

94-140669



DEPARTMENT OF THE TREASURY
WASHINGTON

ASSISTANT SECRETARY

DEC 13 1994

INFORMATION

MEMORANDUM FOR SECRETARY BENTSEN
DEPUTY SECRETARY NEWMAN

FROM: Alicia H. Munnell *AM*
Assistant Secretary
for Economic Policy

SUBJECT: Update on Health Care Costs in the Budget Baseline

The staff at HCFA is still working on the final estimates for Medicare and Medicaid costs that will be in the budget baseline. The savings I reported this morning (about \$3 billion in Medicare and \$8 billion in Medicaid, in FY98, compared to the MSR) could be even larger once they are done. HCFA has to incorporate the final economic assumptions and they expect that will increase both Medicare and Medicaid saving significantly beyond the number available this morning. Although state reporting is frequently problematic, HCFA still expects additional Medicaid saving when they reflect the latest state data (available later this week) in the estimates. The final estimates will be completed and available to us sometime next week.



EXECUTIVE SECRETARIAT

TREASURY CLEARANCE SHEET

NO. 94-140669
Date December 13, 1994

MEMORANDUM FOR: SECRETARY DEPUTY SECRETARY EXECUTIVE SECRETARY
 ACTION BRIEFING INFORMATION LEGISLATION
 PRESS RELEASE PUBLICATION REGULATION SPEECH
 TESTIMONY OTHER _____

FROM: Alicia H. Munnell, Assistant Secretary for Economic Policy

THROUGH: _____

SUBJECT: Update on Health Care Costs in the Budget Baseline

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- Under Secretary for Finance
 - Domestic Finance
 - Economic Policy
 - Fiscal
 - FMS
 - Public Debt

- Under Secretary for International Affairs
 - International Affairs

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- Policy Management
 - Scheduling
 - Public Affairs/Liaison
 - Tax Policy
 - Treasurer
 - E & P
 - Mint
 - Savings Bonds
 - Other _____

NAME (Please Type)	INITIAL	DATE	OFFICE	TEL. NO.
INITIATOR(S)				
John Hambor	<i>JAH</i>	<i>12/13</i>	Director, Policy Analysis	622-2350
REVIEWERS				
Robert Gillingham			Deputy Assistant Secretary for Economic Policy	622-2220

SPECIAL INSTRUCTIONS

Review Officer

Date

Executive Secretary

Date

95-193738



DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

February 28, 1995

ASSISTANT SECRETARY

MEMORANDUM FOR SECRETARY RUBIN
DEPUTY SECRETARY NEWMAN

FROM: Alicia Munnell *AM*
SUBJECT: Health Care Reform Meetings

For several weeks a "map group" health care reform meeting has been scheduled and then postponed, most recently because of Mrs. Clinton's trip to Copenhagen. The most recent plan is to hold a principals' meeting next Tuesday, March 7, but rumor is this date could also slip.

The continued postponements are somewhat dangerous: the Administration needs to make policy and political decisions about how to handle the health reform issue, and the "map group" meeting is a necessary step in making such decisions.

A month ago the agenda for the "map group" was to discuss coverage options for a 1995 incremental health reform proposal, and whether or not such a proposal should be released by the Administration. As we approach the likely release date for the Republican budget, however, determining the Administration response to likely Republican proposals for insurance reform and health program cuts becomes increasingly important.

Thus, the agenda for the "map group" meeting has shifted toward political strategy: How should the Administration assess and react to insurance, malpractice, and ERISA reform proposals? How should the Administration assess and react to proposals for very large Medicare and Medicaid cuts? What kinds of information should be provided to legislators and public to make them aware of the implications of such cuts? These issues will be discussed in the context of reviewing materials to be prepared by HHS, demonstrating the effect of likely Republican proposals.

The Republicans may propose massive health care spending cuts at any moment and are also developing some modest reform initiatives. When they do so, the Administration may well be caught flat-footed, unable to respond quickly and coherently, because the principals' meetings and the associated staff work to flesh out the Administration position keep getting postponed.

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DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

April 11, 1995

ASSISTANT SECRETARY

MEMORANDUM FOR SECRETARY RUBIN

FROM: Alicia Munnell *AM*

SUBJECT: Your Meeting with First Lady

The two attached memos might be useful for your 9:00 a.m. meeting tomorrow with the First Lady.

Attachments



DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

ASSISTANT SECRETARY

April 10, 1995

MEMORANDUM FOR SECRETARY RUBIN

FROM: Alicia Munnell *AM*

SUBJECT: Medicaid and Health Care Reform

Alice's group had expanded to include Chris Jennings, Jennifer Klien, and two other staffers.

The meeting focused on the Medicaid program as 1) a source of deficit reduction and 2) a mechanism for expanding coverage.

Two conclusions emerged. First, with the exception of disproportionate share (DSH) payments, getting deficit reduction through Medicaid was not a realistic option. Second, expanding coverage costs money; the only states capable of expanding coverage are those with large DSH payments.

Medicaid might serve as an alternative to new subsidy pools or refundable tax credits for coverage expansion. One way to accomplish this would involve pooling the DSH payments and augmenting them with tobacco tax revenues. This centralized pool could then be allocated among the states based on coverage expansion proposals.

In that vein, much of the conversation focussed on the "TennCare" plan--Tennessee's effort to offer a standardized benefit to all uninsured in Tennessee through an expanded and state-run Medicaid program. Although Tennessee was forced to limit the increase in coverage to 400,000 and endures noisy complaints from providers about inadequate compensation, the plan now covers the previous Medicaid population and most of the uninsured within a managed care system.

Although it is still too early to judge the success of the TennCare, it was considered worth pursuing as an option for expanding coverage. Health care would then proceed on a state-by-state basis with the states taking ownership and expanding their Medicaid programs.

Going this route involves a big leap from last year's discussion, during which all individuals had to be covered under the same relatively generous plan. Expanding coverage through Medicaid produces a two-tiered health care system. In my view, this is a sensible approach; it is better for the poor and the working poor to have a realistic chance of basic insurance than be chasing the unrealistic goal of cadillac plans for all.



DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

CLOSE HOLD

April 7, 1995

ASSISTANT SECRETARY

MEMORANDUM FOR SECRETARY RUBIN

FROM: Alicia Munnell *AM*
SUBJECT: Lunch with Alice Rivlin

In anticipation of your lunch with Alice, it may be useful to summarize where the Ladies Group left off.

The main principals guiding the group's thinking were that the plan should 1) be simple, 2) expand coverage for children, 3) address problems with Medicare and Medicaid, and 4) provide \$100 billion of deficit reduction over five years. The skeleton of the plan, contained three parts:

Insurance Reform: Two initiatives fall in the category

- Insurance Market Reforms--guarantee issue, availability and renewal, limit exclusion of pre-existing conditions for only 6 months, no limit on lifetime benefits, benchmark benefit packages, etc. Most of these components have been included in previous bills.
- Opening up the Federal Employees' Health Benefits program to small firms. This would drastically reduce administrative costs for small firms. Some questions arise as to whether small businesses should be kept in separate risk pools to avoid any increase in costs to federal employees.

Reform of Medicare and Medicaid:

- Most of the group agreed that--with the possible exception of DSH payments--it would be very difficult to save any money from Medicaid without significant harm to the sick and disabled.
- Most of the savings would have to come from Medicare. HHS reluctantly came up with \$119 billion of savings over 5 years (\$429 billion over 10 years). Roughly half of the 5-year money comes from raising costs to beneficiaries--apparently a source of major concern in previous health care deliberations.

Extension of Coverage: Two types of coverage extensions were contemplated.

- Expanding health insurance for children. The group favored increasing the tobacco tax by 75 cents and using the \$50 billion of revenues to expand coverage for children. The two mechanisms discussed for achieving this goal were 1) a refundable tax credit for the purchase of insurance or 2) turning Medicaid back to the states and giving the states the additional \$50 billion to expand coverage.
- Introducing a Long-term Care Program. This program consisted of the HSA tax provisions and a capped entitlement to the states. This was viewed as important to help assuage the elderly for the Medicare cuts.

The next step -- which has not yet occurred -- was to disband the ladies group and hold a meeting in Leon Panetta's office to determine whether the president would be interested in constructing a stand-by health reform plan either for negotiations in the reconciliation process or to consider during the 1997 budget process.

Attached is a copy of the Group's working document.

Attachment

DRAFT

	5 Years (1996-2000)	10 Years (1996-2005)
Uses of Funds		
Insurance Market Reforms	Effects indeterminate, but likely to be small.	
Access to FEHBP	Could increase federal costs depending upon design. See text.	
Tax Credit for Purchasing Health Insurance for Children (Placeholder. Assumption is that tax credit will not be designed to cost more than cost of childrens' subsidies.)	25.0 50.0	50.0 99.0
Long-term Care Program		
-- Capped entitlement to states	6.2	15.4
-- Long-term care tax changes	3.0	9.2
Medicaid Offset (resulting from Medicare savings)	2.1	4.1
Total Uses of Funds	36.3	78.7
Sources of Funds		
Tobacco Tax	22.9	50.9
Beer and Wine Excise Taxes	Not available	Not available
Reinventing Medicaid		
-- Reform of benefits, eligibility, & financing 1/	0.0	0.0
-- Reform DSH payments	32.7	79.9
Medicare Savings Proposals 2/	118.7	429.2
Total Sources of Funds	174.3	560.0
Impact on Deficit	138.0	481.3

1/ If Medicaid grows at approximately 8.6% (1 percentage point less than baseline Medicaid benefits growth), five years savings are approximately \$13.7 billion and ten year savings approximately \$71.1 billion.

2/ Assumes package shown at 11A. HCFA's last option, shown at 11B, produces \$48 billion - FY 2000

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Medicare Savings Proposals

(Billions of dollars, by fiscal year)

		Total 1996-2000	Total 1996-2005
Hospital Proposals			
Reduce Hospital PPS Update (MB-2%, FY 1997-2000)	HSA	-14.5	-56.0
Extend PPS Capital Reduction from OBRA 90		-6.1	-14.8
Reduce PPS-Exempt Update (MB-1%, 1998-2005)		-0.7	-6.3
Reduce PPS-Exempt Capital Payments		-1.0	-2.6
Moratorium on Long-Term Care Hospitals	HSA	-0.4	-1.8
* Expand Centers of Excellence	HSA	-0.2	-0.5
* Lower Indirect Medical Education to 5.3% by 2001		-2.0	-17.0
* GME Reform		-3.1	-12.6
* Reduce Medicare DSH Payments by 25%	HSA	-5.2	-14.2
OPDs: Eliminate Formula-Driven Overpayment	HSA	-5.9	-37.4
* OPDs: Prospective Payment (5% savings)		-4.1	-12.4
Part A Interactions		1.5	5.0
<i>Subtotal, Hospitals</i>		-41.7	-170.8
Physician Proposals			
Eliminate 1996 Fee Update (Exempt primary care)	HSA	-4.8	-12.6
Eliminate MVPS Upward Bias		-0.4	-13.5
* Single Fee for Surgery		-0.4	-1.0
* High-Cost Medical Staffs (HSA proposal; eff. 10/1/97)	HSA	-1.8	-6.6
<i>Subtotal, Physicians</i>		-7.3	-33.7
Other Provider Proposals			
* Competitive Bidding for Labs	HSA	-1.0	-3.3
* Competitive Bidding for Part B Services	HSA	-0.6	-1.8
HMO Payment: Parts A and B Floor/Ceiling	HSA	-1.0	-3.4
* Home Health Prospective Payment (5% Savings; FY99)		-2.1	-8.5
* SNF Prospective Payment (5% Savings; FY97)		-2.6	-6.9
<i>Subtotal, Other Providers</i>		-7.2	-23.9
Managed Care Enrollment			
* Increase Enrollment: 15% by 2000; 30% by 2005		-10.7	-47.6
Beneficiary Proposals			
Increase Basic Part B Premium to 30% of Program Costs		-20.7	-55.7
Income-Related Part B Premium (\$80K/\$100K)	HSA	-10.3	-46.7
* Home Health Coinsurance (10%; All visits; FY97)	HSA	-8.8	-23.5
* Laboratory Coinsurance (20%; 1/1/96)		-4.8	-13.9
<i>Subtotal, Beneficiary Proposals</i>		-44.6	-139.8
HI Receipt Proposal			
Extend HI Tax to All State & Local Employees	HSA	-7.1	-13.5
TOTAL SAVINGS		-118.7	-429.2

Memo: Medicaid Interactions (non-add)

2.1 4.1

NOTE: ALL ESTIMATES ARE PRELIMINARY - INTERACTIONS MAY CHANGE TOTALS.

1/ Preliminary staff estimate.

2/ Pricing assumes enactment of Medicare "extenders" in FY 1996 President's Budget.

Preliminary staff estimate of savings beyond 25% Part B premium (extender).

Hospital proposals shown between lines may raise more objections from industry than other hospital proposals.

* Denotes structural Medicare reform.

HSA: Proposal or similar proposal was included in the Health Security Act.

Individual estimates are actuary pricing with 1996 Medicare baseline unless otherwise noted.

