other crime that preys on seniors, to provide housing and transportation for the elderly, and to strengthening pension protections and enhance pension portability.

Education -- teacher quality. The DPC believes that the most important and memorable new element to your education agenda should be a focus on teachers -- teacher training, teacher quality, teacher recruitment. This would build on the success this year of beginning to hire 100,000 new teachers (a proposal, it is worth noting, that gained more political traction than any previous education reform efforts).

The proposal being crafted will have several elements. Most noteworthy would be a new requirement, tied to federal aid, that new secondary teachers pass competency tests in a subject before they can teach it. In addition, we will mount a nationwide crackdown on teacher education schools, and move to reform teacher certification. These steps will be coupled with increased teacher recruitment scholarships, funds to help teachers go back to college when they teach outside their field. We can use the opportunity of the reauthorization of the ESEA to provide both "carrots" and "sticks" for a teacher quality initiative.

In addition, we will advance an expanded initiative on social promotion -- giving communitie that end social promotion more money for after school and summer school, tutoring, and other means to help children live up to high standards. Finally, there would be an array of other education initiatives, including a focus on failing schools and a renewed call for school modernization.

Breaking the cycle of violent crime -- a Crime Bill II. The 1994 Crime Act will expire at the end of FY 2000. We recommend that you challenge Congress to pass a new crime bill that builds on the core elements of the successful 1994 Act -- more police, smarter punishment, and more prevention. We believe that a new Crime Act should include the following elements: First, it should hire more community police and community prosecutors, with an emphasis on technology and training. It should expand the use of probation supervision and drug testing and treatment for prisoners and parolees. It should press your longstanding firearms priorities (juvenile Brady, Brady II, federal CAP legislation and child safety locks), and crack down on gun crimes and gun traffickers. Finally, in addition to other crime bill prevention programs, we could invest in promoting values-based crime and violence prevention efforts.

International economics. Last year, you discussed the international financial crisis when it was in its relatively early stages. Given the continued financial turmoil, and its impact on our own economy, we believe that the speech should have a significant discussion of world economy and the need to strengthen the international financial architecture. The NEC will be working to flesh out what should be said in this area, as well as an ambitious trade agenda building on the goals you anticipated at the WTO speech in Geneva. This will be the first time a broad television audience has heard your new synthesis on trade.

Tobacco/prescription drugs for Medicare beneficiaries. Our best leverage over the tobacco industry is the prospect of a federal suit to recoup Medicare costs associated with smoking. We could call on Congress to enact Senator Graham's legislation to authorize such a lawsuit (which would make the Justice Department more likely to bring it). At the same time, we could ask for funds for DOJ and HCFA to prepare a lawsuit against the tobacco industry. We could pledge that any proceeds from such a lawsuit would be used to provide a new prescription drug benefit to Medicare beneficiaries.

At the same time, you would once again push for the Patients' Bill of Rights, and could propose an array of expansions of coverage (including, possibly, a smaller version of the Medicare buy-in).

Workforce skills initiative -- closing the skills gap. With the long struggle for the GI Bill for Workers now successfully completed, you can more overtly address this remaining piece of your ~~lifetime learning agenda~~. Under a proposal being developed by the NEC, every dislocated worker would get training within five years, every unemployed person would get some kind of reemployment services, and every worker would have access to one-stops. You could also advance an adult literacy initiative. You could also challenge American companies to train American workers first, before seeking to import foreign high-tech workers.

* * *

There are, of course, other significant policies being developed.

* Child care and after-school care will need to be revisited.

* Environment – EPA and CEQ are working on a quality-of-life based agenda that would help communities attain 'green spaces' such as parks and wilderness, and address uncontrolled development (the subject of 200 environmental ballot initiative victories this November), and initiatives to protect coastal and river areas. In addition, you can discuss next steps on climate change.

* Consumer protection – From a financial consumers bill of rights now being developed by the NEC, to an array of other consumer protections, you can propose a consumer protection agenda (this would be the first such explicit agenda in one of your State of the Union Addresses).

