1998-SE-011837

Oct. 15, 1998

Memorandum to: Secretary Rubin
Deputy Secretary Summers

From: Alan Cohen ac and the Social Security Group

Subject: Friday's NEC Meeting on Social Security and the FY 2000 Budget

There will be an NEC "principals only" meeting on Friday to discuss the relationship between Social Security and the FY 2000 President's Budget. The major problem that needs to be addressed is that the discretionary cap for FY 2000 will be difficult to meet. This has led to a proposal that the unified budget surplus be used to pay for an increase in the cap. If such a policy were to be proposed, it would require careful co-ordination with our Social Security agenda. There is also a strong argument that we should not use the surplus to raise the cap.

Background

In the absence of any change, the discretionary cap for next year will be exceedingly tight. Under the Budget Enforcement Act, beginning in FY 2000, there is one combined cap for both defense and NDD. In the FY 2000 projections for our FY 1999 Budget, we proposed to switch about \$8.5 Billion of "mandatory offsets" to the NDD side of the ledger and add an additional amount of NDD spending of that magnitude. Now, one year later, some or all of these offsets will not be available for the FY 2000 budget. Some of these offsets have already been enacted and used to pay for more highway funds. Another \$4.6 Billion of the offsets came from increased revenues from tobacco policy. The Budget Committees have refused to score revenue increases enacted in appropriations bills as offsets to discretionary spending (they are willing to score mandatory spending cuts as offsets if enacted in such bills). Furthermore, the Administration must decide what tobacco proposals to make in this year's budget.

At the same time that some or all of the offsets for discretionary spending may be gone, spending needs have escalated. DOD wants an additional \$10-15 Billion beyond what was proposed for FY 2000 in last year's budget. The NDD agencies have collectively proposed an additional \$40-50 Billion for that year. Obviously, we are not going to fund all of the NDD requests. However, we may need to add some money above the amounts that were included in last year's budget for FY 2000.

The needs on the mandatory (pay-go) side of the budget are unclear. We do not know the cost range of options yet for tax cuts and mandatory spending initiatives, nor for payfors. At first blush, there do not appear to be major payfor amounts from last year's proposals that are now infeasible. Also, if "liquidating REITs" do not end up being used in an extenders bill this year, their huge savings will be available for next year's budget (if they are enacted this year with directed scoring that results in the huge sums going on the pay-go scorecard, it may be possible to take advantage of these savings in the FY 2000 budget anyway. This is a topic for further discussion). On the "uses of funds" side of things, there could be new demands in our budget for resources e.g. "marriage penalty relief" and AMT relief.

Options for the Unified Budget Surplus

If we chose to use some of the unified budget surplus to pay for either discretionary and/or mandatory initiatives, we would of course be breaking "Save Social Security First." The only way around that problem would be to divide the surpluses in the budget between those that will be used for Social Security, those that will be used for new initiatives and any that are to be used for debt reduction. This means that we either have to:

a) Decide to have our own Social Security proposal, decide what it is, and cost it out. All of this would need to be completed by the end of December in order to allow OMB and Treasury to get it into the new Budget.

b) Allocate a maximum amount of the surpluses that are to be used for Social Security as a "reserve" and use the rest for new initiatives (or debt reduction) in the Budget.

For either option "a" or option "b" we would have to stipulate that no use of the surpluses for new initiatives could be **enacted** until Social Security reform had been enacted. Otherwise we would be proposing something no different than Mr. Archer did this September, and which we vehemently opposed.

Option "a" seems infeasible logistically and perhaps politically. Moreover, it has a problem if the solution to Social Security that is finally enacted uses more of the surplus than was proposed in our budget. Option "b" has several problems. First, the choice of the percentage to be reserved for Social Security will seem totally arbitrary to the outside world and we will not be able to challenge that notion because we will not have released a plan of our own yet. The arbitrary nature of the percentage will open the door to counter-proposals with much lower percentages. Second, the proposal potentially begins us down the slope of allowing new initiatives to be enacted before Social Security is completed. Even though we will say that this is not allowed, the scenario has the appearance of allowing this to occur and people will begin debating ours and their proposals for new initiatives immediately.

It is my view that the proposing to use any of the surplus for new initiatives in our budget still has very serious dangers to it. I recommend that first see where we stand with savings from "liquidating REITs" and then try as hard as we can to pay for more discretionary spending or tax cuts or mandatory initiatives with other payfors, before we even begin to think about using the budget surplus as a payfor.

Our Social Security group would like to meet with both of you before Friday's NEC meeting to discuss these issues.

NCC to REK 10/15/98
NCC to LS

cc: MF
SS
NC/DI/PA/AR

PLEASE LOG IN

1998-SE-012008

Oct. 19, 1998

Memorandum to: Secretary Rubin
Deputy Secretary Summers

From: Alan Cohen and the Social Security Group

Subject: *Tuesday's* NEC Meeting on Social Security and the FY 2000 Budget

There will be an NEC "principals only" meeting tomorrow (Tuesday) to discuss the relationship between Social Security and the FY 2000 President's Budget. This is a meeting that was postponed from last Friday. Treasury's Social Security group met with Larry today to talk about the issues that will be discussed tomorrow. Larry asked us to provide to you the following viewpoints, which reflect a consensus of those of us who met today:

- It would be unwise -- prior to November 3, 1998 -- to decide on any policy options for using the unified budget surpluses in the FY 2000 Budget

- Based on the political landscape that exists today, there would be significant difficulties in including any policy in our Budget that suggested that less than 100% of the surpluses was needed to save Social Security. In particular, it would create the potential for others to recommend that a different percentage of the surpluses was needed to reform Social Security -- such as one that was substantially *lower* than our proposed percentage. Therefore, as of this time, we contemplate a Budget that would continue to articulate the "Save Social Security First" policy.

- It would be exceedingly difficult to reach Administration agreement on a specific Social Security reform proposal and associated costs -- in time to include them in the Budget.

- If necessary, we could regroup after November 3, 1998, and agree that the Budget would put on the table a plan that envisioned :

  - that less than 100% of the surpluses would be needed for Social Security

  - possibly, a proposal to use some of the surpluses for specific tax cuts that the Administration favored

- DI/AK to RER
LS

- Please Log In with
RER's 10/20 briefing
materials

10/20/98

- DI cc to MF

- NCC cc to SS
NC/DI/PA/JA

1998-SE-013378

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

ASSISTANT SECRETARY

November 25, 1998

MEMORANDUM FOR SECRETARY RUBIN

FROM: Alan Cohen ac
Gary Gensler
David Wilcox DW

SUBJECT: Questions related to adding inflation-indexed special-issue securities to the Social Security Trust Fund

Two important questions related to shifting part of the Trust Fund's portfolio out of nominal special-issue securities and into inflation-indexed special-issue securities (IISS) need consideration before we can move forward:

- What would be the impact on the solvency of the Trust Fund?

  Our preliminary arithmetic suggests that adding IISS to the Trust Fund would have an impact ranging from a small positive effect on solvency to a moderate negative effect (as much as about 0.1 percent of taxable payroll), depending on the investment policy you set, and the near-term and long-term rate-of-return assumptions the Trustees adopt. (The memo deals largely with this question.)

- Are there remaining legal issues?

  There is a question as to which of two alternatives should be used to establish maturities and interest rates for the IISS under current law. One would be very similar to the way rates and maturities are determined for the nominal specials used in the Social Security Trust Fund. The other would be more closely connected to the structure of marketable IIS. The General Counsel is looking into these questions and will provide his views very early next week.

Two key issues require your attention:

- *Investment policy.* There is an important issue of sequencing as between (a) specification of investment policy (how much of the Trust Fund should be invested in IISS) and specification of rate-of-return assumptions for IISS. In effect, the issue is "who goes first."

- The risk in specifying your investment policy first is that the Trustees process might promulgate a relatively unfavorable set of assumptions about the rate-of-return on IISS. (Although we are participants in that process, we cannot guarantee a particular outcome.) In that case, you might ultimately regret having opened the door to committing *any* of the Trust Fund to IISS.

- On the other hand, it may be difficult to induce the Trustees process to lay out a set of assumptions about the rate on IISS in the absence of a statement from you (or from the Board of Trustees as a whole) indicating an intent to invest at least part of the Trust Fund in IISS.

In light of the limited downside risk to the actuarial balance, it may be that the best (and possibly only) course is for you (or the Board of Trustees as a whole) to indicate your intention to invest some small fraction of the Trust Fund in IISS, and then revisit your investment policy once the Trustees have established a set of rate-of-return assumptions.

A related complication concerns the broader question of how "active" you want to be in managing the Trust Fund. The more active a role you take, the more you move away from the tradition of a neutral virtually hands-off automatic-pilot investment policy.

- *Interaction with Social Security reform.* Adding IISS to the Trust Fund at this time could be a politically risky move if it raises questions as to the Administration's views on one or more aspects of Social Security reform. We don't see specific vulnerabilities here, but flag the issue for your consideration.

Optimal Portfolio Composition

If we add IISS to the Trust Fund, we recommend purchasing IISS each year with half the annual social security surplus plus half the maturing trust fund proceeds. We would not shift any of the assets now in the fund into IISS. This approach would strike a balance between the higher yield offered by nominal securities and the risk reduction inherent in IISS. (See further discussion below.)

Effect on Interest Rate Assumption

A crucial fact to bear in mind is that the actuarial balance is a forecast. Like any forecast, it depends crucially on the *assumptions* that are used in preparing it. A shift in portfolio composition will have essentially no immediate effect on the actuarial balance except as it results in a change in the overall rate-of-return assumption for the portfolio.[1]

With regard to changes in rate-of-return assumptions, several outcomes are possible, but the most likely outcome would cause the shift in investment strategy to have a small negative impact on the actuarial balance. This would reflect a balancing of long-term and short-term effects:

- In the long term, the move would likely result in a lower assumed overall rate of return on the portfolio. This is because inflation-indexed securities are generally assumed to pay a lower rate of return than their nominal cousins, because holders of the former bear little or no inflation risk, while holders of the latter do. The other participants in the Trustees' process are likely to insist that the long-term assumption about the real return on inflation-indexed securities be set by subtracting some amount – representing an estimate of the premium for inflation risk – from the current long-term assumption about the real return on nominal securities. Consensus estimates of the premium for inflation risk in nominals are in the neighborhood of 25-50 basis points.

- In the short term, however, the assumed new issue real rate of return on IISS is likely to be *higher* than the assumed new issue real rate of return on nominal specials, partly because the Trustees' assumptions about the real return on nominals are unduly conservative, in our view, and partly because the real return on marketable Treasury Inflation-Indexed Securities (IIS) -- as best we can tell -- is being boosted by a sizeable premium for illiquidity. This premium may well dissipate over time, but is unlikely to disappear soon.