HCFA Preference

Medicare Savings Package
(in billions)

2/21/95

	<u>FY 1996-2000</u>	<u>FY 1996-2005</u>
<u>Medicaid</u>		
Freeze DSH @ FY 1995 Levels	\$8.9 (15.6%)	\$35.9 (18.3%)
<u>Hospitals</u>		
PPS Update (MB-1.0, 97-00)	\$4.0	\$14.8
Hospital Capital (extender)	6.1	14.8
GME Reform Package	3.2	12.6
Medicare DSH (25%)	5.2	14.2
LTC Hospital Moratorium	0.4	1.8
PPS-Exempt Capital	1.0	2.6
PPS-Exempt (MB-1.0, 98-00)	0.7	3.5
Eliminate Add-Ons For Outliers	0.6	1.4
Subtotal	\$21.2 (37.2%)	\$65.7 (31.5%)
<u>Physicians</u>		
1996 MD Update (Freeze)	\$4.8	\$12.6
1997 MD Update (-1%)	0.8	2.7
MVPS Upward Bias	0.4	13.5
No Urban HPSA Specialty Bonus	0.1	0.2
Single Fee for Surgery	0.4	1.0
Subtotal	\$6.5 (11.4%)	\$30.0 (15.8%)
<u>Other Providers</u>		
Home Health PPS (5%)	\$2.0	\$8.5
SNF PPS	0.0	0.0
Competitive Bid--Labs	1.0	3.3
Competitive Bid--Other B	0.6	1.8
Centers of Excellence	0.2	0.5
HMO Part B Floor/Ceiling	0.5	1.8
* AAPCC (Remove GME, IME & DSH)	7.1	23.8
Waiver Liab/Favorable Presump	0.8	1.9
Profile Lab Tests	0.5	1.3
Inherent Reasonableness (Oxyg)	0.1	0.3
Increase ESRD MSP to 24 Months	0.5	1.3
Subtotal	\$13.3 (23.3%)	\$44.5 (23.5%)
<u>Beneficiaries</u>		
No Proposals	\$0.0 (0.0%)	\$0.0 (0.0%)
<u>Other</u>		
HI Subsidy (1/1/96)	\$7.1 (12.5%)	\$13.5 (7.1%)
Total (incl. Medicaid)	\$57.0	\$189.6
<i>Medicare only total:</i>	<i>\$48.1</i>	<i>\$153.7</i>

INSURANCE MARKET REFORMS

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Under this proposal, the following insurance market reforms would be enacted at the federal level and be implemented, in many cases, by states. However, it should be noted that not all of the functions that states would be expected to carry out are new. Some (e.g., certifying health plans and monitoring fiscal solvency of insurers) are already carried out by states to one degree or another.

The major components of insurance market reform include (most of these components have been included in most of the bills proposed in the 103rd and 104th Congresses):

- Plans would be required to guarantee issue (must accept all individuals), availability (must serve entire geographic area), and renewal of policies;
 - Plans would be allowed to limit or exclude benefits for pre-existing condition for only a maximum of 6 months (with appropriate provisions to reduce this period if the insured had prior, continuous coverage);
 - Plans could not place any lifetime limits on benefits;
 - Plans would be required to charge age-adjusted, community-rated premiums to all eligible individuals and small firms with less than 50 workers¹,
-
- age-adjustment is limited to 4:1 in the first year and phased-down to 3:1 over a period of four or five years²;
- Plans would be required to conduct annual open enrollment as specified by state;

¹Most of the reform bills submitted in the 104th Congress limit community-rating to firms with 50 or fewer workers. To increase the size of the risk pool, community-rating could be extended to firms with 100 or fewer workers.

²Most of the reform bills submitted in the 104th Congress place a 3:1 band on age-adjustment factors.

- Plans must offer a benchmark benefits package to all policyholders but can also offer other packages,
 - benchmark package would offer services similar to those offered by the Blue Cross/Blue Shield plan in the Federal Employees' Health Benefits Program (FEHBP)
 - benchmark plan would be actuarial equivalent to the FEHBP Blue Cross/Blue Shield plan
 - Sec. of HHS would specify cost-sharing and other details for the benchmark plan;
- Plans must participate in risk-adjustment mechanism operated by states;
- Plans must meet financial solvency standards;
- Multiple employer welfare arrangements (MEWAs), association plans, Taft-Hartley plans, and self-insured plans would be required to meet new federal standards³;
- Employers would be required to offer, but not pay for, coverage for the benchmark package to their workers⁴,
 - employers would be required to facilitate collection of premiums (for example, collecting premiums through a payroll deduction at the worker's option);
- ~~Small firms would be allowed to join and offer coverage through health insurance purchasing cooperatives (which would operate under state rules).~~

³Such standards would relate to solvency, fiduciary responsibilities, reporting and disclosure requirements, and adherence to guaranteed issue, open enrollment, and other similar market reforms.

⁴While it is not imperative that firms be required to offer coverage to their workers, facilitating the ability of workers to purchase coverage at the workplace could enhance their ability/opportunity to purchase coverage.

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ACCESS TO FEDERAL EMPLOYEES' HEALTH BENEFITS PROGRAM

Small firms would be allowed to offer to their employees, through FEHBP, plans available to federal employees.

Such an approach would require a decision relative to one key issue: what would be the premiums faced by small firms and their employees if they purchased coverage through FEHBP?

- One option would be to mix the rating pools (e.g., federal workers and workers with small firms) and charge the same premiums to both types of workers. Under this approach, if there is adverse selection on the part of small firms (e.g., only less healthier firms decide to purchase through FEHBP), premiums for federal workers would be higher than they would be otherwise. This would have an impact on federal government costs.
- A second option would be to keep the risk pools separate, but allow small firms and their workers to purchase coverage at the same prices as available to federal workers. Under this approach, if there is adverse selection on the part of small firms, premiums for federal workers would not increase. On the other hand, insurers would lose money on small firms. Depending upon a number of other factors, such losses could cause some insurers to stop participating in FEHBP.
- A third option would be to separate the risk pools and charge small firms the same premiums they would face in the community-rated market.⁵ Premiums for federal workers would continue to be determined as under current law. Under this approach, FEHBP would serve as a purchasing cooperative for small businesses, as it does for federal workers.

Adverse selection effects could be limited by restricting the number of firms and individuals that are allowed to enter into FEHBP.

⁵This approach requires the presence of a community-rated market. Small firms would still be able to purchase coverage directly from insurers, through brokers, through purchasing groups, or through MEWAs.

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TAX CREDIT FOR PURCHASING HEALTH INSURANCE FOR CHILDREN

Placeholder.

DRAFT

LONG-TERM CARE PROGRAM

- Capped Entitlement to States

Beginning in 1997, states will be given a fixed allotment of money to provide home and community based services (HCBS) to individuals regardless of age or income. The allotments will reflect the number of severely disabled in a state, the costs of HCBS, and the proportion of low income persons in the state. Services may be limited by amount and type and may be targeted to specific groups or geographic areas.

- Long-term Care Tax Changes

This proposal makes three changes to the tax treatment of long-term care services and expenses. First, LTC expenses and insurance premiums will be treated as medical expenses for income tax purposes. Employers may also treat LTC insurance premium contributions as business expenses. Second, accelerated death benefits paid from riders on life insurance policies will not be counted as taxable income. Third, disabled working persons will receive a tax credit for half of their work-related personal assistance expenses up to \$15,000. At higher incomes-\$50,000 and above-this credit is phased out.

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TOBACCO TAX

The current \$0.24 per pack cigarette tax would be increased by \$0.40 per pack to \$0.64 per pack on January 1, 1997.

BEER AND WINE EXCISE TAXES

DRAFT

Placeholder.

DRAFT

REINVENTING MEDICAID

The current Medicaid program would be restructured but would continue as an individual entitlement. This proposal contains two independent policies. The first policy reforms Medicaid benefits, eligibility, and financing. The second policy reforms payments for disproportionate share hospitals.

The first policy would affect the AFDC and related non-cash populations only.⁶ Medicaid reform would include the following major elements:

- The current array of Medicaid acute care services would be reconfigured into one, standard Medicaid benefit package across all States. States would continue to have the option of providing additional benefits.⁷
- Recipients would be required to pay nominal cost-sharing for most services.
- States would be given the flexibility to:
 - continue determining eligibility with broad Federal guidelines or with minimum federal eligibility requirements and the ability to expand coverage to broader populations
 - move Medicaid recipients from a fee-for-service delivery system into managed care systems; and
 - more efficiently administer the program.
- Federal savings could be guaranteed by controlling the program's rate of growth. States would be given a fixed per capita

⁶Acute and long-term care health services for aged, blind and disabled recipients could be also restructured but would require substantial coordination with Medicare.

⁷Federal funding for the remaining optional services could continue based on the current law matching system. Alternatively, federal funding for these services could be capped and converted into a block grant to states.

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amount based on an estimate of per capita Medicaid costs for the services in the standard benefit package. If the federal contribution to states is grown at current baseline assumptions, this policy would yield no savings. Alternatively, federal savings could be achieved by controlling the rate of growth in the federal contribution.⁸

One key issue that must be resolved concerns eligibility. Eligibility could be simplified by basing it on income (e.g., all individuals below poverty are eligible). However, under this approach, many individuals currently eligible would lose coverage. In addition, many others currently not eligible for Medicaid would gain coverage. On the other hand, it may be difficult to give states flexibility to determine eligibility and still retain the current eligibility structure.

The second policy would convert federal matching payments for state payments to disproportionate share hospitals (DSH) into a capped, vulnerable population adjustment pool. In Fiscal Year 1996, federal DSH payments are expected to be about \$11.1 billion. This amount would be reduced to \$5.6 billion and placed into a vulnerable adjustment (VPA) pool. Payments from this pool could be made to eligible hospitals and other providers or to states. Funding for the pool would grow at the same rate as the growth rate in nominal gross domestic product.

⁸An index could be constructed to allow for growth in population and efficiency (e.g., the per capita amount increases at the same rate as the rate of growth in nominal Gross Domestic Product per capita). Under such an index, states would be at risk for cost increases beyond the rate of growth in the economy, but not for increases in Medicaid enrollment. The index could be adjusted by state by using, for example, nominal total state product (which is conceptually similar to gross domestic product).

MEDICARE SAVINGS PROPOSALS

Medicare savings proposals may be divided conceptually into two categories: "traditional" Medicare cuts and structural reforms.

- "Traditional" Medicare Cuts

- These proposals use Medicare's price-setting authority to generate savings, in most cases by cutting or freezing provider payments. Examples include reducing scheduled updates for hospital, physician and other provider payments; reducing reimbursements for hospitals' capital and medical education costs; and changing payment formulas to impose more stringent upper limits on fees.
- Because of their frequent use in previous reconciliation and health reform bills, these types of proposals are relatively familiar to knowledgeable Members of Congress, providers, and beneficiary groups.
- While generating significant scoreable savings, these types of proposals are not particularly innovative policies because they perpetuate the current "command-and-control" and fee-for-service structures of Medicare. Moreover, these policies can create undesirable incentives as providers try to compensate for lower fees by inducing higher rates of utilization.

- Structural Reforms of Medicare

- Instead of simply cutting or limiting payments, these proposals would reform the price-setting and incentive structures in Medicare.
- Medicare's prices for certain goods and services could be set with a market mechanism (competitive bidding) instead of current centralized methods (e.g., fee schedules). Examples include competitive bidding for clinical laboratory tests and high-volume durable medical equipment, such as oxygen equipment and services. Competitive bidding would also allow Medicare to take advantage of its substantial buying power in the health care market.

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-- In the current environment of third-party payment and fee-for-service medicine, marginal decisions about whether to consume (from the beneficiary's perspective) or provide (from the provider's perspective) health services are often subject to undesirable incentives. These incentives could be changed by introducing more provider and beneficiary risk-sharing into Medicare:

- + reform the payment policy for risk-based Medicare managed care plans and establish incentives to encourage more beneficiaries to enroll in these plans;
- + establish payment risk pools for physicians at the hospital medical staff level to create incentives discouraging excessive use of physician services;
- + establish prospective payment systems for hospital outpatient departments, home health agency, and skilled nursing facility services;
- + reform Medicare payments for graduate medical education to reflect the changing needs of the medical marketplace, e.g., more training slots for primary care physicians and in more settings outside the inpatient hospital;
- + establish beneficiary coinsurance payments for the only two major areas of Medicare which do not require them, clinical labs and home health services. These are also two of the fastest-growing areas of Medicare spending and utilization. Coinsurance payments could help beneficiaries and providers become more sensitive to marginal decisions about using these services.

• A Sample Package of Savings Proposals

The attached package of Medicare savings proposals is one possible combination of "traditional" cuts and structural reforms that reaches approximately \$100 billion in savings over five years (1996-2000).



DEPARTMENT OF THE TREASURY
WASHINGTON

APR 21 1995

ASSISTANT SECRETARY

MEMORANDUM FOR SECRETARY RUBIN
DEPUTY SECRETARY NEWMAN

INFORMATION

From: Alicia Munnell *AM*

Subject: Effect of Medicare Cuts on HI Trust Fund Financing Problems

Some rough estimates by HCFA, at our instigation, have turned up some interesting points about the effect of plausibly sized medicare cuts on the HI Trust Fund balance. We asked for estimates of the exhaustion date and the 25-, 50- and 75-year actuarial balances under two scenarios: (1) a 7 percent HI expenditure cap, (2) roughly \$75 billion (over 1996-2000) from CBO's laundry list of HI cuts.

Actuarial Balance	<i>Present</i>	7% Cap	CBO
	<i>Law</i>		Proposals
25 Years	-1.33%	-0.81%	-0.79%
50 Years	-2.68	-1.53	-1.95
75 Years	-3.52	-2.05	-2.69
Year of Exhaustion	2002	2003	2007

Three points are worth noting:

- None of these approaches avoids trust fund exhaustion within the next 10 to 15 years. The CBO package extends it the longest because it is relatively more front-loaded. The cap proposal tends to build its effect over time and have less short-term impact.
- Neither proposal eliminates the long-term deficit. Because of its "staying power", the cap has a relatively larger effect on the 75-year actuarial balance than the CBO package. Both proposals lower the 25-year balance to roughly the same level.
- We have asked HCFA to provide some further estimates based on larger cut proposals and will keep you informed. To provide perspective, under the current Trustees' assumptions, a 5 percent cap on total spending is more than adequate to produce a long-run trust fund surplus (and not deplete the trust fund in the short-term), because revenues are projected to grow slightly faster than 5 percent.