* Strengthening democracy for the Year 2000 – In addition to campaign finance reform, we are developing new proposals to increase voting and enhance democratic paticipation, such as making Election Day a holiday.

* An appeal for One America, including an overt appeal against anti-immigrant sentiment (as you did powerfully at Portland State)

* Medical research and medical ethics issues

* Y2K

Finally, we are working with the National Security Council on its proposals and outline.

Material for
Senior Administration Officials

White House Conference on
Social Security Workshops

- Schedule for Second Day
- List of Members and Administration Officials, By Group
- Agenda for Kies/Greenstein Workshop
- Agenda for Feldstein/Reischauer Workshop
- Question & Answers

December 9, 1998

SCHEDULE FOR SECOND DAY OF WHITE HOUSE CONFERENCE ON SOCIAL SECURITY

See Attached for Group Designation

GROUP #1: (LOCATION: INDIAN TREATY ROOM)

9:00-10:30 ***Workshop on Social Security and Traditional Reform Options:***

Presenters
- Bob Greenstein (Center on Budget and Policy Priorities)
- Ken Kies (Former Staff Director of Joint Tax Committee)

10:30-10:45 ***Break***

10:45-12:15 ***Workshop on Social Security and Private Market Investments:***

Presenters
- Martin Feldstein (Harvard University)
- Robert Reischauer (Brookings Institution)

GROUP #2: (LOCATION: VICE PRESIDENT'S CEREMONIAL OFFICE)

9:00-10:30 ***Workshop on Social Security and Private Market Investments:***

Presenters
- Martin Feldstein (Harvard University)
- Robert Reischauer (Brookings Institution)

10:30-10:45 ***Break***

10:45-12:15 ***Workshop on Social Security and Traditional Reform Options:***

Presenters
- Bob Greenstein (Center on Budget and Policy Priorities)
- Ken Kies (Former Staff Director of Joint Tax Committee)

BOTH GROUPS:

12:30-1:30 ***Meeting with President Clinton at Blair House***

WHITE HOUSE CONFERENCE ON SOCIAL SECURITY
PARTICIPANTS FOR WORKSHOPS

GROUP #1:

Location: Indian Treaty Room

Larry Summers, Deputy Secretary of the Treasury
Ken Apfel, Commissioner of SSA
Bruce Reed, Domestic Policy Advisor
William Daley, Secretary of Commerce
Maria Echaveste, Deputy Chief of Staff
Sylvia Mathews, Deputy Director of OMB
Senator Edward Kennedy (D-MA)
Senator Mary Landrieu (D-LA)
Senator Bob Graham (D-FL)
Senator Charles Robb (D-VA)
Senator Kent Conrad (D-ND)
Senator Tom Harkin (D-IA)
Senator Judd Gregg (R-NH)
Senator Phil Gramm (R-TX)
Senator Rick Santorum (R-PA)
Senator Susan Collins (R-ME)
Senator Rod Grams (R-MN)
Senator Craig Thomas (R-WY)
Rep. John Spratt (D-SC)
Rep. Charlie Rangel (D-NY)
Rep. Richard Neal (D-MA)
Rep. Sandy Levin (D-MI)
Rep. Ben Cardin (D-MD)
Rep. Xavier Becerra (D-CA)
Rep. Robert Portman (R-OH)
Rep. Jim Kolbe (R-AZ)
Rep. Mark Sanford (R-SC)
Rep. Judy Biggert (R-IL)
Rep. Clay Shaw (R-FL)
Rep. Chip Pickering (R-MS)