Estimated Effect on the Actuarial Balance

Based on rough estimates, the effect on the actuarial deficit of introducing IISS into the Trust Fund could range from a reduction in the deficit of 0.02 percent of payroll to a moderate rise in the deficit of 0.11 percent of payroll. The latter outcome, though plausible, is based on a relatively short (10-year) phase-in of the IISS rate to its long-run value of, say, 30 bp below the nominal special rate. With a more realistic (longer) phase-in for the IISS rate the rise in the deficit would be held to no more than 0.05 percent of payroll. Indeed, if the IISS "illiquidity" premium is especially persistent, the balance could actually improve a tiny bit.

Although insuring the Trust Fund against unexpected inflation is likely to raise

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[1] Over time, the actual performance of the portfolio will also influence the solvency of the Trust Fund, but initially this effect will be quite small relative to the impact of changes in assumptions about the future.

the actuarial deficit slightly because the cost of insurance (the risk premium) lowers Trust Fund investment return, there is a solid reason for taking this step, namely, reduction in risk. The liabilities of the Trust Fund are indexed to inflation. Therefore, it makes sense for at least part of its assets to be indexed to inflation as well. One might say that risk is of no consequence when the two parties to the transaction are different arms of the government. But risk is of consequence in this case, because decisions about the need for, and size of, reforms to the Social Security system are influenced by the financial status of the Trust Fund. By reducing the risk borne by the Trust Fund, the risk borne by participants in Social Security would be reduced as well.[2]

Political Issues

It is critically important that if we go forward with this proposal, the Congress be informed as quickly as possible. Some fear than any change in Trust Fund investment policy will be viewed with suspicion by the Congress, particularly as we are in the middle of the national debate on Social Security reform. We also note that it is important that the Board of Trustees, particularly the Public Trustees, receive an early alert to this change in investment policy.

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[2]A way to reflect the effect of inflation insurance in the projections might be to reduce the inflation rate assumption based on the premise that it includes a positive "premium" for historical inflation variability.

1998-SE-013757

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

ASSISTANT SECRETARY

December 4, 1998

MEMORANDUM FOR SECRETARY RUBIN

FROM: David Wilcox DW
Assistant Secretary (Economic Policy)

SUBJECT: White House Conference on Social Security

As you know, the White House Conference on Social Security will take place next Tuesday and Wednesday, December 8 and 9. The first day will open with remarks by the President and Vice President, as well as several Members of Congress. This will be followed by three public panels: the first will be on the challenges of Social Security reform and the program's fiscal situation; the second will examine the potential impacts of different reforms on various segments of the population; and the third will focus on the particular reforms themselves, including privatization.

These panels will be followed by off-the-record "breakout" sessions, one of which you and another member of the Administration will lead, together with four Members of Congress. The audience for each session will be about 50 representatives of interested parties, including think tanks, academics and special interest groups. A main purpose of these sessions is to serve as an outlet for groups that felt that they did not get an adequate chance to participate in this year's Social Security forums. The Administration's goal is to keep these breakout sessions on a fairly non-substantive level; since there will be roughly half a dozen sessions going on simultaneously, the Administration won't have any new information that it will want to communicate through these forums. Instead, these are largely intended as a listening exercise for the Administration participants.

The second day of the conference will be closed to the public and will consist of about 60 members of the Administration and Congress. They will be divided into two groups, each of which will listen to presentations on reform proposals. This will lead into a discussion within the groups, followed by a concluding meeting with the President and Vice President.

Attached is the list of the President's five principles that any Social Security reform proposal must follow. That is followed by a list of the NEC's draft Q's & A's for Administration participants in the conference.

Attachment

The President's 5 Principles on Social Security

The Administration believes that any plan should be consistent with the five principles that the President articulated at the first Social Security forum in Kansas City.

- First, *reform should strengthen and protect Social Security for the 21st Century.* Proposals should not abandon the basic program that has been one of our nation's greatest successes.

- Second, *reform should maintain the universality and fairness of Social Security.* For half a century, Social Security has been a progressive guarantee for citizens. It should be kept this way.

- Third, *Social Security must provide a benefit people can depend on.* Regardless of economic ups and downs, Social Security must provide a solid and dependable foundation of retirement security.

- Fourth, *Social Security must continue to provide financial security for disabled and low-income beneficiaries.* Unfavorable comparisons are often made between the returns on contributions offered by Social Security and the returns offered by the market, but Social Security is much more than just a retirement program. We must never forget the one out of three Social Security recipients who are not retirees. Any reform must ensure that Social Security continues playing these other roles just as effectively in the future.

- Finally, *Social Security reform must maintain America's fiscal discipline.* Six years ago the deficit reached a record $290 billion. In the just-ended fiscal year we achieved a record surplus of $70 billion. In choosing the way forward on Social Security reform, we will need to be consistent with that strong record.

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.

- We recognize that Congress has a critical role to play in this stage of Social Security reform. Our goal is to do what is most effective to achieve 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. Before we come forward with a specific plan, we will need to have a stronger consensus view from both sides of the aisle in Congress on how best to proceed.

- We want this conference to be balanced and productive -- to lay the groundwork for bipartisan work with Congress over the coming months. *We are open to discussions with Congress on a timetable to move forward from the Conference and achieve reform.*

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.** As the President said in Kansas City, he called for the nation to examine the options to save Social Security. And as part of an overall plan, many ideas are on the table. Ultimately, what we must consider is whether a comprehensive reform package meets his principles.

- **The President Will Consider Whether Some Form of Individual Accounts Can Be Part of a Comprehensive Reform That Meets His Principles.** We especially need to consider whether a Social Security system including Individual Accounts continues to provide a benefit that can be counted on and whether the system continues to be fair and progressive.

<u>**Additional Points:**</u>

- **Higher Returns Come with Higher Risk.** Individual accounts could allow a higher rate of return than Social Security currently offers. And individual accounts could also allow every American more control over their retirement assets and give every American a greater stake in the economy. But we must be straight with the American people and acknowledge that with greater returns comes greater risk.

- **Administrative Costs and Government Involvement in the Stock Market Are Major Issues.** It's clear that if these costs are not kept low, they could take a significant chunk of potential returns. On the other hand, those who point out that trust fund equity investments can be done with lower costs need to recognize that some people have concerns about government involvement in the stock market.

- **Cannot Forget about Transition Costs.** Everyone is going to have to be clear about how benefits for people entitled to benefits under the existing system are going to be paid for.

<u>**Livingston Proposal To Change Budget Accounting for Social Security**</u>

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:

- We have not seen any details of that proposal, so we are reluctant to respond in detail.

- As you know, the President's top priority is to "save Social Security first" – to protect the surplus so that we can address the long-term challenges facing Social Security.

- 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. Their 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:

- First, it is worth stepping back a bit and realizing that the President has changed the debate on Social Security and helped create the environment where comprehensive reform is possible and on the top of the agenda for 1999.
- Second, in his State of the Union address last January, the President said that he would convene "the leaders of Congress to craft historic, bipartisan legislation to achieve a landmark for our generation -- a Social Security system that is strong in the 21st century." He set out a timetable and we are on schedule. We have spent the last year in a dialogue with the American people, through three regional bipartisan forums attended by the President and Vice President, over 5,000 public events conducted by the Social Security Administration as well as hundreds of public meetings organized by interested groups around the country.
- Third, looking forward, we have an historic opportunity this year to preserve Social Security for generations to come and we should not squander it.
- We do not have a deadline. We will work hard to achieve our goal of strengthening Social Security. But we do not have time to waste -- we should work together to move forward on bipartisan Social Security reform.

How Will You Move Forward on Reform

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.

Can We Solve the Social Security Problem With the Budget Surplus

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:

- **Unified Balance is Traditional Measure Used to Evaluate Budget.**

  - 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.

- **If A Dollar Comes Into Social Security, It Goes To Pay Current Benefits or If There Is Extra In Any Year, It Is Invested in Treasury Bonds And Is Paid Back To Social Security When The Money Is Needed. This Investment Is Backed By A Legal Commitment And The Full Faith and Credit of the United States Government That It Will Be Repaid.**

  - 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.

- **Five Years Ago, When We Had $300 Billion Deficits, I Could Understand The Concern That We May Have Been Unable To Repay Meet Our Commitment – But With Surpluses, That Concern Should Be Gone.**

  - When I 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 will have a budget surplus for the first time since 1969. And over the next 10 years, we are projecting $1.8 trillion of surpluses.

<u>**Retirement Age**</u>

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

A:

- **Raising the retirement age is clearly a major issue that needs to be discussed in the context of comprehensive Social Security reform.** In fact, it is such an important topic that the Concord Coalition/AARP Social Security Conference the Vice President participated in during the summer was primarily focused on this issue.

- **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.

1998-SE-013930

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

ASSISTANT SECRETARY

December 7, 1998

MEMORANDUM FOR DEPUTY SECRETARY SUMMERS

FROM: David Wilcox DW
Assistant Secretary (Economic Policy)

SUBJECT: White House Conference on Social Security

As you know, the schedule for the White House Conference on Social Security has been in flux due to the funeral of Albert Gore, Sr. A draft of the latest agenda is attached. This is still subject to change, but the NEC feels this is more or less how events will transpire.

The breakout session is currently scheduled for 3:15 to 4:45. You and Sylvia Mathews will be leading one of the breakout sessions. Secretary Rubin will be leading another session with Larry Stein. Both you and the Secretary are presumed to be the "lead Administration official" in your sessions, unless you express a preference otherwise. Attached is a brief description of the format for the breakout discussion. The NEC is currently determining which Members of Congress and interest group representatives will be in your session. The NEC will be faxing a briefing paper with a list of attendees for your breakout session and other general background information tonight to the Watch Office, which will forward it to you at home.

Also attached is a list of Q's & A's prepared by the NEC for Administration participants in the conference.

Attachments

SCHEDULE AND PARTICIPANTS FOR WHITE HOUSE CONFERENCE ON SOCIAL SECURITY

All times are tentative.

DECEMBER 8, 1998

Location: Marriott Wardman Park Hotel

8:30-9:20: OPENING SESSION WITH PRESIDENT CLINTON AND MEMBERS OF CONGRESS. (Open Press)

9:45-10:45: PANEL – THE CHALLENGES OF SOCIAL SECURITY REFORM: WHY WE NEED TO ACT NOW, THE BUDGET SURPLUS, AND SOCIAL SECURITY REFORM (Open Press)

- Presenters:
  Marilyn Moon – Urban Institute
  Rudy Penner – Former Director of CBO

11:00-12:00: PANEL – THE CHALLENGES OF SOCIAL SECURITY REFORM: IMPACT OF REFORM ON DIFFERENT SEGMENTS OF THE POPULATION (Open Press)

- Presenters:
  Alicia Munnell -- Boston College
  Carol Cox Wait -- Committee for a Responsible Federal Budget
  Kilolo Kijakazi – Center on Budget and Policy Priorities
  Richard Thau -- Third Millennium

12:00-1:30 LUNCH BREAK.