EXECUTIVE SECRETARIAT

TREASURY CLEARANCE SHEET

NO. _____
Date 4-21-95

MEMORANDUM FOR: SECRETARY DEPUTY SECRETARY EXECUTIVE SECRETARY
 ACTION BRIEFING INFORMATION LEGISLATION
 PRESS RELEASE PUBLICATION REGULATION SPEECH
 TESTIMONY OTHER _____

FROM: Alicia H. Munnell, Assistant Secretary for Economic Policy

THROUGH: _____

SUBJECT: Effect of Medicare Cuts on HI Trust fund Financing Problems

REVIEW OFFICES (Check when office clears)

- | | | |
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| <input type="checkbox"/> Under Secretary for Finance
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<input type="checkbox"/> Savings Bonds

<input type="checkbox"/> Other _____ |
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NAME (Please Type)	INITIAL	DATE	OFFICE	TEL. NO.
INITIATOR(S) John Hambor	JH	4/21/95	Director for Office of Policy Analysis	622-8353
REVIEWERS				

SPECIAL INSTRUCTIONS

Review Officer _____ Date _____ Executive Secretary _____ Date _____



ASSISTANT SECRETARY

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

CLOSE HOLD

BRIEFING

April 26, 1995

1458 55

MEMORANDUM FOR SECRETARY RUBIN
DEPUTY SECRETARY NEWMAN

FROM: Alicia Munnell *AM*

SUBJECT: Health Care Meeting with President

DATE AND TIME: Thursday, April 27, 1995, 5:15 p.m.

LOCATION: Cabinet Room, White House

PARTICIPANTS:

TREASURY: Secretary Rubin

BRIEFING: Tab A: Overview Briefing Memorandum
Tab B: Memorandum on Medicare Cuts in the
Context of the HI Trust Fund Financing
Problems
Tab C: Overview of Medicare Program and CBO
Cuts
Tab D: Overview of Medicaid Program and CBO
Cuts
Tab E: Tax Policy Memorandum on Tax Credits
Tab F: Memorandum on Budget Simulations



DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

ASSISTANT SECRETARY

April 26, 1995

MEMORANDUM FOR SECRETARY RUBIN
DEPUTY SECRETARY NEWMAN

FROM: Alicia Munnell *AMM*
Glen Rosselli

SUBJECT: Health care meeting with the President
Thursday, April 27, 1995 at 5:15 pm

The goal of this meeting is twofold:

- o To let the President describe what type of health care reform package he finds acceptable
- o To determine how the Administration should respond to the large medicare and medicaid cuts to be included in Senator Domenici's "Chairman's mark."

This meeting has taken on added urgency. The President will be attending the Senate Democratic retreat this weekend, and speaking at the White House Conference on Aging on Wednesday, May 3. Both events are ones where the interplay of deficit reduction and health care reform will come to the fore.

ACCEPTABLE HEALTH CARE REFORM

The meeting will start with where the Administration has been on health reform, summarizing previously proposed cuts in medicare and medicaid, our FY96 budget proposals, statements in the State of the Union, and recent internal deliberations.

OBRA93 included roughly \$50 billion in Medicare cuts and HSA included \$123 over five years. Much of the HSA cuts were reinvested in expanded benefits for the elderly. More cuts will now be required for any given level of deficit reduction given the lowering of the health care baseline included in the FY96 Budget.

Recent internal discussions have focused on a health reform package that would include:

1. \$100 billion of medicare and medicaid cuts over 5 years;
2. Insurance reform, including access to FEHPB for small business;
3. Limited extension of coverage paid for by tobacco tax or reduction in medicaid DSH payments, plus a little support

for long-term care

Both OMB and HHS have put together lists of possible medicare cuts. OMB has \$90 billion of medicare savings over five years, while HHS has \$70 billion. The medicaid figure for five years will range between \$9 billion and \$15 billion. It is very difficult to get any money out of medicaid without hurting beneficiaries; the only real option is cutting DSH payments.

Should the President indicate his preference for a level of medicare cuts short of \$90 billion over five years, it may be useful to note that even this amount is small within the context of the medicare HI trust fund's financing problems.

Assuming that \$45 billion of the \$90 billion would come from the HI program, these cuts would extend the life of the trust fund by two years from 2002 to 2004. Medicare HI and SMI of \$90 billion is aggressive, but realistic. Attached find a memo, sent to you earlier, that includes CBO options for medicare cuts; while not all desirable, they could be combined into a \$90 billion package.

At the meeting, staff will distribute "sources" and "uses" tables with estimates for five, seven, and ten years. They will also present four possible packages. The first includes Alice Rivlin's option to expand coverage through funds collected by reducing medicaid DSH payments and raising the tobacco tax. This proposal is quite controversial; many think it would be politically difficult to expand coverage through the medicaid program.

The key substantive decisions to be made are how much deficit reduction and how much coverage expansion. The other issues are strategic, such as when to go public with a proposal and whether to start low and get bid up or go out initially with agreed-upon numbers.

RESPONSE TO REPUBLICAN PROPOSALS

The Senate Budget Committee will begin deliberation on the budget resolution on April 27. Senator Domenici will likely announce his mark on May 1, vote on the package the following day, and have the budget resolution on the floor by May 8. (Some have speculated that Domenici may postpone the cuts until after the White House Conference on Aging.)

Domenici will purport to balance the budget by 2002. It is widely reported that he will have at least \$250 billion in medicare and \$160 billion in medicaid savings over seven years. (Remember that the Administration's \$100 billion for medicare and medicaid combined refers to a five-year period.) This level of

cuts is not possible without destroying the both the medicare program and medicaid programs.

The Administration must resolve now how to respond to the \$400 billion in cuts that will be included in Domenici's mark. Attacking the Republicans aggressively is almost certainly the right strategy, although it is not risk free.

The Administration does have an opportunity to score some points attacking Republican proposals that are truly outlandish. Our ability to attack will be greatly enhanced by some material showing how damaging these cuts would be. Such a product is being worked on, but is not yet available. It might be useful to ask about its status.

As background, it may be useful to know that \$250 billion from Medicare (\$125 billion from HI and \$125 billion from SMI) is not unreasonable if one were determined to eliminate the entire Medicare deficit by program cuts alone. In fact, the amount over 7 years is right in line with that generated by a 5 percent cap on Medicare's rate of growth, which is roughly the amount needed to balance the fund over 75 years (see attached memo).

Republican proposals are excessive because it is not reasonable to restore long run balance solely by cutting benefits. A large part of the rising costs of the program is due to demographics; workers and retirees should share the burden. Although difficult, if not impossible, to advance in the current climate, some increase in the payroll tax will have to be part of any long-run solution.

Risks caused by an aggressive strategy toward the Republican health care proposals include:

- o Concern that attacking the Republicans might preclude our endgame. While analytically valid, this concern can be met by "Never \$400 billion, and nothing without health care reform."
- o Once we say "too large" or "not without reform", aren't we haggling about price? "If \$400 billion is too much, then how much is acceptable?" "If nothing is acceptable without health care reform, then how much with reform?" The answer must be that we do not want either the elderly or nonelderly users of the health care system to be worse off; reform must have at least as large as positive impact as the cuts have negative.
- o Republicans will turn around and ask us about our plan. If we think their proposals are so bad, then what are we

proposing to solve the medicare problem? It is difficult to hark back to the HSA, which did not address the long-term medicare financing problem. Our response would have to be some statement about reinstituting the Quadrennial Advisory Council and the importance of health care reform.



DEPARTMENT OF THE TREASURY

WASHINGTON, D.C.
September 8, 1995

95. 150101

ASSISTANT SECRETARY

MEMORANDUM FOR SECRETARY RUBIN

FROM: Glen Rosselli 
Deputy Assistant Secretary for Economic Policy

SUBJECT: Health Care Issues for Ways and Means Meeting

Administration is unlikely to release a new health care reform bill. However, more detailed specifications have been prepared and are likely to be released later this month or early next month to demonstrate that the President has a health plan.

As part of our strategy, we have held back putting our Medicare specifics on the table so that the savings would not be available to the Republican majority.

Elements of our plan include the following:

Health care reform components --

Insurance reform
Purchasing cooperatives for small businesses
Increasing the self employed tax deduction to 50%
Up to 6 months transitional coverage for the temporarily unemployed.
Administrative simplification
Fraud and abuse initiative

Medicare reform components --

Providing more choices/options under the Medicare program such as Preferred Provider Option (PPO's).
Point of service options -- which is an HMO but you get your own doctor.
Strengthening the trust fund by extending solvency to the year 2006.
Respite benefit for families of those with Alzheimer's.
Waiver of copayment for mamograms.

Medicaid

\$54 billion of savings are achieved through cuts in the disproportionate share program.
Per capita cap.
More flexibility for the states.



DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

October 4, 1995

HOLD CLOSE

MEMORANDUM FOR SECRETARY RUBIN
DEPUTY SECRETARY SUMMERS

FROM: Glen Rossett 
Deputy Assistant Secretary (Economic Policy)

CC: Sylvia Mathews

SUBJECT: Health Care

Attached, find a copy of a draft outline of the President's health care initiative.

Although this draft approximates very closely what the final product will ultimately be, some of the provisions and some of the wording in this document are in the process of being revised. An updated version will be made available late in the week.

Note: Again, this document is not circulating widely and should remain in a close hold status.

Attachment

DRAFT

President Clinton's Health Care Initiative

The President's health care initiative is a comprehensive set of reforms designed to protect working Americans, the elderly, individuals with disabilities, and children and families with low income, while making the health care system more effective and efficient. It will:

Preserve our commitment to the elderly, individuals with disabilities, and families with low income as we modernize our health programs

- Continue to provide Medicare beneficiaries with new choices of health care plans as we transform this program for the next century; preserve the financial integrity of the Medicare Hospital Insurance Trust Fund for the next 10 years without imposing substantial new costs on senior citizens and those with disabilities.
- Protect funding for States to continue to provide health benefits for 36 million Americans who receive Medicaid benefits, while providing new flexibility for how States can administer their programs within a targeted growth rate for spending per beneficiary.
- Establish strong new protections against fraud and abuse in the health care system, which currently could add up to 10 percent to the cost of programs like Medicare and Medicaid.
- Provide funding for additional home and community-based care for individuals with disabilities and respite care for families coping with the heartbreak of Alzheimer's disease.

Increase the availability and affordability of private coverage for working Americans

- Provide new protections for working Americans who might otherwise lose their health insurance coverage, through insurance reforms, grants to States to establish voluntary purchasing cooperatives for small businesses, and financing a limited period of continued health benefits for temporarily unemployed workers receiving unemployment benefits.
- Increase the affordability of health benefits for individuals who are self-employed by increasing the tax deductibility of health benefits to 50 percent of costs.
- Simplify the often complex administration of the health care system so that fewer dollars are spent on bureaucracy and health care professionals are freed from unnecessary paperwork.

Preserving and Modernizing Medicare

Medicare provides health care benefits to 35 million elderly and disabled Americans. Medicare Part A provides hospital, home health, and some nursing home coverage through a Trust Fund that is financed primarily through payroll taxes. Part B provides physician and other outpatient care and is financed jointly through monthly premiums paid by beneficiaries and general revenue funds.

The President's plan maintains the 30-year national commitment to this program and makes it more efficient and effective. It builds on the President's 1993 deficit reduction package, which extended the solvency of the Trust Fund by three years, with further reductions in projected Medicare spending of \$124 billion over the next seven years, including \$89 billion in Part A savings that would maintain Trust Fund solvency for the next decade.

Key elements of the President's Medicare proposal are:

- **Continued Expansion of Choice Under Medicare:** The President's plan would continue the expansion of choice for Medicare beneficiaries of tested and proven health care plans. Currently, a record 3.5 million beneficiaries are enrolled in managed care plans and an average of 70,000 beneficiaries are enrolling each month. This progress would be enhanced by:
 - Refining and enhancing the standards for participation, and expanding the types of health plan options available to beneficiaries;
 - Improving Medicare's methodology for paying health plans;
 - Fostering improvement in the quality of care provided by health plans available to beneficiaries;
 - Informing beneficiaries of the availability of choices in their area, and facilitating enrollment in health plans.

- **A More Cost-Effective Medicare Program:** The President's plan makes reasonable, rational, and responsible reductions in the rate of growth in Medicare spending. These changes will protect the solvency of the Part A Trust Fund, and keep the Part B premium at the traditional 25 percent of program costs. It includes:
 - Reforming Medicare financing for graduate medical education provided by the nation's academic health centers and teaching hospitals;
 - Phasing in payment reforms for skilled nursing facility services and home health services;

- Constraining the rate of growth in payments for hospitals, physicians, and other providers.
- Collecting funds from private health insurers for Medicare beneficiaries who remain in the workforce.

Preserving and strengthening Medicaid

Medicaid provides health care services to 36 million low-income women, children, frail elderly, and disabled Americans. Approximately two-thirds of Medicaid expenditures are for care for the elderly and disabled. Medicaid is financed jointly by the States and the Federal government. Eligibility standards are set primarily by the States for a basic benefit package. States add additional eligibles and benefits at their option.

The President's plan maintains the 30-year national commitment to providing health services to poor women and children, elderly, and disabled while making Medicaid more effective and efficient. It would reduce Federal Medicaid spending by \$54 billion over seven years.