GROUP #2

Location: Vice President's Ceremonial Office

Gene Sperling, National Economic Advisor
Larry Stein, Assistant to the President for Legislative Affairs
Janet Yellen, Chair of Council of Economic Advisors
Alexis Herman, Secretary of Labor
John Podesta, Chief of Staff
David Beier, Domestic Policy Advisor to the Vice President
Senator Jeff Bingaman (D-NM)
Senator Barbara Mikulski (D-MD)
Senator John Chafee (R-RI)
Senator Joseph Lieberman (D-CT)
Senator John Breaux (D-LA)
Senator Byron Dorgan (D-ND)
Senator Mike Enzi (R-WY)
Senator Spencer Abraham (R-MI)
Senator Wayne Allard (R-CO)
Senator Sam Brownback (R-KS)
Senator Pete Domenici (R-NM)
Rep. Rosa DeLauro (D-CT)
Rep. Bob Matsui (D-CA)
Rep. Earl Pomeroy (D-ND)
Rep. Bill Jefferson (D-LA)
Rep. John Tanner (D-TN)
Rep. Ed Markey (D-MA
Rep. Jim McCrery (R-LA)
Rep. Mac Collins (R-GA)
Rep. Nick Smith (R-MI)
Rep. Bill Thomas (R-CA)
Rep. Bill Archer (R-TX)
Rep. Henry Bonilla (R-TX)

AGENDA FOR WORKSHOP ON SOCIAL SECURITY AND TRADITIONAL REFORM OPTIONS

Robert Greenstein and Ken Kies

I. Overview of Social Security challenge and program

II. Traditional reform options

A. Full benefit age (also known as the "normal retirement age")

B. Cost of living adjustments

C. Spousal benefits

D. Other benefit adjustments

E. Maximum taxable earnings

F. Coverage

G. Taxation of benefits

H. Means testing

III. General discussion

AGENDA FOR WORKSHOP ON SOCIAL SECURITY AND PRIVATE MARKET INVESTMENTS

Martin Feldstein and Robert Reischauer

I. Pre-funding, budget rules, and the Social Security Trust Fund (10 minutes)

II. Rates of return (5 minutes)

III. Two approaches to private market investments (10 minutes)

1. Investing the Trust Fund
2. Individual accounts

IV. Pros and cons of different approaches to private market investments (35 minutes)

1. National saving
2. Risk
3. Administrative efficiency
4. Corporate governance
5. Progressivity and fairness

V. General discussion (30 minutes)

SOCIAL SECURITY
December 8, 1998

<u>Putting Out A Social Security Plan</u>

Q: When can we expect the Administration to put out a specific Social Security plan?

A:

- The President is firmly committed to whatever steps will advance the cause of comprehensive Social Security reform consistent with the five principles he laid out in Kansas City last spring.

- The President continues to evaluate specific steps in terms of whether they would unify or divide us. The more and quicker members of Congress of both parties engage with us and each other, the better we will be able to determine which steps the President could take that would be most helpful in achieving comprehensive Social Security reform.

- If the President believes that putting a plan forward will help achieve reform, he will do so. If other forms of leadership are more effective, he will take them.

FOLLOW: Is it possible that the President will ever put forward a plan?

A:

- Yes. If the President believes that putting a plan forward will help achieve reform, he will do so. If other forms of leadership are more effective, he will take them.

ADDITIONAL FOLLOW: Rep. Archer says the President must go first. How do you respond?

A:

- The best way to move forward is <u>not</u> to play a game of "who goes first" but rather to work together to strengthen Social Security for future generations.

BACKGROUND:

At the Kansas City Social Security conference, the President enumerated five general principles to guide Social Security reform. The principles are:

1. Strengthen and Protect Social Security for the 21st Century.
2. Maintain Universality and Fairness.
3. Provide a Benefit People Can Count on.
4. Preserve Financial Security for Low-Income and Disabled Beneficiaries.
5. Maintain Fiscal Discipline.

State of the Union

Q: Will the President present a plan in his State of the Union address this year?

A:

- The State of the Union speech is clearly an important vehicle for addressing crucial issues facing the country.

- The President will use the opportunity provided by the State of the Union in whatever is the most effective way for advancing the debate on Social Security.

FOLLOW: So will he use the speech to put forward a plan or not?