1:30-3:00: PANEL – THE CHALLENGES OF SOCIAL SECURITY REFORM: PRIVATE MARKET OPTIONS. (Open Press)

- Presenters:
  Henry Aaron -- Brookings Institution
  Carolyn Weaver -- American Enterprise Institute
  Bob Ball – Former SSA Commissioner
  Josè Piñera -- Cato Institute
  Gene Steuerle -- Urban Institute

3:15-4:45: **OFF-THE-RECORD BREAKOUT SESSIONS TO PROVIDE CONFERENCE PARTICIPANTS THE OPPORTUNITY TO SPEAK DIRECTLY WITH KEY ADMINISTRATION OFFICIALS AND MEMBERS OF CONGRESS.** (Closed Press)

DECEMBER 9, 1998

Location: The White House

9:00-12:15: **TWO WORKSHOPS TO EDUCATE KEY ADMINISTRATION OFFICIALS AND MEMBERS OF CONGRESS ON THE IMPORTANT ISSUES IN SOCIAL SECURITY REFORM.** (Closed Press)

- Presenters:

  Workshop on Scope of Problem and Traditional Reform Options: *Ken Kies (Former Staff Director of Joint Tax Committee) and Bob Greenstein (Center on Budget and Policy Priorities)*

  Workshop on Private Market Options: *Martin Feldstein (Harvard University) and Robert Reischauer (Brookings Institution)*

12:30-1:15: **CLOSING SESSION WITH PRESIDENT CLINTON AND MEMBERS OF CONGRESS.**

FORMAT FOR BREAK-OUT DISCUSSIONS
3:15-4:45

Welcome -- 3:15-3:20: An Administration official welcomes the conference participants and introduces the other Administration officials and members of Congress in attendance. The Administration official conveys that this session is an opportunity for real interaction and give-and-take on Social Security reform and he/she will note that this should be an opportunity for the key Social Security decision-makers to <u>listen</u> to conference participants. He/she will also note that the last portion of the session will be an opportunity for the members of Congress to give their thoughts on what they have heard.

Opening Question -- 3:20-3:30: The lead Administration official asks two pre-selected participants with differing perspectives to comment on the day's panels and begin the dialogue. This will allow the discussion to begin in a balanced and organized way. (See attached for potential list of pre-selected participants.)

Continuing the Discussion -- 3:30-4:30: Since the goal of the session is to allow interested parties to air their views, the lead Administration official could then open the floor after the two initial comments/questions to allow people to comment on their perspectives on the day, and on reform more broadly. *Members of Congress and Administration officials would participate, and could try to help to direct the discussion by recognizing various points of view.*

Wrapping Up -- 4:30-4:45: The lead Administration official could turn to all of the members of Congress to give their closing thoughts on what they heard during the day and during the breakout.

To David Fischer
From Liebman

SOCIAL SECURITY
December 5, 1998

Putting Out A Social Security Plan

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.

<u>**State of the Union**</u>

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.

<u>**Will The President Lead?**</u>

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.

NCC to LS

NCC cc TO MF
SS

12/7/98

Please log and file
with LS' briefing
book for 12/8

December 23, 1998

Memorandum to: Secretary Rubin

From: Alan Cohen

Subject: Meeting with the President on Social Security/Budget

There was a meeting with the President yesterday on what should be our opening bid on Social Security and what we should show in the Budget. Treasury attendees were Larry and myself. This memo describes the meeting. There was also a "Principals" meeting today on this subject. Treasury attendees were Larry and David Wilcox. David will send you a separate memo on that meeting .

Yesterday's meeting worked from a document that included three options. These are described very briefly below; if you want a fuller explanation of each option, please call Larry or me or David.

1. Announce that 50% of the surpluses will be transferred to the Trust Fund and used to buy equities, with a cap on how much the Trust Fund can hold in equities. Announce that an additional 17.5% will be used for contributions to individual accounts. The remainder would go for defense and discretionary spending and for Medicare.

2. Same as option 1 but announce that 67.5% of the surpluses would be used for Social Security without specifying how much would be used for buying equities for the Trust Fund and how much would be used for contributions to individual accounts.

3. Take Social Security off-budget with a phase-in, invest some of the Trust Fund in equities, transfer 0.85% of taxable payroll every year from the general fund to the Trust Fund (that is less than we would transfer under option 1 but would continue after surpluses run out), and do traditional reforms to eliminate the remaining 1/3 of the actuarial imbalance of 2.19%.

The President opened up the meeting by noting three constraints that he thinks we face: 1) we can't use all the surplus for Social Security 2) Government ownership of 10% or more of the stock market would be hard to sell and 3) politically, **we can't** carve out some of the 12.4% payroll tax for individual accounts.. The President also noted, that in general, we had a tough road to hoe because, unlike 1983, there is no Commission to give politicians political cover

The Vice-President then said that he thought if we marketed aggressively , we could exceed 10% of the stock market being held by the Trust Fund. . I'll have more to say on this below. Gene was concerned about the Vice-President's comment: Gene was worried that if the President would go forward with more than 10%, and a lot of heat was generated, then Democrats would not support the President and leave him out on a limb.

It was noted that option 1 could give us the worst of both worlds: it proposes both investments in equities by the Trust Fund **and** individual accounts (IAs).. Thus both sides of the debate could be strongly opposed to it. Of course, it could be a compromise in which everyone gets part of what they wanted.

Option 2, by not specifying how the 67.5% of surpluses would be used for Social Security avoids the "worst of both worlds" problem. But the President could be attacked for the plan's lack of specificity. Also, Democrats could attack the President for seeming to leave the door wide open for individual accounts.

Regarding Option 3, The President and the Vice-President were both very skeptical about taking Social Security off-budget with a phase-in. The fear is that many members in Congress would demand to take it off-budget immediately. Ken Apfel agreed but also expressed the fear that some in Congress might try to force us to take Option 3.

In the course of the discussion of option 3, some interesting points of view on all of the options were articulated:

The Vice-President argued that investing the Trust Fund in equities is an attractive option. He thinks that the Republicans are scared of Social Security as an issue and that if the President comes out strongly for such investment, Democrats will join him and we will win the argument. The Vice President crystallized his opposition to individual accounts with the line, "Individual accounts means that "Granny will have to protect her Social Security by trading stocks on the Internet"" Gene disagreed with the Vice-President, saying he (Gene)was worried about the fallout from the "corporate governance issue." During the meeting, the President was also concerned about the negative impact on us from Alan Greenspan's public opposition to the government being invested in the stock market. The President was also concerned that opponents of this proposal would hit him with, "the President wanted the government to run your health care, now he wants it to run private companies."

Both John Podesta and Larry Summers raised the possibility of having voluntary savings plans as part of a package. Recall that Mr. Gephardt also advocates this. John argued that we should not give up the "wealth creation for everyone" issue" to the Republicans. Larry argued that you could make this proposal more progressive and universal with appropriate subsidies and matching payments from the government, scaled to the recipient's income. Larry noted that we should market this as "universal pensions, not individual accounts."

There was also discussion of the point that adding IAs to current law traditional Social Security benefits means that even more of society's resources would go to the elderly than under current law. Larry noted that under current law, a huge fraction of future budgets will go to the elderly and that we should not exacerbate that problem. The President resonated to this argument.

The President specifically asked about risk from investing in equities, whether in IAs or investing through the Trust Fund. Larry responded that we had looked at that and pointed out that this problem was not as serious as it first appeared. The reason is that even in 2033, payroll taxes will be enough to pay for 72% of annual benefits. So 72% of the benefit is not subject to risk at all. Larry did say that if we had a stock market downturn like Japan has had, that then we could have a problem.

The Vice-President was asked if he would favor having any traditional reforms in the package. He said "yes." But when shortly thereafter, the topic of "covering all state and local government workers" came up, he noted that he would have to oppose that one. Everyone laughed. Janet Yellen said that she favored having some traditional reforms in the package; she endorsed a plan that would eliminate 1/3 of the actuarial imbalance through such reforms.

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*** ACTIVITY REPORT ***
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DEPARTMENT OF THE TREASURY
WATCH OFFICE
FAX COVERSHEET

– If received INCOMPLETE, call (202)622-1825

TO: SECRETARY RUBIN — Room #26

FROM: ALAN COHEN

OFFICE PHONE NUMBER: ____________________

FAX NUMBER: (202)622-1829 (unsecure) (202)622-1851 (secure)

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Page 1 of 5 Pages

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FAX COVERSHEET.doc LAST REVISED 9/14/98

SERIAL NR. 3268

Bob,

Larry asked me to prepare a memo for you on a meeting with the President on Tuesday on Social Security and the Budget!

Here's the memo.

Alan

1999-SE-000035

Bob:

There is good news on the budget front that may also help us in Social Security:

At this time, the unified budget surpluses for the first five years of the budget -- 2000-2004 -- are about $220 Billion larger than in the Mid-Session Review!! I got these numbers from Dick Emery on Thursday morning. These numbers are not complete, however. They reflect preliminary revenue numbers from Treasury, which show substantial increases in revenues during the five-year period, relative to the Mid-Session. However, on the outlay side, while the numbers may include economic changes, they do not include technical changes. Thus the numbers are not final. Dick hopes to have better numbers next week. But the numbers we have already are still important:

1. If we are going to use some of the unified surpluses in the first five years to fund more defense and non-defense discretionary spending on a contingent basis, there are now more surpluses available than there were before.

2. Much of the improvement in the surplus numbers thus far has occurred in the non-Social Security Budget. We may be able to balance the non-Social Security budget in FY 2000 as well as in the aggregate over the five years FY 2000-2004!! This may be true even with increased defense and non-defense discretionary spending in FY 2001-2004. Note: recall that in FY 2000, we are paying for increased defense and NDD with offsets.

   If we can balance the non-Social Security budget in the first year and in the aggregate over the first five years, some very interesting possibilities open up for our "opening bid" in Social Security. However, these possibilities will not be known one way or the other until we have more complete budget numbers from OMB, particularly on the outlay side.

At the close of the Social Security meeting on Tuesday, the President indicated to Gene Sperling that he (the President) would be looking at options for our Social Security opening bid next week (the week of December 29). I have suggested to Larry Summers that coming to closure on a Social Security opening bid (or close to closure) should <u>**NOT**</u> occur until we have somewhat more complete budget surplus numbers from OMB. Larry agrees with this and he is going to make this point to Gene the next time he talks to him.