Key elements of the President's Medicaid proposal are:

- Coverage is Preserved: Low-income women and their children, the elderly, individuals with disabilities, Medicaid/Medicare dual eligibles, and qualified Medicare beneficiaries, would retain their guarantee of health care coverage.
- Cost Effectiveness: To limit the growth in federal Medicaid expenditures, a per capita limit would be established, which constrains the rate of increase in federal matching payments per beneficiary. Since this is a per capita limit, it maintains the federal commitment in the event that states need to add beneficiaries. Federal payments for disproportionate share hospitals would also be constrained.
- Increased State Flexibility: States would be given greatly enhanced flexibility in how to manage their Medicaid programs and pay for services, so that they can reduce costs, not coverage. States could offer coverage of additional services including nurse-supervised clinics, and vocational training for people with disabilities. The Boren Amendment on hospital and nursing home payment policy would be revised to allow states more leeway in payment policy. States would be permitted to mandate enrollment in a choice of managed care plans or provide home and community-based care at their option without a Federal waiver.
- Quality Protection: Existing quality protections for nursing home residents would be maintained as would protections against impoverishment for the at-home spouses of nursing home residents.

Operation Restore Trust: Combating Fraud and Abuse

[The American health care system is plagued by waste, fraud, and abuse.] The Clinton Administration stepped up efforts to combat fraud and abuse and has had remarkable results. Key to this success has been Operation Restore Trust -- a pilot program launched earlier this year in New York, Florida, Illinois, Texas, and California. More than 3,000 citizens have already called the newly established hotline; over 200 fraud investigations are ongoing; and 20 criminal convictions, 7 civil judgements, and 7 indictments have been brought since March -- yielding \$32 million returned to the Federal government. It is now time to take Operation Restore Trust nationwide, with a three-part initiative to combat fraud and abuse in federal health programs.

Make Operation Restore Trust Permanent: The President will submit legislation that will give law enforcement officials additional authorities to investigate, prosecute, and sanction those who defraud Federal health programs; ensure adequate and dependable sources of funds to support program integrity activities; and change reimbursement policies that inadvertently may have contributed to program abuse and fraud.

Immediate Executive Orders: The President will issue a series of Executive Orders to coordinate health care anti-fraud activities government-wide and direct executive departments to: mount a major media campaign in partnership with the Ad Council; report convictions of health care fraud to appropriate state officials and urge them to hold hearings on license revocation; cut health care payments where they are out-of-line with private sector payments; and develop legislation to provide monetary awards to citizens whose tips lead to conviction of providers who defraud Medicare and Medicaid.

Emergency Supplemental Funding: The President will submit a supplemental appropriation request to allow immediate hiring of 1,000 investigators, auditors, and computer specialists who will be engaged in anti-fraud and abuse activities. Efforts will be targeted at areas that have been the most vulnerable to fraud.

Long-Term Care

Frail elderly Americans and those living with disabilities frequently require long-term care, either in nursing homes and other institutions or at home. The President's plan would improve access to such services in the following ways:

Home and Community-Based Care: A new grant program to the States would provide funding for home and community-based care for the elderly and disabled.

Respite Care: Family members of persons with Alzheimer's disease would be eligible for up to five days of respite care each year under a new Medicare benefit.

Protecting Working Americans

Today, a majority of working Americans receive their health care insurance coverage through their employer. The security of that coverage often depends on economic conditions and on insurance rules that can exclude coverage for some people.

There has been strong, bipartisan support for a series of reforms on the group health benefits market to protect and preserve the coverage of working Americans, based on actions taking place in many states. The President's plan includes many of those proposals along with measures to protect workers when they move from job to job or from work to unemployment and back to work. Highlights of those proposals are:

- **Portability of Coverage:** Under the President's plan, workers who move from one job to another would be able to continue their existing group health insurance.
- **Pre-existing Medical Conditions:** Group health plans and insurers would not be permitted to exclude individuals from coverage because of a pre-existing medical condition.
- **Small Business Assistance:** Grants would be provided to states to permit them to create voluntary small group insurance purchasing cooperatives to encourage competition and affordability in the small group market. The Federal Employees Health Benefits Program would be made available to small employers in states that opt not to create such purchasing cooperatives. Insurers would also be required to sell coverage to small businesses regardless of the health status of their workers.
- **Coverage for the Self-Employed:** Self-employed individuals, including farmers, would be allowed to deduct 50 percent of the cost of their health insurance premiums from their taxable income.
- **Temporarily Uninsured Workers:** Grants would be made available to the States to finance a six-month period of health benefits for laid-off workers who had employer-based coverage and are now receiving unemployment benefits.

Administrative Simplification

The American health care system includes a tremendous amount of overhead and paperwork which often gets in the way of providing care to patients. The President remains committed to reducing such red tape. Standards would be adopted to simplify the use of electronic health information transactions and shared data systems. Strong privacy and security safeguards would assure confidentiality.

TREASURY CLEARANCE SHEET

NO. _____
Date Oct. 4, 1995

MEMORANDUM FOR: SECRETARY DEPUTY SECRETARY EXECUTIVE SECRETARY
 ACTION BRIEFING INFORMATION LEGISLATION
 PRESS RELEASE PUBLICATION REGULATION SPEECH
 TESTIMONY OTHER SYLVIA MATHEWS

FROM: Glen Rosselli

THROUGH: _____

SUBJECT: Health Care

REVIEW OFFICES (Check when office clears)

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<input type="checkbox"/> Under Secretary for International Affairs
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<input type="checkbox"/> Inspector General
<input type="checkbox"/> IRS
<input type="checkbox"/> Legislative Affairs
<input type="checkbox"/> Management
<input type="checkbox"/> OCC | <input type="checkbox"/> Policy Management
<input type="checkbox"/> Public Affairs Liaison
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NAME (Please Type)	INITIAL	DATE	OFFICE	TEL. NO.
INITIATOR(S) Glen Rosselli	<i>GR</i>	10/4/95	DAS for Economic Policy	2-0090
REVIEWERS				

SPECIAL INSTRUCTIONS

Review Officer _____ Date _____ Executive Secretary _____ Date _____

1996-SE-002297



DEPARTMENT OF THE TREASURY

WASHINGTON

April 2, 1996

To: THE SECRETARY

Through: Josh Gotbaum *JG*

From: Glen Rossell *GR*

Re: Health Care Reform Update: Kassebaum/Kennedy Bill

CC: Alan Cohen

The House: Action on its version of Health care reform legislation was completed March 28th, when HR 3103 passed by a vote of 267 -151 with only one Republican voting against it.

The Administration: Issued a SAP opposing the House bill for the following reasons: inclusion of MSA's, capping malpractice awards and limiting malpractice actions, the weakening of the ban on the sale of duplicative insurance policies to Medicare enrollees, and the weakening of anti-fraud and abuse protections.

The Senate: The basis of this latest movement for health care reform is the Kassebaum/Kennedy bill which will be brought to the floor under a unanimous consent agreement the week of April 15.

Kennedy/Kassenbaum would do the following:

- Allow employees to switch employers and still maintain group coverage, regardless of pre-existing conditions. This is commonly called "group to group portability.
- Require insurers who offer individual coverage to issue an individual policy to anyone who meets these three criteria:
 - 1) Had coverage under a group plan for at least 18 months;
 - 2) Is not eligible for coverage under any group plan; and,
 - 3) Has exhausted so-called COBRA coverage.

COBRA, which stands for the Consolidated Omnibus Budget Reconciliation Act of 1985, requires continued health care coverage for some people who quit or lose their jobs. Under COBRA, employees who become ineligible for permanent coverage because they quit or are laid off can continue coverage for up to 18 months. It applies to workers at firms of 20 or more.

- Require insurers to offer group health plans to all employers in markets in which they already sell -- with a few exceptions. Prohibit insurers who offer a group plan to an employer from excluding some of that company's employees or their dependents from a group plan because of pre-existing conditions.

1996-SE-008509



DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

ASSISTANT SECRETARY

September 13, 1996

To: The Secretary
From: Joshua Gotbaum 
Re: Child Health Care Proposals

In June, Democrats released their Families First Agenda, which among other things, contained a proposal for a children's health initiative tailored to provide help for the 10 million children that are uninsured. The FFA health initiative has three components:

1. Make "Kids-Only" Insurance *Available* -- Require that all insurance companies and managed care plans that do business with the Federal Government (through FEHBP, Medicare, Medicaid, etc.) offer "children-only" policies for children up to the age of 13. Require these policies to cover no less than the benefits offered in their government packages.
2. Make "Kids-Only" Insurance *Accessible* -- Require consumer protection in these policies similar to those under Kenriedy-Kassebaum bill, including guaranteed issue, guaranteed renewability, no discrimination based on health status, etc.
3. Help Make "Kids-Only" Insurance *More Affordable* -- Provide assistance to working families to cover a portion of the cost of the premium, including tax relief and premium subsidies.

Administration Views to Date

The Administration's health care team has been reviewing the proposal, but has taken no position on it. Our initial reaction is that it is very poorly targeted. The proposal would be costly and most of the subsidy would go to families whose children already have health insurance. We have -- privately -- provided suggestions to Congressional staff.

We are also considering, quietly, whether the Administration should have a health initiative aimed at children, and what form such an initiative might take. Beyond the 10 million children that are uninsured, many more are underinsured, with limited access to preventive and primary care services. Although we are nowhere near going public with a proposal, among the possibilities are: expanding school health programs; additional funding for consolidated health centers; and increasing Medicaid funding for children and working families who are already eligible under current law.

1997-SE-000261



DEPARTMENT OF THE TREASURY
WASHINGTON

January 10, 1997

To: **The Secretary**

From: Joshua Gotbaum

A handwritten signature in dark ink, appearing to be "JG", written over the name "Joshua Gotbaum".

Re: **Home Health Care Transfer**

Here is the 1-pager you requested on home health care transfer.

Transfer of Some Medicare Home Health Costs to Part B and Establishment of a Post-Hospital Home Health Benefit in Part A

- The home health care transfer makes sense and is a responsible way to help extend the solvency of the Hospital Insurance (HI) trust fund.
- Medicare Part A was originally designed to finance short-term, recuperative, post-acute care services. When OBRA -1980 eliminated Part A and Part B limitations, an unintended consequence was to burden the Part A Trust Fund with approximately 99 percent of the financing for the home health benefit, regardless of whether visits are acute or chronic care.
- The President's proposal recognizes that Part A covers post-acute care services and allows Part B to finance all other home health services, just as was intended and implemented before 1980.
- The transfer reduces the cuts that would otherwise have to be made from Part A to extend the life of the trust fund, thus protecting home health, hospital, and nursing home providers from excessive Medicare cuts.
- *Virtually every Republican Member of the House of Representatives, including Newt Gingrich, Dick Armev, John Kasich, Bill Archer, and Bill Thomas, voted for this concept in the fall of 1995 when they passed their budget reconciliation bill.*

Administration Proposal

This proposal shifts about 70% of the financing for the Medicare home health benefit from Part A to Part B by redefining the benefit under Part A as a "post-hospital" home health benefit, establishes a new Part B home health benefit and would save the HI Trust Fund roughly \$80 billion over five years.

Under the proposal, the first 100 visits provided to a beneficiary following discharge from a hospital would be paid under Part A if such services begin within 30 days of discharge and the hospital stay was at least 3 days. All subsequent visits would be paid under Part B.

For beneficiaries who *do not* have a prior hospital stay, all home health visits would be paid under Part B. Beneficiaries using services under Part A or Part B would not be charged a copayment nor be responsible for paying a deductible. The shift in financing would not result in an increase to the Part B premium.

1997-SE-012647



DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

November 24, 1997

MEMORANDUM TO: SECRETARY RUBIN
DEPUTY SECRETARY SUMMERS

FROM: JONATHAN GRUBER

RE: Health Care Budget Priority: Outreach for Low Income Children

As the debate over budget priorities moves forward, it is important that we consider the remaining hole in our safety net for low income children: *the more than three million children who are currently eligible for Medicaid but not enrolled.*

This memo lays out a performance-based outreach proposal which will provide incentives for states to enroll these children, but will only reward those states that are successful in doing so. This approach provides a low cost means of ensuring that the lowest income children in the U.S., who are now largely uninsured, obtain public coverage, even as we expand eligibility much further up the income distribution through other policies.

Performance-Based Outreach Bonuses for Medicaid-Eligible Children

The Problem

Millions of Very Low Income Children Remain Uninsured: Access to affordable health insurance for children has been significantly improved. The new State Children's Health Insurance Program (CHIP) will help low-income, working families purchase coverage for their children. This builds upon Medicaid, which offers coverage to most children in poor families.

However, identifying, educating and enrolling children in these programs is not simple — especially for low-income children eligible for Medicaid. Despite years of efforts by States, providers, children's groups, and others, more than 3 million children who are eligible for the Medicaid program are still uninsured.

Unequal Incentives for Covering Children: Despite the fact that Medicaid children are usually harder to enroll and more expensive to cover, Medicaid has a lower Federal matching rate than does CHIP. This creates a backward incentive to reward states more for signing up more higher income children in CHIP with the better matching rate than lower income children in Medicaid.

The Solution: Performance-Based Outreach Bonuses

Reward States for New Enrollment in Medicaid: States would receive a financial "bonus" for each child who is enrolled in the traditional Medicaid program above an enrollment "baseline". This bonus would equal to the extra matching percentage under CHIP, erasing the difference between the two programs. This bonus would be available only for new enrollment, tying dollars to state performance.

How it Would Work:

- HCFA would project baseline Medicaid enrollment for 1998, based on 1997 enrollment, adjusted for the projected change in the poverty rate in that state or region.
- At the end of 1998, states would receive a bonus for each child (calculated in person-years) enrolled above that baseline level.
- The bonus would be equal to the average cost per child enrolled in the state Medicaid program, times the difference between the state's Medicaid and CHIP Federal matching rate. Combined with the Medicaid matching rate, this provides the same match rate for these newly enrolled children as the state would receive under its new CHIP program.
- In each future year, the baseline would be proportionally adjusted upwards or downwards by the projected share of the state in poverty, and the bonus would be based on the extent to which enrollment exceeded that baseline.