A:

- The State of the Union speech is the President's opportunity to address the nation, and it would be inappropriate for me to reveal the possible details of that speech in any way. So I am simply not at liberty to discuss what is and what is not likely to be in it.

Will The President Lead?

Q: An influential bipartisan group (Stenholm-Kolbe, Breaux-Gregg) has written to the President asking him to be more specific about his "priorities and objectives" at the conference. They also want the President to agree to a timetable for congressional negotiations. Will the President lead on Social Security?

A:

- Over the past year, the President has led -- by changing the debate on Social Security in two important ways: first, by reserving the surplus until Social Security is reformed and second, by striving to create a climate conducive to bipartisan Social Security reform by not attacking specific plans to reform the system.

- The White House Conference provides a unique opportunity to bring together Democrats and Republicans -- prior to the beginning of the legislative year -- to lay the foundation for working together on achieving Social Security reform.

- To build a bipartisan consensus for reform, we will need to consult very broadly. We have already begun that and will continue to do so over the coming weeks and months.

- We want this conference to be balanced and productive -- to lay the groundwork for bipartisan work with Congress over the coming months.

Individual Accounts

Q: Would the President support a plan that includes individual accounts?

A:

- The President will examine any proposal in the context of comprehensive reform that is consistent with his five principles. The President believes that rather than ruling in or out specific elements, we should consider whether a comprehensive package meets his principles.

- [**IF NEEDED:** There are difficult issues with individual accounts that would need to be worked out -- for example, what are the administrative costs, what are the risks to people, and would they would provide beneficiaries a solid progressive benefit that they could count on.]

Livingston Proposal To Change Budget Accounting for Social Security

Q: Congressman Livingston, the new Speaker, has said that he wants to change the way we treat Social Security in our budget accounting. Would you support that change?

A:

- Clearly many people have different views on the complicated budget accounting. Our simple message is that when so much of surplus is from Social Security it makes sense to reserve it until we have addressed comprehensive Social Security reform.

BACKGROUND:

- We have not seen any details of that proposal, so we are reluctant to respond in detail. As a general matter, the budget rules work effectively, and we now have the first budget surplus in a generation. Traditionally, we measure the unified budget which reflects the federal government's contribution to national saving. By eliminating the budget deficit, we have more than doubled our national saving rate. That higher savings rate helps us raise investment and productivity, which helps us prepare for future fiscal challenges -- like the retirement of the baby boomers.

Vice President Gore and the 2000 Election

Q: Does Vice President Gore want Social Security resolved this year or does he want to save the issue for the Presidential election in 2000? Is it to the Vice President's advantage or disadvantage to see the Social Security issue addressed in 1999?

A:

- The President and Vice President both believe that we must act now to save Social Security and we should not play politics with this crucial program. Next year provides an extraordinary opportunity to act early to address this long-term challenge. The President's and Vice President's primary concern is ensuring that any reform is consistent with the principles that they have outlined.

- The Vice President has participated actively in this year of national discussion about Social Security reform -- he has participated in the national forums, given speeches and attended rallies in support of strengthening Social Security for future generations.

- Both the President and Vice President have indicated that as this year of national dialogue comes to a close, they want to begin a bipartisan process to achieve reform early next year.

Window of Opportunity for Reform

Q: When do you think the window of opportunity for achieving Social Security solvency will close? By July, September? What do you think the chances are that a meaningful reform package will be passed in 1999?

A:

- No one can make any predictions about the future, but we know we have an historic opportunity to strengthen Social Security for future generations.

- We've approached the task of Social Security reform with a practical eye from the beginning. Clearly we felt in 1998 that it would be better to try to educate the public and build bipartisan support for getting reform done next year, rather than rush into an election year.

- We do not have a deadline, but certainly we feel that getting a quick start in 1999 will increase the chances of reform. But we do not have time to waste -- we should work together to move forward on bipartisan Social Security reform.