If you have any questions on this before Monday, please do not hesitate to call me through the Treasury operator. I also plan to be in town for the first several days of next week.

Alan Cohen

Please Log and file -NC 12/28

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DATE 12/25/98

DEPARTMENT OF THE TREASURY
WATCH OFFICE
FAX COVERSHEET

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TO: Sec Robert Rubin
Room #26

284-495-5661

FROM: Alan Cohen

OFFICE PHONE NUMBER: ______

FAX NUMBER: (202)622-1829 (unsecure) (202)622-1851 (secure)

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Page 1 of 2 Pages

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SERIAL NR 3275

December 29, 1998

Memorandum to: Secretary Rubin
Deputy Secretary Summers

From: Alan Cohen

Subject: Sensitivity Numbers For Non-Social Security Surpluses

Len Burman has just sent you a memo with a sensitivity analysis for the latest very preliminary baseline budget surplus estimates. Len's memo lays out four alternative scenarios to the baseline. He compares the deltas from these scenarios to **unified budget** surplus numbers over five years and ten years. My memo tries to compare these deltas to **non-Social Security budget** surpluses over the same periods.

We do not have preliminary OMB numbers for the non-Social Security surpluses. I have made an extremely rough estimate of these surpluses. I took the Mid-Session Review non-Social Security surpluses and applied the changes in revenue technicals to them. The changes in revenue technicals are probably mostly on the non-Social Security side of the budget (e.g. capital gains). I have not applied any economic changes but these are probably of a lesser order of magnitude than the revenue technicals. Perhaps Jack will have better non-Social Security numbers for your meeting. In that case, you could apply the deltas in this memo to Jack's numbers.

The five-year baseline surpluses are $139 Billion and the ten-year numbers are $845 Billion. Len provides revenue deltas to this baseline for each of four scenarios. As he indicates in his memo, his numbers are understated because they do not include debt service effects. However, for purposes of comparing the deltas to the non-Social Security budget, the numbers are overstated, because some of the revenue effects occur on the Social Security side of the budget (from payroll tax changes), not on the non-Social Security side. For purposes of this memo, I am going to make the incredibly simplistic assumption that these two effects roughly cancel. Therefore, Len's deltas for his four scenarios, when compared to the non-Social Security baseline surpluses are as follows:

Scenario	Percent of 5-Year Surpluses	Percent of 10-Year Surpluses
Real GDP Growth Declines by 1%:		
One-Time	73%	NA
Sustained	215%	NA
Receipts Fall to Historical Ratio	431%	143%
Receipts fall to Historical Ratio and there is a severe recession	569%	166%
Stock Market Declines Suddenly and Remains Depressed	168%	52%

As can be seen from this table, in most of these cases, the non-Social Security budget is thrown way into deficit.

As we discussed earlier, this problem might be mitigated by announcing that our POLICY is to maintain balance (or surplus) in the non-Social Security budget in normal economic times i.e. our policy could be altered if we were in poor economic times.

Comstook

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SUBADDRESS	
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ST. TIME	12/30 01:56
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PGS.	16
RESULT	OK

- Prepared by Alan Cohen
- Watch faxed to RER
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- NU cc to MF
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  NC/DI/PA/AK
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DATE 12-30-98

DEPARTMENT OF THE TREASURY
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– If received INCOMPLETE, call (202)622-1825

TO: Secretary Rubin

FROM: Alan Cohen / Len Berman

OFFICE PHONE NUMBER: ____________

FAX NUMBER: (202)622-1829 (unsecure) (202)622-1851 (secure)

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Page 1 of 16 Pages

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SERIAL NR. 3293

Bob,

Here are 2 memos.

The first ~~th~~ is from

Len Burman (with attachments)

The second ~~is~~ from

Alan Cohen.

Please call with questions.

Len and Alan

1999-SE-000319

DEPARTMENT OF THE TREASURY
WASHINGTON

INFORMATION

January 12, 1999

MEMORANDUM FOR SECRETARY RUBIN
DEPUTY SECRETARY SUMMERS

From: Mark McClellan MM
Deputy Assistant Secretary
Economic Policy

Subject: Medicare in Social Security Reform

Yesterday, you asked for some background information on the Medicare proposal in the Social Security reform package. This memo addresses two sets of issues:

1. How would the proposal to dedicate some of the unified surplus to the Medicare Trust Fund be implemented?

2. Should this Medicare financing proposal be accompanied by any other proposals to reform the Medicare program, or simply a general commitment to work with Congress and the Medicare Commission toward a bipartisan solution?

MEDICARE IN SOCIAL SECURITY REFORM

Core Proposal: Dedicate 18% of Future Surpluses to Medicare Trust Fund

The surpluses would be added to the Medicare Part A Trust Fund, which finances the hospital insurance (HI) portion of Medicare. Medicare Part B, which includes physician and outpatient care, is financed by general revenues. Under current OMB projections, this will extend the solvency of the Part A Trust Fund from 2010 to around 2020.

With the impending release of the Medicare Commission's report, the proposal will almost certainly encourage Congressional debate of long-term Medicare reforms this year -- leading to pressure to adopt Medicare program reforms to accompany the additional revenues.

How would this proposal be implemented?

There has been little discussion of the details of this question.

- There has been no consideration of departing from the current practice of investing this Trust Fund entirely government specials. One justification for investing the Medicare Trust Fund differently than the Social Security Trust Fund might be that the Medicare surpluses are much smaller and projected to last less far into the future.

- There is no proposal to take the Medicare Trust Fund "off budget." As you know, taking the Social Security Trust Fund off-budget was debated and rejected, because this would have eliminated any on-budget surpluses for the next few years (Table). The Medicare Trust Fund is projected to operate at about a $5 billion deficit for most of the next five years, so taking it off-budget would improve the on-budget surplus, but only slightly.

Contributions of the OASDI (Social Security) and HI (Medicare Part A) Trust Funds to the Projected Unified Surplus

FY	Unified Surplus	Total OASDI Surplus	Non-Social Sec. Deficit(-)/ Surplus(+)	Total HI Deficit(-)/ Surplus(+)	Non-Social Sec., Non-HI Deficit(-)/ Surplus(+)
1998	70	99	-29	3	-26
1999	54	105	-51	-6	-45
2000	61	113	-52	-4	-48
2001	83	117	-34	-6	-28
2002	148	123	25	0	25
2003	150	129	21	-5	26
2004	184	135	49	-9	58
2005	213	147	66	-12	78
2006	245	152	93	-23	116
2007	300	160	140	-24	164

- There is a "double counting" problem inherent in this proposal, because much of the projected surplus to be dedicated to the Medicare Trust Fund is generated by surplus in the Social Security Trust Fund. Presumably the Social Security funds will be invested in equities or other bonds according to the reform plan; only general revenue surpluses that are not needed for current Medicare financing would be invested in additional specials.

- We are working with NEC on budget scorekeeping rules that avoid "triple counting," so that the transfer of unified surplus to the Medicare Trust Fund does not leave the door open to spending the unified surplus in some other way.

Should the proposal to dedicate a portion of the surplus to Medicare be accompanied by other Medicare reform proposals (Option 1) or not (Option 2)?

Context for Medicare Proposals

- No one, including the Medicare Commission, has developed a long-term Medicare reform plan that assures financial solvency through the Baby Boom as well as quality of care and access to care for the elderly and disabled.

- Despite serious technical weaknesses in its staff and slow progress to date, the Commission is moving toward a general endorsement of *premium support* in its March 1 report. Under premium support, beneficiaries would choose from a set of approved plans that met certain standards, and the government would contribute a fixed percentage (up to a cap) of the premium for the chosen plan. This system is similar to the Federal Employees' Health Benefits Plan (FEHBP), and would be supported in principle by most health policy experts. All of the Commission Republicans plus Chairman Breaux and Administration appointees Laura Tyson and Stuart Altman are likely to endorse such a plan, giving it the needed 11 of 17 votes.

- The principal alternative to premium support is "rationalization" of the traditional Medicare program – reforming its benefits but keeping its basic structure. This alternative is supported by most of the Congressional Democrats on the Commission, and Administration appointee Bruce Vladeck. It would include the possible short-term proposals to "modernize" Medicare similar to those in recent Administration budget proposals, possibly with the addition of a prescription drug benefit and new limits on beneficiary out-of-pocket payments. "Modernized" traditional Medicare might be included as one plan in a premium support system.

- Almost any announcement of Medicare reforms might benefit from advance discussion with some of the Commission members, at least the Administration appointees and Commission Democrats, to avoid the appearance of circumventing the bipartisan process.

Option 1: Propose to dedicate additional revenues to Medicare, along with a credible set of short-term, relatively uncontroversial reforms to shore up Medicare for the next few years.

This year's budget already includes a number of initiatives to "modernize" the Medicare program, primarily by giving the Health Care Financing Administration the authority to do many things that private health care payers do now to limit costs and improve quality: selective contracting with providers for certain specialized services (e.g., mental health, bypass surgery), preferred provider organizations, etc.

Pros

- Congress may be reluctant to commit significant new revenues to Medicare without program reforms. Republican leaders, including Thomas and Archer, are on record as opposing the commitment of any additional revenues, at least until reforms to increase efficiency and control costs in the program are adopted.

- Proposing a credible set of short-term reforms would encourage a two-stage Congressional process on Medicare reform – enact some clear, relatively uncontroversial reforms now, to be followed later by more fundamental reforms, when all the kinks have been worked out. This might avoid bogging down the Social Security reform process.

- Announcing specific reforms could alter the upcoming Medicare debate, by providing a counterpoint to the Medicare Commission report – which may propose reforms (e.g., premium support) not endorsed by the Administration and many Democrats.

- Commission Democrats will be sympathetic to proposals to modernize traditional Medicare, and may welcome the Administration's precommitment to expected Commission recommendations for strengthening the program. Some Commission Republicans and staff members apparently are downplaying the formulation of a credible proposal to modernize traditional Medicare, because premium support would look better next to the current "antiquated" Medicare program. A clear Administration commitment to shore up traditional Medicare for the next few years could help assure that a serious proposal to modernize the current program is included in the Commission report. The question of more fundamental reforms, such as making traditional Medicare one choice in a premium-support system, could be left open.

Cons

- No Medicare reforms are completely uncontroversial. The package of proposals to modernize traditional Medicare would probably be opposed by provider groups, and possibly by Republicans and others because it significantly increases HCFA's discretion.

- It is possible that Commission Republicans and Chairman Breaux would react negatively to any specific proposals for Medicare reform on the eve of the Commission report.

Option 2: No specific reform proposals – propose only to dedicate additional revenues to Medicare to "seed" a bipartisan reform process.