- To ensure that the program works, it would be reviewed after five years. Based on its success, it would be:
 - Continued as is;
 - Sunsetting; or
 - Continued, but the baseline would be reset to the actual enrollment level at that point in time to prevent the baseline from becoming too artificial.

The Advantages

Levels the Playing Field: Removes the unequal and perverse incentives for states to seek out higher income children under CHIP before signing up lower income children under Medicaid

Limited Substitution for Private Insurance: Almost two-thirds of the more than 3 million children who are eligible for Medicaid but not enrolled are uninsured. Thus, there will be little problem with "substitution" of public for private coverage as a result of this outreach incentive; the vast majority of the children newly covered by Medicaid will have been otherwise uninsured.

Pays only for Performance: Under current law, Medicaid does not select which outreach activities it will match based on their success nor does it pay more for approaches that work. Indeed, CBO has not been willing to score federal outreach subsidies as reducing the number of uninsured children. This approach only pays states if they actually improve their Medicaid enrollment.

Nothing to Lose: If states do not respond to this incentive and does not enroll any additional children for the bonus, there is no cost to the Federal government. We only pay if enrollment rises.



DEPARTMENT OF THE TREASURY
WASHINGTON

ASSISTANT SECRETARY

INFORMATION

March 23, 2000

**MEMORANDUM FOR SECRETARY SUMMERS
DEPUTY SECRETARY EIZENSTAT**

FROM: JON TALISMAN
ACTING ASSISTANT SECRETARY (TAX POLICY)

SUBJECT: Vaccine Initiative and Congressional Health Care Bills

Summary

This memorandum explains the tax provisions affecting vaccines and the development of new drugs in H.R. 2990 (currently in conference with S. 1334) and how those proposals differ from the Administration's vaccine tax initiative. We understand that Mr. Archer has been saying that H.R. 2990 deals with the vaccine issue, but he is not correct. H.R. 2990 would expand the orphan drug tax credit, provide a new 40 percent medical innovation tax credit, and reduce the vaccine excise tax rate from 75 cents to 50 cents per dose. None of these proposals directly addresses the development of new vaccines for diseases that afflict developing countries and thus they cannot be viewed as a substitute for the Administration's proposed vaccine sales tax credit.

Discussion

H.R. 2990 would: (1) Expand the orphan drug tax credit to allow expenses for human clinical testing after the taxpayer files an application with the FDA for designation of the drug as a potential treatment for a rare disease or disorder (currently only expenses after the date of FDA designation are eligible); (2) Provide a new 40 percent medical innovation tax credit for human clinical testing expenses attributable to academic medical centers and other qualified hospital research organizations; and (3) Reduce the present excise tax on vaccines from 75 cents per dose to 50 cents per dose.

We do not object to the proposed change in the orphan drug credit. It addresses taxpayers' concern with the long time lag between their application to FDA and FDA's designation of a drug as a potential treatment for a rare disease or condition. Expenses related to drugs that do not receive FDA designation would not be eligible. This proposal would not benefit vaccines for diseases targeted by the vaccine tax initiative because they would not be eligible for the orphan drug credit (which applies only to certain rare diseases or conditions).

We do not support the proposed medical innovation tax credit for human clinical testing expenses attributable to academic medical centers and qualified hospital research organizations. This proposal is unwarranted for two reasons: (1) The present research credit contains provisions that address contract research and basic research conducted at educational institutions; (2) It is unlikely that this proposal will increase biomedical research. It will likely shift this research

from other medical research organizations to university-based hospitals. Further, this proposal is unlikely to benefit the development of vaccines targeted by the vaccine initiative; many of those trials will have to be conducted overseas where the strains of the diseases are prevalent. The tax credit for clinical trials that we discussed with you in the context of the vaccine initiative is preferable because it focuses on the targeted diseases and would allow the credit for expenses related to clinical trials conducted overseas in cases where the US testing population is inadequate.

H.R. 2990 also contains a provision that would reduce the excise tax rate for vaccines from 75 cents to 50 cents per dose, effective for sales after December 31, 2004. Receipts from the vaccine excise tax are earmarked for the Vaccine Injury Compensation Trust Fund and are used to compensate those injured by vaccinations. The trust fund has a large surplus and annual receipts exceed trust fund expenses. Cutting the vaccine excise tax rate also relieves the CDC budget because it buys vaccines at prices that include the excise tax. The proposed reduction in the excise tax would reduce revenues by about \$50 million per year. The vaccine excise tax applies to a specified list of vaccines routinely administered to children, but does not include the ones targeted by the vaccine initiative. A provision to add streptococcus pneumoniae to the list of taxable vaccines is included in the House and Senate bills, but was enacted last year as part of the extenders bill.

cc. Burman
Elmendorf
Herold
Muldoon
Robertson
Sandberg
Thomas

TREASURY CLEARANCE SHEET

No. _____
Date: 3/30/00

MEMORANDM FOR: SECRETARY DEPUTY SECRETARY EXECUTIVE SECRETARY
 ACTION BRIEFING INFORMATION LEGISLATION
 PRESS RELEASE PUBLICATION REGULATION SPEECH
 TESTIMONY OTHER Charles O. Rossotti, Commissioner, IRS

FROM: Jon Talisman, Acting Assistant Secretary (Tax Policy)
 THROUGH: _____
 SUBJECT: Vaccine Initiative and Congressional Health Care Bills

REVIEW OFFICES (Check when office clears)

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| <input type="checkbox"/> Domestic Finance | <input type="checkbox"/> ATF | <input type="checkbox"/> Scheduling |
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| | <input type="checkbox"/> OCC | |

NAME (Please Print)	INITIAL	DATE	OFFICE	TEL. NO.
INITIATOR(S) Len Burman			DO/XA	622-0120
REVIEWER(S) Jon Talisman			DO/X	622-0050

SPECIAL INSTRUCTIONS

Review Officer Date Executive Secretary Date

ADMINISTRATION HISTORY APPENDIX
CHAPTER FOUR: INCREASING ECONOMIC
OPPORTUNITY

MINIMUM
WAGE



DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

April 4, 1995

ASSISTANT SECRETARY

95-144630
INFORMATION

MEMORANDUM FOR SECRETARY RUBIN
DEPUTY SECRETARY NEWMAN

FROM: Alicia Munnell *AM*

SUBJECT: Three Memoranda

Attached are three memos that might be useful. The first is a minimum wage memo discussing the controversy that has arisen over Alan Krueger's study. The second memo shows that, based on the decline in the dollar since January 1994, the price level should be roughly 1-1/4 percent higher by late 1996. The third attachment contains talking points on the current budget battle prepared by Larry Haas at OMB.

EXECUTIVE SECRETARIAT



DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

ASSISTANT SECRETARY

April 4, 1995

MEMORANDUM FOR SECRETARY RUBIN
DEPUTY SECRETARY NEWMAN

FROM: Alicia Munnell *AM*

SUBJECT: Minimum Wage

SUMMARY

The claim that raising minimum wages has no negative effect on employment at all has come under attack. The restaurant-funded Employment Policies commissioned a study to reassess Alan Krueger and David Card's finding of no negative employment effect. This new study concludes that Card and Krueger's work is flawed. The debate will continue in the academic literature. In the meantime, the safest argument remains that the negative effect of raising the minimum wage on employment--if there is any effect--is small, and is outweighed by the benefits of raising the minimum wage in terms of the boost provided the incomes of low-wage workers.

DISCUSSION

Context

One Op-Ed in the *Wall Street Journal* last week, and one Op-Ed in the *Washington Post* today have cited an academic study by two economists, Neumark and Wascher, casting doubt on the reliability of a study (conducted by Princeton's David Card and by Labor Department Chief Economist Alan Krueger) that found that New Jersey's increase in its minimum wage had had a positive, not a negative effect on New Jersey minimum-wage employment. Neumark and Wascher used newly-collected data covering a subset of the businesses surveyed by Card and Krueger, found a negative effect on New Jersey employment, and concluded that Card and Krueger's finding was the result of bad data.

The Card-Krueger argument--either in its strong form that there is no sign of a negative effect of the minimum wage or in its weaker (and preferred) form that the ambiguous evidence indicates that any negative effect is small--has been a powerful support for the Administration proposal to raise the minimum wage. Thus Neumark and Wascher's critique has excited some press comment, and will attract more.

For example, see the attached Op-Ed from this morning's *Post* written by James K. Glassman, the former publisher of *The New Republic*, which used to be a liberal magazine. Glassman uses Neumark and Wascher to argue that minimum wage increases harm rather than help their intended beneficiaries, and to conclude that: "ultimately the cure for low working wages may be nothing more mysterious than high personal diligence."

Card and Krueger

All participants in the academic debate-in-progress--Card, Krueger, Neumark, and Wascher--are well-respected analysts, with reputations as careful students of labor economics.

Card and Krueger's study of New Jersey's minimum wage increase did find that boosting the minimum wage boosted low-wage employment. Card and Krueger understood this result as a consequence of the particular hiring strategy followed by employers of low-wage labor. Economists viewed the conclusions of this particular study as provocative and interesting, but not conclusive.

Card and Krueger's New Jersey minimum wage study is only a small part of their recent book on the economics of the minimum wage. Most of the book is spent arguing that previous economists have stretched a bit too hard to find that the minimum wage reduces employment: the evidence is ambiguous and hard to read, and the only certain conclusion is that the disemployment effect, if any, is small.

Neumark and Wascher

Neumark, an economist at Michigan State, and Wascher, an economist at the Federal Reserve Board, analyzed data that had been collected by the anti-minimum wage increase Employment Policies Institute to cover the same firms as Card and Krueger. Neumark and Wascher found a negative impact of the minimum wage on employment, and concluded that Card and Krueger's findings had been due to data errors.

There is one big reason to place more confidence in Neumark and Wascher:

- Their conclusion--that the minimum wage has a negative effect on employment, albeit not an effect that is statistically significant given their small sample--seems highly reasonable.

There are a number of reasons to place more confidence in Card and Krueger:

- Neumark and Wascher's data were collected by a group with a definite axe to grind. If the EPI's data had not shown what the EPI wanted, then we would not have heard about it.

Dog Bites Man: Minimum Wage Hikes Still Hurt

By RICHARD B. BERMAN

In 1994 Princeton economists David Card and Alan Krueger unveiled a study of the New Jersey fast-food industry purporting to show that increasing the minimum wage does not depress and may even expand entry-level employment. These findings amounted to a revolution in economic thinking—raising the price of labor increases the demand for it. In the dry field of labor economics, this was akin to declaring that Columbus was wrong and the world was flat after all. The mainstream press loved this “man bites dog” story and reported the findings as “compelling” (Washington Post), “influential” (San Francisco Chronicle), “comprehensive” (Detroit News), and “overwhelming” (Financial Times), to cite just a few of the glowing descriptions.

With the Card-Krueger study serving as the administration’s intellectual underpinnings, the president last month proposed a 21% increase in the minimum wage—to \$5.15 an hour from \$4.25. But in any empirical work there is one undeniable truth: Results are no better than the data on which they are based. And the Card-Krueger data are worse than flawed—they are grossly inaccurate.

How do I know? My organization took the time to check the actual payroll records from many of the fast-food restaurants the professors had surveyed by phone. The payroll records do not match the Card-Krueger data. Only a handful come anywhere close.

Consider Card-Krueger’s reporting for franchised Burger King units in the Pennsylvania zip code block with the first three digits “194.” Messrs. Card and Krueger reported data on eight such units, five of which were shown as having cut jobs. In fact, all of these units had employment gains—not one showed a single lost job. Overall, job growth in these restaurants was strong at 23%, yet Messrs. Card and Krueger reported them as losing 19% of their workers.

Similar errors are found in just about every other zip code where we were able to match data. In the New Jersey zip code block with the first three digits “088,” Card-Krueger reported an employment gain of 54% for franchised Burger Kings, when payroll data showed job growth was only 23%. In that same block, franchised Wendy’s operations were reported as increasing employment by 24%, compared with 12% from the payroll data—not too far off the mark, except that Card-Krueger’s data included a unit with 96% employment growth when none actually exceeded 26%.

We uncovered the professors’ errors, partly by instinct, partly by luck. Knowing from numerous existing studies and real-life experience that the new view was anomalous, and having painstakingly ruled out mathematical error, we concluded that if Messrs. Krueger and Card’s answers were wrong, perhaps they had asked the wrong question.

The Card-Krueger data were collected by people hired to call 410 fast-food restaurants in New Jersey and eastern Pennsylvania on two separate occasions: in February 1992, before New Jersey raised its minimum wage to \$5.05, and then again the following November, after the raise. Pennsylvania, the control group, did not raise its minimum wage.

While the stated purpose of the New Jersey study is the impact on job growth of a minimum wage hike, to our surprise we found that only one of the 24 questions was related to minimum wage employment. (The other questions dealt primarily with prices and employee benefits.) And the sole inquiry, “How many full-time and part-time workers are employed in your restaurant, excluding managers

and assistant managers?” is highly problematic.

The survey methodology allowed each telephone respondent to assign his own interpretation to how many people were “employed” (e.g., that day, week, payroll cycle); and to the definition of “full-time” (e.g., 40 hours, 35 hours, more than 20 hours).

The 1992 survey results saw wild swings in employment patterns that could not be accounted for by seasonal sales changes. It was obvious that the Princeton survey had used a rubber ruler. Without consistent yardsticks, the survey definitions were left to whoever answered the phone. Second, there was never any possibility that this single question (even if defined properly) could have supplied sufficient data for analysis.