<u>How Will You Move Forward on Reform</u>

Q: The President talks about beginning bipartisan negotiations next month (January). How does he propose to begin those negotiations? A Commission? Private meetings with the Leadership?

A:

- The President intends to begin a constructive bipartisan process at the start of next year. He will continue to consult with the Leadership and Members of Congress as to how best to proceed.

<u>Can We Solve the Social Security Problem With the Budget Surplus</u>

Q: Can the surpluses that are projected solve the long-range solvency problem facing Social Security?

A:

- When President Clinton took office, the budget deficit was projected to grow to $357 billion in FY1998. Because of his 1993 deficit reduction plan, the actual budget situation in 1998 had swung by $427 billion -- so that we had a surplus of $70 billion. With $1.5 trillion in surpluses projected over the next 10 years, we have put our fiscal house in order. That means that we are in better shape to fix our generational deficit.

- The projected surpluses provide another possible mechanism to prefund the Social Security system. Our fiscal discipline has opened up new possibilities and opportunities for Social Security reform.

- We must "save Social Security first" -- preserving the budget surpluses until we know what role they should play in reform.

Raiding the Trust Fund

Q: **Isn't all of the unified budget surplus really just Social Security funds? Aren't you just raiding Social Security to pay for the rest of the budget?**

A: The fact that most of the projected budget surplus comes from Social Security reinforces the President's view that we should reserve the surplus until we have addressed Social Security reform.

BACKGROUND:

- The unified balance is the same measure that has been used by all administrations going back to the Johnson Administration. The unified budget is the simplest and clearest measure of how much the government is taking in and how much the government is spending and it allows us to look out into the future to see if the government will be able to meet all of our obligations, including Social Security.

- Every dollar received by Social Security is either used to pay current benefits or helps pay future benefits by being invested in special-purpose Treasury bonds, which represent a legal commitment *now* to finance Social Security later. Under the law, if Social Security requires funds and the Trust Funds have assets in them, the Treasury must make the funds available.
- The special-purpose bonds held by the Trust Funds have the same legal standing as regular Treasury bonds, which are the benchmark of reliability in the world's capital markets.

- When the President took office, the deficit was $290 billion and there were real questions about whether the government would be able to meet its commitments in the future. Because of the fiscal discipline of the past five years -- instead of the $357 billion deficit in 1998 projected when we took office -- we have a budget surplus for the first time since 1969. And over the next 10 years, we are projecting $1.5 trillion of surpluses.

Retirement Age

Q: **What is the Administration's position on raising the retirement age?**

A:

- Changing the retirement age is clearly a controversial option that is being actively debated by many people in the Social Security reform debate.

- The President believes that rather than ruling in or out specific elements, we should consider whether a comprehensive package meets his principles.

BACKGROUND:

- We need to recognize that increased life expectancy and early retirement are one of the primary causes of the Social Security problem -- both here and around the world:

  - Not only is our senior population doubling in the next 30 years, but life expectancy among seniors is increasing dramatically. Sixty years ago, life expectancy for those at age 65 was about 77 for men and 79 for women. Today, it is 81 for men and 85 for women. And rising for both.

  - And more Americans are retiring earlier: in 1962, only 18 percent of Americans chose to receive their Social Security benefits at age 62. By 1996, that percentage had more than tripled, to 60 percent. The reasons for the increase in early retirement are diverse -- but its occurring across the world.

- However, in examining any proposal to improve Social Security solvency -- including this raising the retirement age -- we must balance the goal of solvency with the goal of fairness. Thus, we must look closely at this proposal's impact on Americans who have physically demanding jobs.

  - For example, rock quarry workers have physically demanding jobs and working late into their 60's is not a real possibility. The same is true with kindergarten teachers who have to stand on their feet. Therefore, we must balance the goals of solvency with fairness.

  - Today, 12 percent of the near elderly are already receiving disability benefits. And another 20-25 percent of those about to retire feel that they must retire because of health reasons or the fact that they no longer can do their physically demanding jobs.