Pros

- Not clear that the Administration needs to get in front of a potentially controversial Medicare debate. It may be possible to "save Medicare second" through a bipartisan process, and avoid delaying Social Security reform. A general commitment to working with Congress and the Commission is sufficient to get credit for raising the issue.

- Medicare Commission will be covering similar ground, and so the specific proposals on the eve of the Commission's report may be viewed as disruptive to the bipartisan process. Commission Chairman Breaux would support this approach, as he would like the Commission report to be the focal point of Medicare debate this year.

Cons

- Opens a broad debate that is likely to be influenced primarily by the Commission report. The debate may bog down or focus on a premium support plan that the Administration would have difficulty supporting – potentially complicating Social Security reform.

1999-SE-001549

DEPARTMENT OF THE TREASURY
WASHINGTON

INFORMATION

ASSISTANT SECRETARY

February 12, 1999

MEMORANDUM FOR SECRETARY RUBIN
UNDER SECRETARY SUMMERS

FROM: Gary Gensler
Assistant Secretary
(Financial Markets)

GG

SUBJECT: Social Security Equity Investment: Returns to Public and Private Pension Funds

We had a very informative meeting with Wilshire Associates, which produces the Wilshire 5000 index and also consults on asset management. Wilshire shared with us some of their recent research on public pension investment performance. While we didn't independently research these figures, we wanted to summarize Wilshire's findings. (We are preparing a separate memo on issues related to investing in equities.)

Wilshire recently compared the returns to public and private funds, with an eye towards seeing whether social investing had effected returns. Wilshire performed this study at the request of CALPERS, after Greenspan's recently expressed concerns. Wilshire found that, over the past 10 years, corporate pension funds outperformed public pension funds by ½ to 3/4 of a percentage point. The principle reason was asset allocation. Currently, private pension funds allocate approximately 65% of assets to equities, compared to 60% for public pension funds. At the beginning of the ten-year period under study, public funds were only 48% allocated to equities, compared with 62% for private funds at that time.

According to Wilshire, public funds' common stock holdings actually returned approximately 20 bp per year more than private funds' equity holdings. This is despite a modest amount of "social investing" of equities by a number of public funds. Wilshire cited several reasons why public pension funds were able to outperform the private funds with respect to equities.

- A larger percentage of public funds are indexed. Indexing has lower administrative costs than active management, and active managers generally have not done as well as the index over the past decade.
- Public funds' larger size means lower management fees.
- Public expense ratios are lower than private expense ratios, possibly due to the discipline of procurement.
- Public sector funds may be more willing than private funds to allow securities lending. On a dollar basis, the majority of public pension assets are available for securities lending.

Wilshire agreed to ask CALPERS for permission to send us a copy of their report.

cc: DWilcox, ACohen, LBurman

1999-SE-001762

February 16, 1999

Memorandum to: Secretary Rubin
Deputy Secretary Summers

From: Alan Cohen

Subject: Social Security Update: On-budget Deficits

This memo updates you on four events from today:

-- a one-page letter issued by CBO
-- a phone call I had with a key staffer with the Senate Budget Committee *Republican* staff
-- an internal Administration meeting on budget accounting rules for the President's plan
-- a meeting between Administration individuals and the Senate Budget Committee *Democratic* staff.

One common theme pervaded all these events: on-budget deficits.

CBO Letter

Senator Gregg wrote a letter to CBO asking the following question: If 62% of the budget surpluses were transferred to Social Security, would this create on-budget deficits and by how much. CBO's answer was $803 Billion of deficits over ten years (see attached letter)..

If one views the budget as being composed of two parts -- on-budget and off-budget, then CBO's answer is the right answer. If one thinks that looking at the unified budget is the right way to look at the budget, then Senator Gregg's question -- and CBO's answer -- are irrelevant.

Larry Stein called me. He is very concerned about the impact of this CBO letter on Democrats, especially Senate Democrats.

Conversation with Senate Budget Committee Republican staffer

Press accounts have indicated that Senator Domenici is intending to structure his Budget Resolution by using <u>only</u> on-budget surpluses for tax cuts and new spending i.e. he does not plan to use <u>Social Security</u> surpluses for these purposes at all. If he is able to do this, he will not create any on-budget deficits, he will not spend any Social Security surpluses on non-Social Security initiatives, and he will not have a double-counting problem . Needless to say, these results would be quite advantageous to him and would leave him and other Republicans free to continue their attack on our plan. However, at first blush, Administration individuals were quite skeptical that he could make the numbers work. In particular, with CBO's baseline showing virtually no on-budget surpluses in the first two years, it seemed that, politically, the Senator could not delay his tax cut and defense spending increases for two full years. **The first blush thoughts appear to be wrong however:**

Based on my conversation with his staffer, Senator Domenici may very well be able to make the numbers work. Here's how he plans to proceed. In a budget resolution, reconciliation instructions for tax cuts are issued to the Finance Committee for one year, five years and ten years. For year one, when there is no on-budget surplus in the CBO baseline, the resolution would pay for its phased-in tax cut with unspecified revenue raisers. For years two through five, CBO's baseline shows $172 Billion of on-budget surpluses. These amounts --in conjunction with the outyear effects of the unspecified revenue raisers -- would create the room for the Senator's phased-in tax cut. And for the second five years, the on-budget surpluses certainly appear large enough to accommodate the Senator's tax cut (especially if there are some revenue raisers included).

As far as defense spending increases, it appears that the Senator plans to stay within the caps -- which expire after 2002 -- by using large outyear across-the-board cuts in other discretionary spending areas. Keep in mind that the outyear numbers for discretionary spending in a budget resolution are essentially irrelevant. Thus, the Senator does not have to use on-budget surpluses to pay for more defense spending. The on-budget surpluses can support his phased-in tax cut as described in the preceding paragraph.

The ability of Senator Domenici to successfully use only on-budget surpluses creates real difficulty for the President's plan and Democrats who want to support it. The Senator can argue that his budget leaves the Social Security surpluses alone while our budget does not. In addition, our budget will create huge on-budget deficits, as the CBO letter indicates.

It should also be noted that it is possible that Republicans in the House -- and thus in conference with the Senate -- will run into trouble because they want larger tax cuts right away. This may force them either to either into using Social Security surpluses to pay for their tax cuts, or to start moving in the Senate's direction. We will just have to wait and see (note they could also use Mr. Kasich's proposal to treat Social Security interest earnings as on-budget --rather than transfers from on-budget to off-budget -- but this has great political peril to it).

Internal Administration Meeting on Budget Accounting

This afternoon, staff from "Economic team" agencies met to discuss accounting and budget rules that are needed for implementation of the President's plan. Topic one was how to treat transfers to Social Security and Medicare with regard to on-budget and off-budget numbers. The upshot was that either of the two main options would result in on-budget deficits in each of the first five years. The only difference was the size of these deficits. Thus, in presenting the results of our plan, we would generate the same result as in the CBO letter.

Meeting with Senate Budget Committee Democratic Staff

This afternoon, Larry Stein, Sylvia Mathews and a number of others from the Administration -- including me -- met with the Senate Budget Committee Democratic staff. The purpose was to begin discussions and problem-solving relating to how to put the President's plan into the framework of a Budget Resolution that the Democrats could offer as a substitute in Committee and on the floor.

One theme that kept coming up was the difficulty that many Senate Democrats are having with the double-counting attack. In spite of much effort by a variety of Administration officials, Hill staff felt that many Democrats still do not understand how they can respond to the double-counting charge. Furthermore, today's CBO letter will only make things worse.

Subsequent to the meeting, I was trying to see how we could construct a Budget Resolution that handles this problem. One possibility is to have the Resolution call for reserving 62% of the surpluses for Social Security and 15% for Medicare, without specifying that these funds would be used for general revenue transfers. In other words, we would leave unspecified how these funds would be used to extend the exhaustion dates. In this way, Senators would not be voting to support double-counting or in favor of on-budget deficits.

Another issue that came up was why we can't say that the President's plan uses general revenue transfers for Social Security and Medicare. To admit this would make it a lot easier to explain the plan to members and staff. Obviously, using general revenue transfers causes grief to some program advocates because the program would no longer *appear* to be fully paid for by workers' contributions. However, many people already know that we are using general revenue transfers in our plan.. Many people also do not have a problem with us using general revenues. I think that our principals should consider revisiting this issue.

Other parts of the meeting dwelt with the possibility that Senator Domenici
's resolution will have $36 Billion more of spending for elementary and secondary education over five years than is in the President's plan. How would the Democrats respond to this? A number of good ideas were offered. Another issue at the meeting concerned how to structure offsets for FY 2000 discretionary spending in the Democratic budget resolution to stay inside the caps. Some of our offsets are infeasible for Hill Democrats ~~to~~ use so others would have to be found. Some progress was made on this issue.

In general, I felt that the meeting was very constructive.

CONGRESSIONAL BUDGET OFFICE
U.S. CONGRESS
WASHINGTON, D.C. 20515

February 10, 1999

Honorable Judd Gregg
United States Senate
Washington, D.C. 20510

Dear Senator:

In your letter of February 3, you posed two questions concerning possible transfers from the general fund to the Social Security trust funds.

If an amount equal to 62 percent of the projected total budget surplus were transferred to the Social Security trust funds each year (including any increase in interest payments to the trust funds), how would on-budget surpluses be affected? They would be eliminated. Specifically, under CBO's baseline projections, the transfers would total $1,591 billion in 2000 through 2009, and cumulative on-budget surpluses of $788 billion projected under current law for that period would turn into cumulative deficits of $803 billion. CBO does not make detailed budget projections for years beyond 2009 and is unable to provide fifteen-year estimates.

If such transfers were limited to the on-budget surpluses that would occur under current law, how much would be transferred? CBO estimates such transfers would total $795 billion through 2009, an amount equal to the cumulative projected on-budget surpluses in 2001 (the first year for which CBO projects an on-budget surplus) through 2009.

Sincerely,

Dan L. Crippen
Director

CONGRESSIONAL BUDGET OFFICE
U.S. CONGRESS
WASHINGTON, D.C. 20515

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Sincerely,

Dan L. Crippen
Director

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***   TX REPORT   ***
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SUBADDRESS
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cc: MF

SS

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PLEASE LOG IN

To:

Bob, Larry

From: Alan

To: Alan Cohen

R

February 19, 1999

Memorandum to: Secretary Rubin
Deputy Secretary Summers

From: Alan Cohen

Subject: Today's Budget and Social Security Meeting on the Hill

There was a meeting today between Democratic staff of the House Budget Committee, staff from the House Democratic Leadership office, and Administration individuals (Larry Stein, Sylvia Mathews, and other Administration staff, including me). Ranking member Spratt joined the meeting halfway through. The purpose of the meeting was to discuss how a Democratic alternative budget resolution would be structured. As you may recall, a similar meeting was held with Senate staff on Wednesday. Today's meeting was, in my view, helpful and informative to all the participants.