The Card-Krueger inquiry focused on people employed. The questions that should have been asked concern how many hours were being worked. If, in February, a manager reported four full-time employees, and in November said he employed five, Messrs. Card and Krueger would report an increase in employment. But if in February the four each worked 30 hours (for a total of 120), and in November the five each worked 20 hours (for a total of 100), then, despite the higher number of workers, employment would actually have gone down.

Our analysis of the payroll data for both the New Jersey and Pennsylvania restaurants reveals that these fast-food franchisees increased employment from February to November along historical seasonal trends. However, while the Card-Krueger data imply that the New Jersey minimum wage hike resulted in an employment increase of 12 percentage points relative to Pennsylvania, the actual payroll data show that New Jersey’s employment growth lagged Pennsylvania’s by five percentage points. The Card-Krueger results—so heavily relied on by Secretary of Labor Robert Reich on numerous occasions—had been stood on their head.

To further test the Card-Krueger premise on the relationship between minimum wages and employment, we provided David Neumark of Michigan State University with all of the data we were able to amass—roughly 25% of the franchised units in the Card-Krueger survey. He and his co-author, William Wascher of the Federal Reserve Board, then subjected this data to the same analysis carried out by Messrs. Card and Krueger. Their estimate shows that every 10% increase in the minimum wage decreased employment by 2.7%. (The New Jersey minimum wage increase in 1992 amounted to an 18% hike.)

The significance of this last finding merits further elaboration. One of the main contentions of the minimum wage research inspired by Messrs. Card and Krueger has been that whatever effect the minimum wage may once have had on employment no longer holds in the 1990s. Yet the Neumark-Wascher findings, carried out in an identical manner as the Card-Krueger work, with the correct payroll data, place the effect of minimum wages right where President

Carter’s minimum wage commission estimated it to be almost 15 years ago.

Given the counterintuitive findings of the Princeton study, many economists initially expressed reservations about it. Gary Becker, 1992 Nobel Prize winner in economics, counts himself among one of the doubters “who believe that these studies have serious defects.” But Prof. Krueger (who has been hired by Secretary Reich as chief economist at the Labor Department) has blasted academicians who resist his findings. “Such people,” he said, “hold beliefs which are probably not alterable with data.”

Much has been written in praise of the Card-Krueger minimum wage work. Laura D’Andrea Tyson, chairman of the president’s Council of Economic Advisers, has called it the product of “the most sophisticated techniques available to economists!” But these “sophisticated techniques,” coupled to the right data, produce a result the administration cannot now deny. Higher minimum wages cost jobs.

Mr. Berman is executive director of the Employment Policies Institute, a research organization funded by a cross-section of manufacturers, restaurants and retailers that studies entry-level employment.



Robert Reich

REPLY TO RICHARD BERMAN'S WSJ MINIMUM WAGE OP-ED

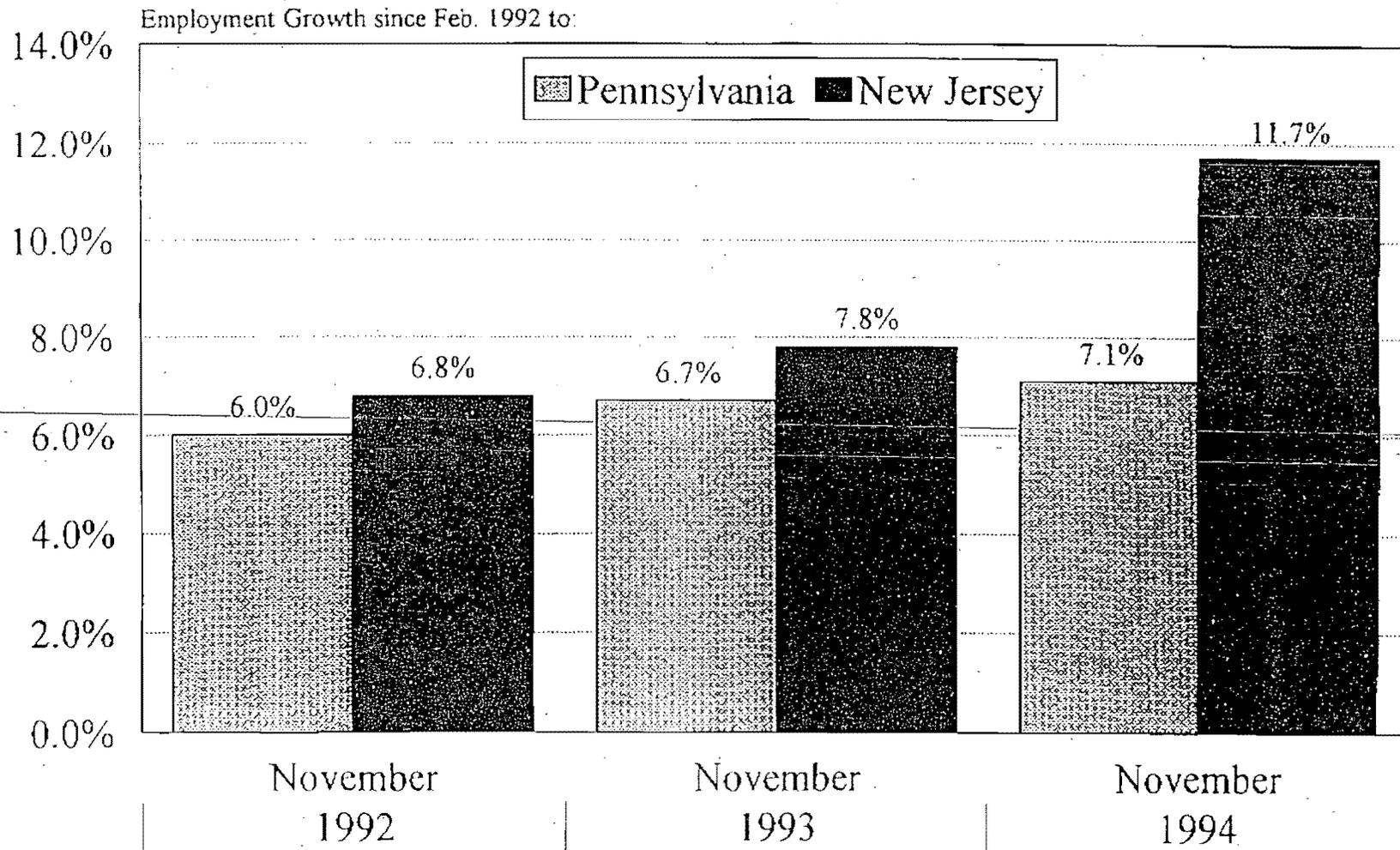
- The *Wall Street Journal* reported on January 31, 1995 that a group of lobbyists opposed to a minimum wage increase was organizing to "poke holes" in Professors David Card and Alan Krueger's study of the New Jersey minimum wage.
- The Card-Krueger study was published in the *American Economic Review*, a leading economics journal, after undergoing professional peer-review.
- The survey methodology used by Card and Krueger is both widely accepted and state-of-the-art. Card and Krueger evaluated and reported on the reliability of their data, and the data were deemed accurate. There is no reason to expect that New Jersey managers would be less accurate in responding to a survey than Pennsylvania managers.
- BLS payroll employment data for all eating and drinking establishments between February 1992 and November 1992 -- the same time period cited by Mr. Berman -- also shows that the rate of employment growth in restaurants in New Jersey exceeded that in Pennsylvania. This corroborates the original Card and Krueger findings. See graph.
- The payroll data collected by the Employment Policies Institute and reported by Mr. Berman followed up a selected sample of less than one-fifth of all the establishments surveyed by Card and Krueger.
- Mr. Berman provided his small sample of payroll data to David Neumark to analyze. With such a small sample, one cannot conclude with any statistical confidence that employment growth based on our survey data differs from that of the payroll data in these restaurants.
- Several methodological aspects of the Card-Krueger study should be emphasized:
 - Contrary to the impression given by Mr. Berman, the Card-Krueger survey interviewed managers or assistant managers, not "whoever answered the phone."
 - Contrary to the impression given by Mr. Berman, hours of work were indeed taken into account in two ways in the Card-Krueger study. First, they analyze full-time equivalent employment. And second, the number of hours the store was open was also examined. This goes much further than other studies on the minimum wage (e.g., Neumark and Wascher's earlier work and other studies circulated by the Employment Policies Institute), which simply analyze the number of workers employed -- treating full- and part-time employees equivalently.
 - Not only did the Card-Krueger study analyze the change in employment in New Jersey relative to the change in Pennsylvania, it also looked within New Jersey. Restaurants that were required to raise their entry wage the most had, if anything,

greater employment growth than those that were unaffected by the increase (because they already paid above the new minimum wage).

- Many studies of older data -- when the real value of the minimum wage was much higher -- did conclude that a minimum wage increase had a small negative effect on employment. But when these same studies are updated to incorporate newer data, they find a statistically insignificant effect on employment. Over a dozen studies -- including a majority of those published in peer-reviewed journals in the last five years -- find that increases in the minimum wage have not noticeably affected employment. The Administration's position is based on the weight of the evidence, not just one study.

Employment Growth in All Restaurants in New Jersey and Pennsylvania since February 1992 to:

APR-04-1995 23:37



Source: Based on data from the Bureau of Labor Statistics payroll survey.

P.04

James K. Glassman

Raising the Minimum Wage Isn't the Answer

The biggest economic problem right now is not growth, inflation or unemployment. It's that so many Americans can't earn a decent living even though they work long hours at tough jobs.

"As a group," says Labor Secretary Robert Reich, "these Americans go by a name that ought to be an oxymoron: the working poor."

Over the past 15 years, the real earnings of lower-income families have dropped while those of upper-income families have risen. That's an abrupt change from the 1950s, '60 and '70s, when real incomes doubled across all income groups.

The divergence is growing, and it has serious moral, political and social implications. For example, it nearly defeated important trade legislation last year since many Americans believe, incorrectly, that foreigners are to blame for their low pay.

What can Reich and his colleagues do to help the working poor? Alas, not much. Like many economic problems, this one is not really amenable to a government solution.

To understand why, just look at one step that President Clinton has proposed—raising the minimum wage from \$4.25 to \$5.15 an hour. He believes this increase is long overdue: If the minimum wage set in 1979 had been adjusted for inflation, it would be about \$6 today.

Last year, only 3 percent of full-time American workers earned \$4.25 or less. But a hike in the minimum wage could affect a far higher proportion—certainly everyone making up to \$5.14 an hour and probably those making \$6 or \$6.50 as well. The Economic Policy Institute estimates that 20 percent of the work force would feel the change.

But the government can't simply require businesses to pay workers more without

"Ultimately the cure for low working wages may be nothing more mysterious than high personal diligence."

causing some adverse consequences. Otherwise, as a paper issued by Republicans on the Joint Economic Committee puts it, "there would be no logical reason why the minimum wage could not be set at \$10 or \$400 per hour."

One result is that some workers would lose their jobs. In a famous 1978 survey in the American Economic Review, 90 percent of economists agreed that raising the minimum wage increases unemployment among low-skilled workers.

That stands to reason. The Clinton legislation, for example, would cost a business with 100 minimum-wage workers about \$200,000 a year. That extra cost could come out of profits (thus, no expansion next year), or it could be defrayed by firing 20 low-paid workers and replacing them with machines or with a few more skilled workers, whose wages don't have to rise by government decree.

But this link between minimum wages and lost jobs was recently challenged by research conducted by economists David Card and Alan Krueger of Princeton. (Krueger was later hired by Reich as chief economist for the Labor Department.)

In April 1992, New Jersey raised the minimum wage within its borders from \$4.25 to \$5.05, so Card and Krueger looked at how employment at fast-food restaurants in that state changed—before and after the in-

crease. They compared those changes with fast-food employment in nearby Pennsylvania, which kept the the \$4.25 standard.

The results surprised most economists—including Card and Krueger themselves. They found "no evidence that the rise in New Jersey's minimum wage reduced employment." In fact, employment went up! New Jersey outdid Pennsylvania by 12 percentage points.

Had Card and Krueger found an economic perpetual-motion machine? Some administration officials seemed to think so. Said Laura D'Andrea Tyson, chairman of the Council of Economic Advisers, "The theory that somehow an increase in the minimum wage might affect employment is now at odds with the empirical evidence."

But is the evidence valid? Economists David Neumark of Michigan State and William Wascher of the Federal Reserve Board have doubts.

While Card and Krueger studied the results of a telephone survey of employers, Neumark and Wascher, in a reevaluation published last week, examined actual payroll records from Burger King and Wendy's franchises. These records gave the opposite conclusion: Jobs in New Jersey decreased 5 percent compared with Pennsylvania.

The Labor Department disputes the findings, pointing out that Neumark and Wascher

received their data courtesy of the Employment Policies Institute, an interest group funded in large part by restaurants, and that they looked at a far smaller sample than Card and Krueger.

These differences will be hashed out tomorrow at a hearing of the Joint Economic Committee, whose senior economist, Reed Garfield, says, "Compassionate politicians and well-meaning government programs like the minimum wage cannot repeal the laws of supply and demand any more than they can repeal the law of gravity."

In fact, the real reason that so many workers are paid so little is that the work they do isn't valuable enough.

"Skills matter more" is the way Reich describes the workplace today, and he has the numbers to prove it. A worker with a high school education and no training earns an average of \$365 a week while a trained worker with the same education earns \$513 and a trained worker who has graduated from college earns \$785.

The real question is how to improve the skills of the lower half of the work force so employers will pay them more. It's doubtful, based on history, that the answer will come from government.

Instead, it will come from businesses—which will have a better chance to fund training if they're relieved of some of the high costs government imposes, including the minimum wage.

But the ultimate answer lies with workers themselves. In a high-tech world, what they earn is directly tied to what they know. Government can help a bit through tax breaks for education, but ultimately the cure for low working wages may be nothing more mysterious than high personal diligence.