A major topic at the meeting was how to pay for all the discretionary spending in FY 2000, including the President's defense proposal. Many of our offsets won't be acceptable politically to House Democrats. Richard Kogan of the House Budget Committee suggested that the resolution create a contingency that would add to discretionary spending in FY *2000*, once Social Security had been fixed. As you know, the President's budget has a contingency that makes such funds available beginning in FY ***2001, not FY 2000***. Administration individuals at the meeting indicated much queasiness about this, arguing that it could be seen as coming too close to violating Save Social Security First. Richard countered by saying that the President's budget had FY 2000 funding for USA accounts that was contingent on Social Security reform, so why not do the same for discretionary spending. Some of our folks didn't realize that we started USA accounts in FY 2000, so at first, the response to Richard was somewhat muted. Later the response became stronger. I used the argument that the appropriators need to get going soon on their work on discretionary spending for FY 2000, whereas the USA accounts could be worked on later in the year. What do you think about this argument? Are there others we can use? The issue of Richard's suggestion was left unresolved.

I'm not sure, but one thing to do would be mp: USA accounts won't start in 2000.

With regard to tax cuts, Mr. Spratt indicated that he wanted to have a "package" in the Budget Resolution that would consist of USA accounts and targeted tax cuts. The targeted tax cuts would be paid for with unspecified loophole closers -- staff mentioned $32-33 Billion over five years. The USA accounts would be paid for from the surplus on a contingent basis, as in our budget. Larry Stein assumed that tobacco tax receipts (which would not be revenue neutral) were a non-starter for Mr. Spratt. With no tobacco receipts, Mr. Spratt was looking for a **revenue-neutral** package of targeted tax cuts and so there was unlikely to be any help from the revenue side for offsets for discretionary spending. However, it was suggested by Administration members that maybe the Democrats could assume some savings from the lawsuit the Administration plans against the tobacco companies. One problem, however, is that it might not be so plausible to assume any savings in FY 2000 from a law suit that hasn't been initiated yet.

If this is on top of what we ~~already~~ already have, where would it come from.

As in the meeting with the Senate staff, everyone at this meeting agreed that the alternative resolution needed to have something in it to reflect the "62% Social Security/15% Medicare framework" that the President has proposed. This would be especially important because the most likely House Republican resolution would have 62% of the surplus for Social Security and most or all of the remaining 38% for tax cuts. Thus, this would set up a great comparison between using surpluses for Medicare versus using them for tax cuts. (note: the presumption was that the House Republicans would not raise the caps for discretionary spending and hence would not use any of the surplus for such spending).

OMB staff is beginning to think about how to put our "surplus framework" into a budget resolution. I am also thinking about that. This issue could get a lot of attention next week.

The House Democrats will most likely offer their substitute resolution on the floor. In Committee, they could have a string of amendments such as an amendment to reduce the size of tax cuts by X and increase funding for education by Y. On the floor, it is anticipated that several Democratic groups would offer their own budget resolution substitutes e.g. the Black Caucus and the Progressive Caucus. The trick for the Democratic Leadership is to have Democrats maintain some kind of common theme in voting for the various substitutes so that our message does not become diluted.

The Secretary of the Treasury

February 23, 1999

NOTE FOR ALAN COHEN

FROM: BOB RUBIN

Page 1 – Second Paragraph

I'm not sure, but one thing I would bet on: USA accounts won't start in 2000.

Third Paragraph

This is on top of what we already have, where would it come from?

Attachment

February 19, 1999

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Deputy Secretary Summers

From: Alan Cohen

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DATE 2-19-99

DEPARTMENT OF THE TREASURY
WATCH OFFICE
FAX COVERSHEET

– If received INCOMPLETE, call (202)622-1825

TO: Deputy Secretary Summers
cc: Secretary Rubin's copy has
been sent to New York

FROM: Alan Cohen

OFFICE PHONE NUMBER: ____________

FAX NUMBER: (202)622-1829 (unsecure) (202)622-1851 (secure)

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Page 1 of 3 **Pages**

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DATE 2-19-99

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Page 1 of 3 Pages

COMMENTS:

to: Alan Cohen
Rubin

February 26, 1999

Memorandum to: Secretary Rubin
Deputy Secretary Summers

From: Alan Cohen

Subject: Today's Report on Budget and Social Security

If only to, where interesting things going on — as for example, in today's memo.

Budget Resolution

The Joint Republican Leadership of the Congress will meet with Chairmen Domenici and Kasich beginning next Tuesday to try to reach agreement on how to do the Budget Resolution. The two chairmen have two huge chasms dividing the two chambers:

1. Mr. Domenici insists on paying for tax cuts with *on-budget surpluses* only i.e. no Social Security surpluses can be used for this purpose. Adding in a few revenue raisers, Mr. Domenici could still cut taxes by only $5 Billion in the first year and $150 Billion over five years.

Mr. Kasich will try to claim that the interest paid by the General Fund to the Social Security Trust Funds -- about $50 Billion a year right now -- should not be charged as an outlay to the on-budget side nor as a receipt to the Social Security side of the budget. This would increase each annual on-budget surplus by $50 Billion starting now. This would allow for much bigger tax cuts in the early years than Mr. Domenici has room for. There are also significant splits within the House Republican caucus on this issue.

The stakes on this issue are enormous. It will be fascinating to see how negotiations on this issue proceed.

2. Mr. Domenici does not want to raise the discretionary caps now. He would later until later in the year. Mr. Hastert seems to want to raise them now. It is not clear where Mr. Kasich is. again, there are splits within the House Republican caucus on this issue. Needless to say, this is a huge issue.

Isn't this a politically impossible place to be, on social security

The Secretary of the Treasury

March 4, 1999

NOTE FOR ALAN COHEN

FROM: BOB RUBIN

Only do, when interesting things going on – as for example, in today's memo.

Isn't that a politically impossible place to be, on social security?

Attachment

March 2, 1999

Memorandum to: Secretary Rubin
Deputy Secretary Summers

From: Alan Cohen

Subject: Today's Update on Budget and Social Security

1. CBO Re-estimate of the President's Budget

CBO will release its re-estimate of the President's budget tomorrow. We received several draft tables from that report tonite. We have reached some preliminary conclusions -- I must emphasize that these are preliminary because we have not seen the whole report yet. Highlights:

-- From the regular part of the budget -- i.e. the part other than our Social Security framework proposal, CBO says that our plan **reduces** surpluses by $89 Billion over ten years, rather than being surplus-neutral as we claimed. This re-estimate averages less than $10 Billion a year over the ten year period. This is **not** a re-estimate that is vastly outside the range of re-estimates of previous years' reports.

-- CBO's re-estimate of our budget *including* our Social Security proposal shows that publicly held debt (net of stocks held by the Trust Fund) is being reduced on approximately the same schedule as we indicated. This is an important validation. CBO assumes a higher rate of return on stocks, which roughly offsets the $89 Billion re-estimate of the regular part of our budget.

-- CBO appears to show that in FY 2000, we break the outlay cap for discretionary spending by $33 Billion. But closer inspection shows that this number is actually between $10 and $14 Billion, which is not vastly outside the range from previous year's reports.

-- CBO's report re-iterated what it stated in a previous letter to Sen. Gregg: the President's budget results in huge on-budget deficits in all years. Unlike CBO, we do not treat our transfers to Social Security and Medicare as outlays to the on-budget side of the budget, however, and so our on-budget deficit estimates are much lower. We also believe that the unified surplus/deficit is the meaningful measure, not the on-budget deficit/surplus.

2. Interesting News about the Gramm-Domenici Social Security reform plan

In a private discussion I had with a staff member who is working on the Gramm-Domenici plan, I was told that other Republican Senators are balking at the plan because it doesn't do much to reduce publicly held debt. Note: the reason it does not reduce publicly-held debt much is that it carves out 2 or 3 percentage points of payroll tax revenues and uses them for contributions to individual accounts in lieu of retiring publicly held debt. These Senators appear to want more reduction in publicly-held debt. This is fascinating and would also be a very important development if these Senators continue to hold this view.

3. Kasich-Domenici Meeting

In an update I sent last week, I reported that the Joint Republican Leadership was supposed to meet today with Domenici and Kasich to try to get them to agree on a common approach to the Budget Resolution. Marti Thomas relayed the following report today from Linda Robertson:

> While the Republican Leadership did not meet today as planned, Chairmen Domenici and Kasich did meet to discuss how they will proceed on their respective budget resolutions. They are still very much at odds on how to handle the surpluses and what to do with the interest from the trust funds and the political viability of dipping into them for tax cuts. Kasich's main concern with Domenici's position is that it will not allow for a significant tax cut prior to 2000. Domenici reportedly shopped an idea with Kasich to construct a short-term capital gains tax cut, which Kasich is considering.

4. Feldstein admits double-counting for his plan

Marti Thomas reported the following:

> Lott's office sponsored a meeting today with staff from "centrist" Members and Senators' offices that featured Martin Feldstein. Democrats in attendance represented Conrad, Robb, and Stenholm. I'm told that Feldstein acknowledged in this meeting that his plan resulted in double-counting. He said "you can't get around it. But the money would have been blown anyway."

I take this as good news.

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*** ACTIVITY REPORT ***
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DATE 3-2-99

DEPARTMENT OF THE TREASURY
WATCH OFFICE
FAX COVERSHEET

— If received INCOMPLETE, call (202)622-1825

TO: Sec. Rubin

FROM: Linda Robertson / Alan Cohen

OFFICE PHONE NUMBER:

FAX NUMBER: (202)622-1829 (unsecure) (202)622-1851 (secure)

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Page 1 of 8 Pages

COMMENTS:

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SS
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3/3/99

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1999-SE-002307

File copy

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

ASSISTANT SECRETARY

March 2, 1999

MEMORANDUM FOR DEPUTY SECRETARY SUMMERS

THROUGH:	Linda L. Robertson LR Assistant Secretary (Legislative Affairs and Public Liaison)
FROM:	Marti Thomas Deputy Assistant Secretary Legislative Affairs and Public Liaison (Tax and Budget)
SUBJECT:	Scenesetter and Polling for House Ways and Means Committee Subcommittee on Social Security hearing on "Investing in the Social Security Trust Fund in the Private Market".
<u>Date</u>:	Wednesday, March 3, 1999
<u>Time</u>:	10:00 a.m. – 12:00 p.m.
<u>Location</u>:	1100 Longworth House Office Building

BACKROUND:
You are scheduled to testify before the House Ways and Means Subcommittee on Social Security on Wednesday, March 3, 1999 at 10:00 a.m. For your information, the White House is unveiling the Democratic agenda tomorrow at 11:00 a.m. As a result, many Democratic members will be either unable to attend the hearing or will leave early in order to get over to the White House for the ceremony.