Richard Cohen

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ADMINISTRATION HISTORY APPENDIX
CHAPTER FOUR: INCREASING ECONOMIC
OPPORTUNITY

NEW
MARKETS



DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

ASSISTANT SECRETARY

MEMORANDUM FOR SECRETARY SUMMERS
DEPUTY SECRETARY EIZENSTAT

From: JONATHAN TALISMAN 
Acting Assistant Secretary (Tax Policy)

Date: August 1, 2000

Re: Community Renewal and New Markets Act of 2000 (H.R. 4923)

Last Tuesday (July 25th), the House passed H.R. 4923. As stated in the attached SAP, the Administration strongly supports H.R. 4923, which includes in substantially similar form the New Markets Tax Credit, empowerment zone, and low-income housing credit proposals from the President's FY 2001 budget. The elements of H.R. 4923 are as follows:

New Markets Tax Credit.—Investors would be allowed to claim a credit of 5% for each of the first 3 years, followed by a credit of 6% for each of the next 4 years, for amounts invested in selected community development entities which, in turn, use the investment proceeds to provide equity capital and loans to businesses in low-income communities. Community development entities would be selected by the Treasury Department following a competitive application process and would be authorized (during the years 2001-2007) to receive a total of \$15 billion of new investment with respect to which credits could be claimed by the investors. Although similar to the proposal contained in the President's budget, the proposed credit in H.R. 4923 would be slightly more valuable in present-value terms.

Empowerment Zones.—The existing 31 empowerment zones ("EZs") would be extended through 2009, and 9 additional EZs would be designated for the period January 1, 2002 through December 31, 2009. This expansion of the current-law empowerment zone program would be similar to the proposal contained in the President's budget (which called for the designation of 10 additional EZs). Under H.R. 4923, the following tax incentives would be available in 40 EZs:

- 20% wage credit for the first \$15,000 of wages paid to employees who live and work in the EZ (i.e., a maximum wage credit of \$3,000 per eligible employee);
- \$35,000 additional section 179 expensing;
- work opportunity tax credit for hiring youth who reside in an EZ;
- enhanced tax-exempt financing benefits (currently available only in 20 "Round II" EZs enacted in 1997);
- tax-free rollovers of gains from new investment in one EZ business to investment in another EZ business; and
- 60% exclusion for gains on the sale of small EZ business investments (rather than the 50% exclusion under current-law section 1202).

Renewal Communities.—A total of 40 renewal communities (“RCs”) would be designated for the period July 1, 2001 through December 31, 2009, generally using the designation criteria provided for under earlier-introduced renewal community bills (subject to a 200,000 population cap for each RC). Within these RCs, the following tax incentives would be available:

- 15% wage credit for the first \$10,000 of wages paid to employees who live and work in the RC (i.e., a maximum wage credit of \$1,500 per eligible employee);
- \$35,000 additional section 179 expensing;
- extension of the work opportunity tax credit for hiring youth who reside in renewal communities;
- 100% capital gains exclusion for RC business investments held for more than 5 years; and
- so-called “commercial revitalization deduction,” under which taxpayers receiving an allocation (up to \$12 million of expenditures per RC per year) would be allowed to deduct 50% of the costs of renovating a nonresidential, commercial building in the RC, or could elect to deduct such costs on a straight-line basis over 10 years.

District of Columbia Tax Incentives.—The bill provides that any area within the District of Columbia that is nominated to be a renewal community (and which otherwise satisfies the eligibility requirements for a renewal community) shall be given priority in the designation process. The designation of such an area within the District of Columbia as a renewal community would be effective for the period January 1, 2003 (when the current-law DC Zone incentives are scheduled to expire) through December 31, 2009

Low-income housing credit.—The current-law per capita limit for each State would be gradually increased from \$1.25 to \$1.75 for calendar year 2006 and thereafter, and would be subsequently indexed for inflation. The bill also makes several programmatic changes to the credit.

Private Activity Bonds.—The bill accelerates the currently scheduled phased increase in the State volume cap for private activity bonds from \$50 per capita (or \$150 million if greater) to \$75 per capita (or \$225 million if greater) for calendar year 2007 and thereafter.

Brownfields.—The current-law provision (which expires on December 31, 2001) that allows expensing of certain environmental remediation expenses for certain targeted areas would be extended but only for designated empowerment zones and renewal communities through 2009.

Non-Tax Provisions.—H.R. 4923 also includes several non-tax provisions, most notably: Federal guarantees for loans to certain new investment funds (e.g., “APICs” and “New Market Venture Capital Companies”) that will focus on low-income communities, which was part of the Administration’s broader “new markets” initiative, as well as a so-called “charitable choice” provision that would allow faith-based organizations operating drug or substance abuse treatment programs to be eligible for Federal funding.

Remaining issues for further negotiation.—The above provisions generally reflect the Community Renewal/New Markets agreement reached by the President and Speaker Hastert in May of this year. However, in a few areas, the negotiators differed in their interpretations of

what was agreed to by the President and the Speaker. These different interpretations were not fully resolved over the last two months. Consequently, H.R. 4923 (as passed by the House) represents Mr. Archer's interpretation of the agreement between the President and the Speaker. The primary issues that remain subject to further negotiation between the White House and congressional negotiators are as follows:

- Whether the per-capita limit for the low-income housing credit should be immediately increased to \$1.75 in 2001 (with inflation adjustments thereafter), as proposed in the President's budget;
- Whether the current-law tax incentives for the District of Columbia (perhaps including the D.C. homebuyer's credit) should be extended through 2009, rather than merely giving priority to areas within the District for designation as a renewal community; and
- Whether the new tax-free rollover provision for gains from investment in empowerment zone businesses should apply to investment made in a zone after the area was first designated as an empowerment zone (which could include investment made as early as 1995), provided that the gain is rolled over into replacement zone investment during the period 2002-2009, or whether the new provision should apply (as in the House-passed bill) only to gains from investment originally made during the period 2002-2009.

From: ex.mail."Jason_E._Hartke@who.eop.gov"
To: ex.mail("Adrienne_K._Elrod@hud.gov", "DWalsh@doc.go...
Date: 7/26/00 2:33pm
Subject: FYI

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

STATEMENT OF ADMINISTRATION POLICY
(THIS STATEMENT HAS BEEN COORDINATED BY OMB
WITH THE CONCERNED AGENCIES.)

July 25, 2000
(House)

H.R. 4923 - Community Renewal and New Markets Act of 2000
(Rep. Watts (R) OK and four cosponsors)

The Administration strongly supports House passage of H.R. 4923, the Community Renewal and New Markets Act of 2000. H.R. 4923 embodies all of the elements of the bipartisan agreement between the President and the Speaker of the House announced on May 23, 2000. This initiative will help encourage private sector equity investment in underserved communities throughout the country to ensure that all Americans share in our nation's economic prosperity.

H.R. 4923 includes the President's New Markets Tax Credit, authorization for America's Private Investment Companies (APICs) and the New Market Venture Capital (NMVC) program, and the extension and expansion of Empowerment Zone (EZ) incentives. The EZ incentives include extending the life of all existing EZs through 2009, equalizing tax incentives in all EZs by making the Round 1 wage credit and Round 2 bonding authority available in all EZs, creating new capital gains incentives in EZs, and creating 9 new Round 3 EZs. This package also includes the creation of 40 new Renewal Communities with certain tax incentives. The Administration looks forward to securing the commitment for \$200 million in appropriations for Empowerment Zones, as the bill moves forward.

The bill also makes clear that religious organizations may apply for drug abuse prevention and treatment funds on the same basis as other non-profit organizations. The Administration supports the principle that community and faith-based organizations can play a valuable role in addressing substance abuse. At the same time, the Administration has made clear that charitable choice provisions must be implemented consistent with full respect for the constitutional separation of church and state. The current version of this bill satisfies this constitutional prerequisite. The bill provides important protections for program beneficiaries and, similar to the Personal Responsibility and Work Opportunity Act of 1996 (P.L. 104-193), states that a religious organization's eligibility for the Civil Rights Act

Title VII exemption allowing religious organizations to hire on the basis of religion will not be affected by an organization's participation in the program. The language also makes clear that nothing in the bill "shall be construed to modify or affect" the application of other Federal or State law prohibiting employment discrimination. It also preserves state certification authority, while prohibiting States from discriminating against substance abuse training provided by specifically qualified religious organizations.

While the Administration supports H.R. 4923, there are concerns with the legislation and the Administration looks forward to working to address these concerns as the bill moves through Congress. Specifically, while the bill includes an increase in the Low Income Housing Tax Credit and Private Activity Bonds, that increase is phased in more slowly than is sought by an overwhelming majority of Democrats and Republicans in the House. The Administration is deeply committed to ensuring that the increase is phased in more quickly. The Administration is also disappointed that the bill does not extend more of the existing tax incentives in the District of Columbia. The Administration looks forward to addressing these concerns as the bill moves forward.

The Administration applauds the bipartisan action on H.R. 4923 and urges its swift passage.

Pay-As-You-Go Scoring

H.R. 4923 would affect receipts; therefore, it is subject to the pay-as-you-go requirement of the Omnibus Budget Reconciliation Act of 1990. The Administration has not yet completed its estimates of the costs of the bill. However, the absence of an offset to H.R. 4923 could cause a sequester of Federal resources. The Administration supports House passage of this bill, and will work with Congress to avoid an unintended sequester.

2000-SE-001663



ASSISTANT SECRETARY

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

February 14, 2000

Memorandum for: Secretary Summers
Deputy Secretary Eizenstat

From: David Wilcox
Marti Thomas
Douglas Elmendorf

Subject: New Markets and the Budget Framework

Different parts of the Administration continued on Monday to operate under starkly different assumptions about the conditionality that will be applied to various possible new budget initiatives, including the New Markets initiative.

- One of our regular contacts in the White House expressed the view that the Administration's position is (and has been since November) that if we get a good enough New Markets bill, we'll sign it, outside of any framework.
- This runs directly counter to our understanding of where Administration policy was as of last week.
- It also potentially severely undermines the positions that some of our allies on Capitol Hill are taking on our behalf. Marti has been told that the House Democrats are very happy with a high degree of conditionality being applied even to initiatives we and they like.
- We fear that taking New Markets outside of any framework may well effectively invite an "open season" on unpaid-for measures.

We strongly recommend that this issue be litigated at Tuesday's 8:30 meeting.



DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220
August 5, 1999

**MEMORANDUM FOR SECRETARY SUMMERS
DEPUTY SECRETARY EIZENSTAT**

THROUGH: Gary Gensler *GG*
Under Secretary for Domestic Finance

FROM: Cliff Kellogg *CK*
Senior Policy Advisor
Community Development Policy

Alan Berube *AB*
Policy Analyst
Office of Community Development Policy

SUBJECT: New Evidence on the Advantages of New Markets

Summary

In advance of the President's tour of economically disadvantaged areas across the US, several cabinet agencies – including Treasury, HUD, Labor and Commerce – began discussions on how to highlight the latent economic potential in these areas. This memo summarizes some of this preliminary work, which examines communities targeted by the Administration's New Markets Initiative. The new research includes a Treasury-commissioned analysis of the Consumer Expenditure Survey for these lower-income communities -- the first time these data have been analyzed at this level of geographic detail -- and a HUD report on "under-retailed" inner-city communities. The major findings are:

- Both urban and rural New Markets contain significant spending power. These areas account for a much larger portion of the nation's consumer spending than of its household income. Spending per square mile in urban New Markets is higher than in urban areas in general.
- New Markets contain a diversity of family incomes. Median income data can conceal the number of middle class and higher-income families.
- Inner city New Markets have substantial untapped retail spending power. Analysis indicates that residents of even the most distressed city neighborhoods account for \$67 billion in annual retail spending. However, according to a HUD study, much of this buying power is exercised outside of the neighborhoods where these consumers live.
- The buying power of minorities is expanding. Studies suggest that growing Hispanic and black populations have enjoyed greater growth in spending power over the last decade than the population at large.

• The home mortgage industry has made significant inroads into serving New Markets. These lenders have already recognized the substantial business opportunities that exist in these communities.

We expect that in the next few weeks, the President will issue an Executive Order creating an Inter-Agency Group specifically charged with reviewing existing federal data sources with an eye towards revealing economic potential in these areas. This group's duties would include producing a regular compendium of New Markets business indicators.

Logic of the New Market Initiative

Tapping the economic potential in America's lower-income communities, both urban and rural, can benefit the residents of these communities and the businesses that successfully serve these markets. Many of these communities possess meaningful business advantages if approached strategically. These "New Markets"¹ possess several underappreciated advantages from a business perspective:

- In New Markets, retail spending power is significant, and in urban areas, quite concentrated.
- Many of these markets are not as well-served with retail outlets. This means that residents may need to leave their neighborhood to find adequate shopping opportunities.
- Some argue that urban New Markets have location advantages, in that they are close to downtown commercial districts (for firms offering business services), are close to major interstates and airports (for distribution businesses), or have available real estate with the appropriate infrastructure for manufacturing businesses.²

The home mortgage industry's expansion into low and moderate-income communities since 1993 is a leading example of how businesses can serve these customers profitably while reaching populations previously excluded from these markets.

At the same time, there are very real barriers to New Markets business development that must be addressed for these areas to reach their economic potential, including:

- Access to capital, especially equity capital.
- Access to technical expertise and to business opportunities.
- Access to market information.

¹ "New Markets" census tracts are defined as: (1) tracts in metropolitan areas with a poverty rate of 20% or greater, or median family income 80% or less than the greater of metropolitan area median family income and statewide median family income; and (2) tracts outside metropolitan areas with a poverty rate of 20% or greater, or median family income 80% or less than statewide median family income.

² See Michael Porter (Harvard Business School) and his series of studies on the competitive advantages of inner cities.