In your testimony, you will cover the same points that you will be covering before the House Commerce Finance and Hazardous Materials Subcommittee in the afternoon. Your testimony focuses on the benefits of the President's proposal, protecting the investments from political influence, and the effect of investing in equities on the rate of return earned by the Social Security Trust Fund. Your testimony will also answer possible concerns regarding the experience of state and local governments, and comparisons with individual accounts.

DISCUSSION:
Representative Shaw is working on a plan that he hopes to introduce next month which would include add-on individual accounts to the traditional Social Security benefits which would be funded from the general revenue surpluses from the unified budget. Part of the rationale behind

Shaw's plan to tie the add-on accounts to Social Security is to allow the accumulations in individual accounts to be used as a future justification for cutting the defined benefit part of Social Security. Chairman Archer, who will not be attending, is rumored to be working on an alternate bill that would be more along the lines of the plan outlined by Feldstein with add-on individual accounts and some clawback provision. As of last yesterday, the House Republican leadership is still debating advocating mandatory add-on individual accounts funded out of the unified budget surplus or voluntary carve-out individual accounts of about 2-3 percent of payroll tax.

Representative Cardin (D-MD) has approached Treasury about drafting his own Social Security bill that would also invest part of the Social Security Trust Fund in the private market.

POLLING:
Republicans

<u>**Chairman Clay Shaw(R-FL)**</u> – Will attend.
- On February 25, Rep. Shaw expressed his concern with lack of details on how to reform the Social Security over the long term.
- Representative Shaw is working on a plan that wold be a straight add-on using general revenues from the unified budget surplus.

<u>**Representative Jim McCrery, (R-LA)**</u> – Staff has not responded.

<u>**Representative Sam Johnson, (R-TX)**</u> – Staff has not responded.

<u>**Representative Mac Collins, (R-GA)**</u> – Staff has not responded.

<u>**Representative Rob Portman, (R-OH)**</u> – Probably will attend.
- Rep. Portman is concerned about political interference, huge infusion of money into the market, and possibility of stock picking.

<u>**Representative J.D. Hayworth, (R-AZ)**</u> – Staff has not responded.

<u>**Representative Jerry Weller, (R-IL)**</u> – Probably will attend.
- Rep. Weller is likely ask general questions.

<u>**Representative Kenny Hulshof, (R-MO)**</u> – Probably will attend.
- Rep. Hulshof has no specific questions as yet.

Democrats
<u>**Ranking Member Robert Matsui, (D-CA)**</u> – Will attend.
- Rep. Matsui is likely to ask about the safety of investing the Trust Fund in equities, and flesh out the details.

Representative Sander Levin, (D-MI) – Will attend for first part of hearing.

- Rep. Levin is very supportive of the President's proposal.

Representative Ben Cardin, (D-MD) – Will attend.

- Rep. Cardin is very supportive of investment in the private sector.
- He will try to ask questions that will allow LHS to strengthen.
- He has a proposal which involves investment in the private sector and would like Treasury guidance on drafting his proposal.

Representative John S. Tanner, (D-TN) – Staff has not responded.

Representative Lloyd Doggett, (D-TX) – Will attend.

- Rep. Doggett is generally supportive of the President's proposal.

Representative Charles Rangel, (D-NY) – Not likely to attend.

ATTACHMENTS: Witness List
Biographies of Committee Members

Ncc to LS

Ncc cc to MF
SS

3/2/99

Please Log and
file

1999-SE-003555

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

ASSISTANT SECRETARY

March 29, 1999

MEMORANDUM FOR SECRETARY RUBIN

From: David W. Wilcox
Assistant Secretary for Economic Policy

Subject: Background for Social Security and Medicare Systems

Attached is in response to your request for information about the reasons for the change in the actuarial balance in the Social Security and Medicare Systems.

OASDI Trust Fund Change in 75-Year Actuarial Balance From 1998 to 1999 (Percentage of Taxable Payroll)	
Valuation Period	-0.08
Short-Term Economic Assumptions (essentially, stronger growth in 1998 and near-term implications thereof)	+0.03
Long-Term Economic Assumptions (implications of the change in CPI methodology [worth 0.09], and reduction in the long-term unemployment rate from 6.0 to 5.5 [worth 0.03])	+0.12
Demographic Assumptions	+0.03
Methods	+0.02
Total Change in Actuarial Balance	+0.12

HI Trust Fund Change in 75-Year Actuarial Balance From 1998 to 1999 (Percentage of Taxable Payroll)	
Valuation Period	-0.05
Base Estimate	+0.38
Managed Care Assumptions	+0.04
Hospital Assumptions	+0.29
Other Provider Assumptions	-0.03
Economic, Demographic Assumptions	+0.01
Total Change in Actuarial Balance	+0.64

What will it take to restore patient trust?

BY KAREN I. TITLOW, JONATHAN E. RACKOFF, AND EZEKIEL J. EMANUEL

A focus on efficiency and cost management appears to have eroded the most fundamental value in health care.

Managed care has tremendous potential to improve America's health care system. By monitoring outcomes, developing guidelines and coordinating care, it can improve quality and standardize best practices. The increasing diversity of health plan products provides added choice in weighing cost against coverage options. Also, by improving efficiency and reducing costs in the aggregate, managed care practices may expand access to health coverage by underserved populations.

But despite these opportunities, managed care organizations have come under substantial criticism by patients, physicians, the press and state and federal governments. Recent studies highlight this discontent: Individuals surveyed in 1996 viewed representatives of both the federal government and the auto repair industry as more trustworthy than their managed care plans and providers.[1] Focus groups conducted in 1998 by the American Hospital Association revealed consumers' consistent belief that no one in the health care system is on their side.[2] These perceptions are a serious blow to the tradition of the doctor-patient relationship.

What accounts for this disparity between the promise of managed care and the growing expression of concern? Why don't people trust managed care organizations or their personal physicians any more? One answer may lie in patients' perception of how economic forces have influenced their ability to trust their physician's clinical skills and judgment. Patients fear, with some justification, that managed care's commitment to efficiency is in conflict with its commitment to quality health care and that efficiency is winning.

Patient trust is an invaluable component in the creation of a flourishing health care system. High levels of patient trust in their physician are strongly associated with benchmark measures of a successful health care system, including improved health status, adherence to medical advice and patient satisfaction.[3] There is a boomerang effect when the drive for efficiency undermines trust and, therefore, the patient behaviors necessary for quality health care and outcomes. Managed care must actively support mechanisms that encourage patient trust if it is to realize its clinical goal of quality health care.

In the context of the physician-patient relationship, trust is a complex and multifaceted concept. Commentators have suggested that it comprises six factors: provider competence, physician control, continuity of care, communication, confidentiality and no conflict of interest.[4,5,6]

Provider competence

For trust to develop, patients must believe that their provider is technically competent and will provide them with high-quality care. By organizing the delivery of care, managed care creates a unique opportunity to systematically assess physician competence

Karen Titlow, PT, GCMT, MA, and Jonathan Rackoff are Fellows at the Department of Bioethics in the Warren G. Magnuson Clinical Center at the National Institutes of Health, Bethesda, Md. Ezekiel Emanuel, MD, PhD, is the director.

through a feedback loop consisting of the collection of quality measures, dissemination of practice guidelines and outcomes monitoring reinforced with the lurking threat of deselecting. Managed care plans frequently use these techniques to motivate improvements in quality of care, and some success has been achieved.

Studies consistently document that managed care plans provide superior preventative care.[7,8] Nevertheless, fears about substandard care continue to trouble patients and network providers alike. A 1997 study of patients in managed care found that 17 percent rated the quality of their doctors as "fair to poor," compared to only 4 percent with fee-for-service insurance.[9] In a 1998 survey, a majority of physicians reported that managed care practices had "significant negative effects" on both the quality of health care delivery and the physician-patient relationship.[10]

Managed care organizations have taken steps to counter these perceptions and reassure patients about the quality of their care. The industry is supporting attempts to develop standardized quality measures, and many are publicizing the outcomes in easy-to-understand "report cards." To counter the questionable belief that more health care is better, some companies have begun advertising the fact that sometimes doing less can improve patients' health. Such initiatives, made in conjunction with continuing efforts to monitor and improve quality, could help rebuild patients' trust in the competence of their doctors.

Physician control

In order for patients to trust that their doctors will provide the best treatments, doctors must have—and be perceived to have—authority over clinical decisions and services. Because of factors such as utilization reviews, practice guidelines and benefit limits, the physician's clinical authority is often circumscribed in fact and appearance.

Collins found that 80 percent of physicians in managed care plans report somewhat or very serious problems with being able to refer patients to specialists; and 31 percent of the surveyed reported categorical denials of their referrals in the areas of mental health, substance abuse and physical therapy.[11]

The shift of authority for referrals from physician to plan means that the patient must now be able to trust the motivations of the plan. Trust in the managed care organization can be promoted by encouraging physicians to act as patient advocates within the plan. Managed care plans should actively facilitate advocacy by creating incentive structures tied to patient complaints, enrollee turnover rates and consumer satisfaction surveys. To be consistent with these incentives, managed care companies must end the practice of deselecting physicians when they become active patient advocates. Establishing an independent mechanism to review physician allegations of inappropriate exclusions could complement these approaches.

Continuity of care

Patients are more likely to trust a physician with whom they have a continuous, long-standing relationship than a physician with whom they interact infrequently.[12] This is particularly important for patients who have chronic conditions. Managed care's use of a designated primary care physician who facilitates appropriate referrals to specialists could promote improved continuity of care, as long as the individual stays with the same plan.

Unfortunately, as a consequence of employers frequently changing insurance plans, managed care organizations rearranging networks and limited physician panels, continuity of care has been disrupted. Among managed care enrollees who had changed plans over the past three years, 41 percent also changed physicians, whereas only 12 percent did so among indemnity enrollees. Of the patients in managed care, 80 percent of those who changed primary care physicians did so involuntarily.[13]

This problem may be mitigated as managed care becomes more established. In particular, continuity of care will improve if employers and purchasers begin making long-term commitments to one—or a small set of—plans. Also, plans may maintain an increasingly consistent affiliation with providers, and they should concurrently expand the number of physicians available in provider panels. But, efforts by managed care organizations cannot materially improve physician continuity unless employers and purchasers refrain from changing plans.

Communication

When lines of communication between the patient and physician are disrupted, patients may doubt their physician's intentions to provide them appropriate care. This disruption is detrimental to both the patient and physician. For example, poor communication has been identified as the primary factor leading to noncompliance with prescribed medications and treatment regimens.[14,15] It is also the most common reason cited in patient malpractice suits against providers.[16] The value the public places on communication in a medical setting is reflected in recent legislative actions. Even though gag clauses were never widely used in the managed care industry, the public's concern about their impact on candid communication between doctor and patient led to government regulations restricting the practice.

Effective physician-patient communication requires time; yet one by-product of managed care's drive for efficiency has been a reduction in the amount of time a physician can spend with each patient. One study found that 41 percent of physicians in managed care, as opposed to 29 percent of fee-for-service physicians, report they are spending less time with patients than just three years ago.[17] Similarly, 75 percent of nurses reported having less time to teach, comfort and talk with patients.[18]

Plans increasingly acknowledge the importance of effective physician communication. This is due, in part, to plans' recognition that patients use physicians' interpersonal abilities as proxies for their technical competence, and, in part, to the patient backlash against the shortened office appointment. Many managed care organizations sponsor workshops that teach physicians appropriate communication skills and better "bedside manner." This technique, coupled with efforts to restore the amount of time physicians spend with patients, could go a long way to improving patient-physician communication and trust.

Confidentiality

Patients reveal highly personal information to their physicians with the expectation that it will remain confidential. This amount of disclosure is necessary for accurate diagnoses and effective treatments. The public has voiced concern about the ability of large managed care plans to protect their confidentiality. Third-party payers access medical records primarily to monitor quality and to determine if the services they are paying for are medically necessary and covered by the benefit. Prior to the advent of managed care, most medical records were housed in the individual physician's office; complete patient records were difficult to compile and not accessible to many people. The benefits of maintaining coherent, centralized electronic records do have a price. In order to monitor quality and benefit information, health plans have had to make personal medical records accessible to many people. One expert asserts that when an individual enters the hospital, between 70 and 80 people gain access to that medical record.[19]

> Traditional medical ethical norms require physicians to place their patients' well-being ahead of their own personal interests.

Recent events suggest that patients have reason to fear the erosion of confidentiality. In 1996, after a Massachusetts HMO fired hundreds of psychiatrists, the policyholders were instructed to describe their symptoms over the phone to an agent before they could be assigned a new doctor.[20] Another HMO informs patients of abnormal mammogram results by the somewhat public mechanism of sending postcards, which are cheaper than sealed first-class letters. In a highly publicized incident, Harvard Community Health Plans routinely entered psychotherapy notes into computer records that were accessible to all clinical employees.[21]

Public concern about the confidentiality of medical information has reached the ears of federal legislators. Congress is currently considering legislation mandating improved health record security and limiting dissemination of personal health information. Managed care companies can help allay patient fears by developing standards for the handling, storage and destruction of paper medical records; by adopting state of the art computer security systems; and by asking members to participate in developing confidentiality standards for the plan. In addition, the use of patient names or other identifying data should be limited to documents and reports for which they are absolutely necessary.

No conflict of interest

Patient trust in the medical system also depends upon perceptions of how health needs and financial interests are prioritized. Traditional medical ethical norms require physicians to place their patients' well-being ahead of their own personal interests, especially financial interests. Under fee for service, patients' perceptions were that their medical needs coincided with the financial interests of providers. With the advent of managed care, however, patients perceive that the financial interests of providers and insurers are frequently aligned against their medical needs. Some of this shift is a result of the fact that the financial risk, traditionally borne almost exclusively by insurance companies, is now shared with physicians.

In 1995, the Physician Payment Review Commission reported that 60 percent of plans share risk with physicians and that this percentage is rising.[22] One quarter of plans have greater than 20 percent of physicians' incomes tied to financial incentives.[23] By hinging too large a proportion of physician income on risk-sharing mechanisms that provide incentives to reduce utilization, plans jeopardize physicians' responsibility to put clinical decisions ahead of their financial interests. In 1998, the Center for Studying Health System Change documented that 25 percent of managed care doctors felt that they could not make clinical decisions in the best interest of their patients without compromising their income.[24]

Part of patients' concerns is that they cannot judge the amount of financial incentive that their physician must balance against the patient's well-being. A growing number of managed care companies are making the financial contracts between the plan and the physician public in an effort to allay these concerns. It is unclear, however, whether disclosure will reduce or exacerbate the level of distrust. Finally, voluntary limitations on the magnitude of compensation-based incentives may help persuade patients to trust in their physicians' motivations.[25]

What needs to be done

Unfortunately, in the current medical system, each of the six components of trust is precarious. Managed care organizations are working to reinforce the multifaceted aspects of patient trust in the physician, the plan and the system as a whole. But more needs to be done. Plans must engage patients and members in creating policies that support patient trust, such as: developing mechanisms to monitor physician quality, improving systems that protect patient confidentiality, limiting the magnitude of compensation-based incentives, increasing time for communication, reducing disruption of networks and limiting certification requirements that undermine physician authority.

In its best incarnation, managed care promises to foster much needed improvements in the quality and efficiency of the health care system. It is clear, though, that managed care organizations will reach these self-stated goals only if they ensure that the preconditions of patient trust are maintained. Managed care organizations must be cautious when their policies—intended to improve efficiency—conflict with patients' ability to trust that both their physicians and the health system itself are fundamentally committed to providing quality health care.

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1999-SE-003589

1999-SE-003589

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

GENERAL COUNSEL

INFORMATION

2 To: ESK
Fm: RER
cc: Mike F
This doesn't sound right to me, legally. Let's discuss. In any case, our arguments in the same as to the real value of additional specials.

April 8, 1999

MEMORANDUM FOR SECRETARY RUBIN

FROM: EDWARD S. KNIGHT ESK

SUBJECT: Social Security

I understand that you spoke with Senator Specter about, among other things, the nature of the federal government's obligation to pay Social Security benefits. I would like to take this opportunity to reinforce our views on the matter.

The Social Security Act commits the federal government to pay Social Security benefits to individuals who meet the eligibility criteria specified in the Act. In our view, the federal government's commitment to pay Social Security benefits is an obligation of the United States that is backed by the full faith and credit of the United States.

That said, the Social Security Act also provides that such benefits shall only be paid from the Social Security trust funds. Taken together, the direction to pay Social Security benefits and the designation of the source of funds to be used (the trust funds) constitute a standing appropriation to pay Social Security benefits, but only from the trust funds. As you know, these trust funds hold the surplus of Social Security payroll tax collections over Social Security benefit payments, and this surplus is invested by Treasury in Treasury securities issued exclusively to the trust funds ("Treasury specials").

If a month comes when there are not enough of either Social Security payroll tax collections on hand or Treasury specials in the trust funds available to be redeemed to make the Social Security benefit payments that are required to be made in that particular month, then the federal government would default on its full faith and credit obligation to make those benefit payments, unless Congress appropriates additional funds for making the benefit payments.

cc: Deputy Secretary Summers
Chief of Staff Froman
Assistant Secretary Robinson
Assistant Secretary Wilcox

EXECUTIVE SECRETARIAT

The Secretary of the Treasury

April 13, 1999

NOTE FOR ED KNIGHT

FROM: BOB RUBIN

This doesn't sound right to me, as to default. Let's discuss. In any case, our argument is the same as to the real value of additional specials.

Attachment

Copy to: Mike Froman
A. Cohen

Froman
Robertson
+
Wilcox will
be hand delivered -
Roni

1999-SE-004196

4/26/99

Bob/ Larry:

This note (and the subjects it deals with) are complicated.

My apologies for the complexity. Please call me with questions.

Alan

Bob/Larry:

1) After some thought, I still think that it will be argued that we are double counting if we try to justify additional transfers to Social Security (beyond those in current law) on the basis of interest savings from the debt reduction achieved by current law.

Every dollar of off-budget surplus today results in a one-dollar special being issued to the Social Security Trust Fund today. This special then accumulates interest -- and thus more specials -- within the Trust Funds. Together, by 2020 (for example), the value of the special plus the specials from the accumulated interest equals some number: let's call it "x."

Now suppose this dollar of off-budget surplus is used for debt reduction This dollar of debt reduction will result in interest savings in each year before 2014 as well as in each year after 2014. The interest savings in the years before 2014 is not spent because the on-budget baseline already acts as if that interest is unavailable for other spending (when determining whether there is an on-budget surplus or deficit in any year). If, in addition, we do not spend any of the interest between 2015 and 2019, then by 2020 we will have achieved debt reduction equal to "x,." the same number as above. If we now spend "x" in 2020, we will have the same amount of debt as if we spent the original dollar today and accumulated no specials (or interest) in the Trust Fund. **This is the sense in which debt reduction of one dollar is equivalent to putting one dollar of specials in the Trust Fund today.**

If instead, we use the interest savings in 2017 (for example) to add *more* dollars of specials into the Trust Funds, some will accuse us of double-counting.

2) As Bob and I discussed, it is not necessary to use the interest savings after 2014-- or before 2014 -- as a justification for transferring additional dollars to the Social Security Trust Funds. All we have to do is count the transfer -- and the interest that it earns thereafter -- as expenditures from the on-budget side of the budget, and keep the on-budget side from going into deficit in any year. This is clean, easy to explain, and involves no double-counting. Note also that any transfer -- including any transfer of interest from the on-budget to the off-budget side -- is backed up by an equal amount of debt reduction. This makes a good argument for justifying the transfer.

3) We should try to make room to do at least a small amount transfers (beyond those required by current law) before 2014 as well as a lot after 2015. By doing some transfers before 2014, we can avoid the appearance that all of our additional transfers (beyond current law) are backloaded. This means juggling our demands of the on-budget side before 2014 in order to make sure the on-budget side is not oversubscribed.

While it is not necessary to have a justification for transferring some on-budget surpluses to the off-budget side, there is a justification available if one wants to use it:

Some portion of the Social Security Trust Funds ought to be entitled to a higher rate of return than it gets from the specials.. If Social Security were a private pension, it would invest some of its assets in equities which have a higher rate of return than specials. However, this option may be precluded to policy makers because of governance issues. This is not fair to the Social Security Trust Funds. To restore fairness, some of the assets in the Trust Fund should be given a higher rate of return than under current law, but without actually investing them in private equities. The assets would be credited with a rate of return that represented the **opportunity cost** of not spending them today. As long as the extra returns are taken out of the on-budget side of the budget, and the on-budget side is kept in balance, then the extra returns are being matched dollar for dollar by the debt reduction. If we allow some of the on-budget surpluses before 2014 to match the transfers of the extra returns, then we have succeeded in finding a rationale for additional transfers from the on-budget side of the budget to the off-budget side before 2014.

Comstock

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W.O. faxed to RER 4/26/99

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