The New Markets Initiative aims to address the first two issues. Together with HUD, Commerce and Labor, we have begun to work on the third issue, access to market information.

The Importance of Market Information

Facilitating private sector investment is essential to economic growth in New Markets, and investors often look to business and population demographics in choosing where to invest. Business research indicates that there are a fairly uniform set of criteria that retailers use to determine retail location. Although specific measures depend on the merchandise, private sector consultants report that retailers look for a concentrated customer base, the demographic traits of core customers, product demand for their merchandise and existing retailers and competitors.³

However, potential investors often lack relevant information, or view such information as too costly to amass or obtain. This is primarily a matter for the private sector to address, but the federal government can help. Up until now, the federal government has not viewed its various databases with an eye toward compiling useable business information to help investors appraise these communities as markets. Within the federal government, we have pooled expertise from Commerce/Census Bureau, Labor/Bureau of Labor Statistics, Treasury, and HUD to review available government data sources and, just as importantly, determine how to present it most usefully for potential business investors.

There is an increasing business audience for such data. Bill Goodyear, Chairman of Bank of America, Illinois, sums up the shift in corporate perceptions: "We're no longer accepting the deficiency-based statistics. And when you do that, you can come to some pretty different conclusions."⁴

Both Urban and Rural New Markets Show Significant Spending Power

A special analysis of the Consumer Expenditure Survey (CES), commissioned by the Treasury Department for the New Markets Initiative and conducted with the Bureau of Labor Statistics, shows that total consumer expenditures in all urban and rural New Markets communities equal almost \$695 billion (\$323 billion in urban New Markets, \$192 billion in suburban New Markets and \$180 billion in rural New Markets).⁵

These New Markets can be sizeable and lucrative markets when analyzed by local spending rather than median income. Traditional market analysis that relies on household income to project sales can be inadequate, since new market areas spend a much higher portion of their

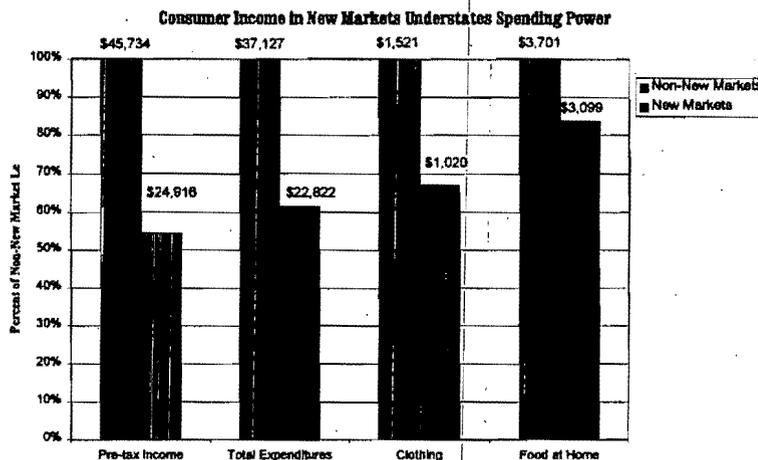
³ Interview with LocationNet Consultants, June 25, 1999. Businesses seeking to site non-retail facilities, such as headquarters, distribution facilities or back-room processing will consider different factors, specific to their firm's strategy. See unpublished paper by Brookings Institute, Center for Urban Policy.

⁴ Christian Science Monitor, August 10, 1998, p.7.

⁵ Bureau of Labor Statistics, Consumer Expenditure Survey, February 1997 through January 1998. These and other figures based on the Consumer Expenditure Survey research may be subject to sampling error, and should be interpreted as estimates only.

income, especially on basic items such as food and apparel. New Market areas have a higher proportion of the nation's consumer spending than of the nation's income. According to the Treasury/BLS analysis:

- Nationwide, the average income of consumer units (households) in New Markets areas is just 55 percent of the rest of the country, but these households spend 62 percent as much as the rest of the country. For clothing, they spend 67 percent as much. For food at home, they spend 84 percent as much. This translates into substantial spending power.



Data source: Bureau of Labor Statistics, Consumer Expenditure Survey, February 1997 through January 1998.
New Markets: Census tracts with 20% or greater poverty or census tracts with median income 40% or less of MSA median income if in an MSA, or 60% or less statewide median income if outside an MSA.

- The pattern is even more pronounced in central cities: On average, New Market residents of central cities earn 54 percent of what other central city residents earn, but spend 62 percent as much in total, 67 percent as much on clothing and 89 percent as much for food at home.

New Markets contain concentrated spending power due to higher population densities.⁶ Nationwide, consumer expenditures per square mile averages \$983, whereas residents in New Markets spend over \$33,493 per residential square mile. Even within central cities, the higher population density of New Markets neighborhoods translates into greater spending per square mile of residents - \$33,493 for central city New Markets, compared with \$25,879 per square mile for non-New Markets central cities.

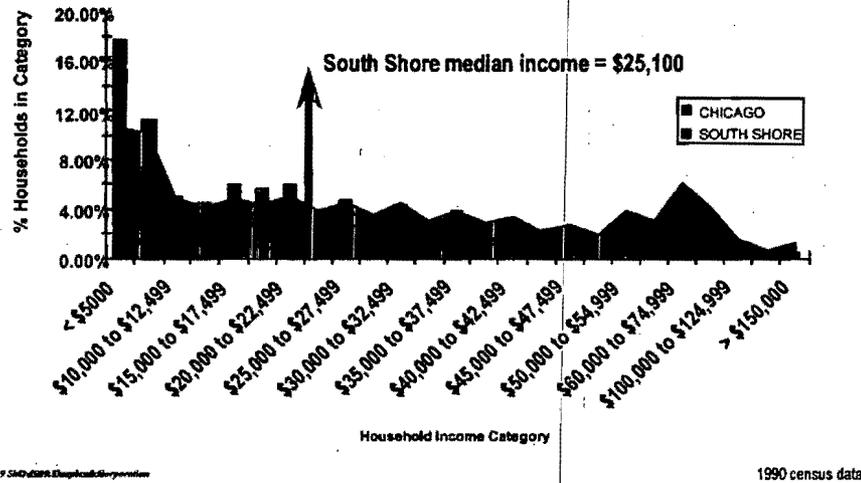
Income Diversity in New Markets Neighborhoods

Although we typically think of them as low and moderate-income areas, New Markets may contain substantial numbers of middle class and even higher-income families (“pockets of affluence”) that are masked by median income figures. For example, a study by Shorebank/Claritas that analyzed the South Shore neighborhood in Chicago showed a median household income of only \$25,100 in 1990, but over 5,100 South Shore households still earned

⁶ Treasury Department analysis of Bureau of Labor Statistics, Consumer Expenditure Survey, February 1997 through January 1998, plus Census Bureau calculation of square mileage for New Markets tracts.

more than \$50,000 annually. In the highest-income Chicago neighborhood, Forest Glen, where median household income was \$65,400, only 4,300 households earned over \$50,000 annually.

Income Profile: South Shore vs. Chicago



Significant Retail Spending Power Exists in Even the Most Distressed Inner Cities

Using a more restrictive definition to target the most distressed inner cities, Treasury/BLS analysis confirms the importance of retail spending in these areas.⁷ The Initiative for a Competitive Inner City (ICIC), an organization founded by Harvard Business School professor Michael Porter, has conducted a great deal of research on these sorts of inner city retail advantages. A widely quoted figure from ICIC is that inner cities contain \$85 billion in annual retail purchasing power.⁸ Treasury/BLS analysis suggests that this figure is closer to \$67 billion,

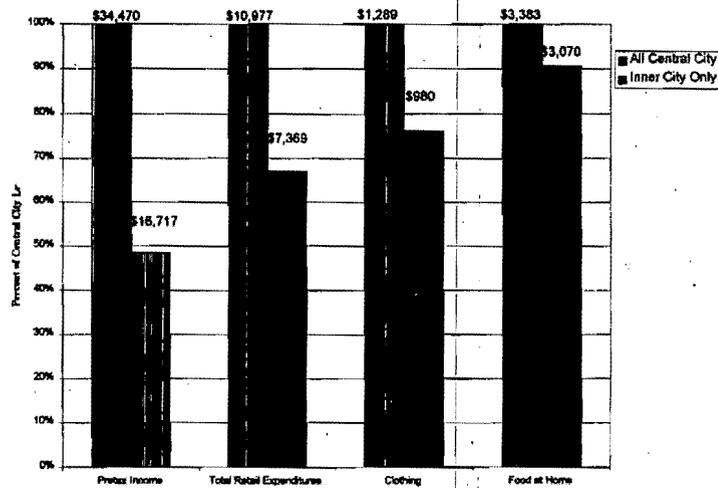
⁷ Our analysis isolated expenditures for consumer units residing in those census tracts that, in 1990, had a median family income less than or equal to 75% of the metropolitan area median family income, unemployment rates 130% poverty and unemployment rates 150% or greater than corresponding metropolitan area rates. This definition thus isolates areas of greater economic distress than does the New Markets definition.

⁸ "The Business Case for Pursuing Retail Opportunities in the Inner City." The Boston Consulting Group / Initiative for a Competitive Inner City 1998.

or about one-fifth of all retail spending by central city residents.⁹ Compared to the \$323 billion figure for urban New Markets, the \$67 billion figure uses more restrictive poverty measures, excludes rural areas and counts only retail spending.

- According to the Treasury/BLS analysis, families in these most distressed inner city neighborhoods spend a greater portion of their income on retail goods than do central city residents in general. Although family income in the inner city is only 48 percent of average nationwide family income, inner city families, on average, spend 67 percent as much on retail goods, 76 percent as much on clothing, and fully 91 percent as much on food at home.

Consumers in Distressed Inner Cities Wield Substantial Retail Spending Power



Data source: Bureau of Labor Statistics, Consumer Expenditure Survey, February 1997 through January 1998.
 Central City: All consumers residing in cities with population of at least 300,000.
 Inner City: See Footnote 7.

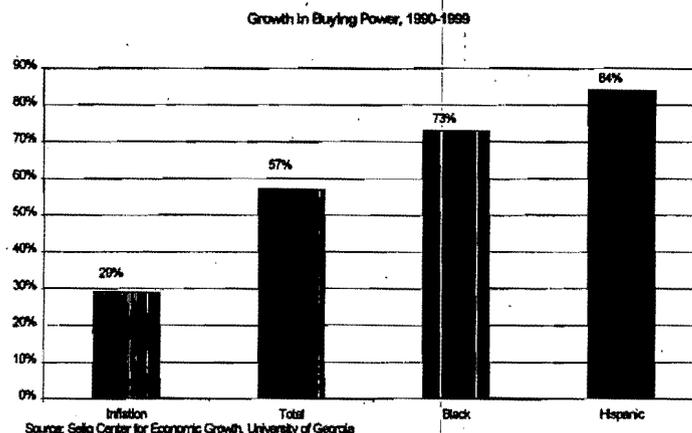
Buying Power of Minorities is Expanding

From 1990 to 1999, the buying power of the quickly-growing African-American and Hispanic population segments has outpaced the buying power growth of the population at large, according to a study by the University of Georgia's Selig Center for Economic Growth.¹⁰ While the total

⁹ We believe that the Treasury/CES estimate is more accurate for three reasons: (1) the ICIC method estimates the number of inner city households in the US as a percentage of total US population, whereas the Treasury/CES method uses a sample-weighted estimate of these households from the survey itself; (2) the ICIC method estimates average inner city disposable household income from data in only 6 US cities, whereas the Treasury/CES method uses a nationally representative survey; and (3) the ICIC method estimates retail expenditures by applying a retail spending ratio to average disposable household income, whereas the Treasury/CES method uses actual average reported expenditures on retail items to estimate total retail spending.

¹⁰ Humphreys, Jeffrey M., "African-American Buying Power by Place of Residence: 1990-1999", Georgia Business and Economic Conditions, July-August 1998; Humphreys, Jeffrey M., "Hispanic Buying Power by Place of Residence: 1990-1999", Georgia Business and Economic Conditions, November-December 1998; Humphreys, Jeffrey M., "Total Buying Power by Place of Residence: 1990-1999", Georgia Business and Economic Conditions, March-April 1998.

population's buying power has increased 57 percent, African-Americans' has increased by 73 percent and Hispanics' has increased by 84 percent.



Retail Spending Power in Urban New Markets Remains Untapped

Despite the presence of concentrated retail spending power in urban new markets and inner cities, a lack of adequate retailers in these neighborhoods forces residents to look elsewhere to meet their retail shopping needs. The "retail gap" that exists in these areas – the difference between retail spending by residents and receipts at local retailers – represents significant untapped business potential.

A recent HUD study confirms that many of America's urban new markets are currently "under-retailed."¹¹ The study compared income data for residents of these areas to retail receipts in those same areas. It concluded that:

- Forty-eight cities contained new markets areas that were significantly under-retailed. These areas were found not only in large cities like Chicago, whose inner-city neighborhoods had a retail gap of approximately \$2.3 billion, but also in small and medium-sized cities like New Haven, CT, where new market areas showed a retail gap of over \$300 million.
- The report estimated the total retail gap across all urban new markets in these 48 cities to be \$8.7 billion. This represents nearly 17 percent of the total retail purchasing power of these neighborhoods, and highlights the substantial untapped market potential therein.

[While we agree with HUD's point that many communities are under-retailed – the Harlem USA and Pathmark grocery store projects are good examples – we believe their calculations are flawed. We can provide you background on this if you are interested in the detail.]

¹¹ HUD PD&R, "New Markets: The Untapped Retail Buying Power in America's Inner Cities", July 1999.

Success Story: The Home Mortgage Industry

Since 1993, home mortgage lenders have made significant strides in serving new customer segments among minorities and in low-income communities. For some lenders, complying with the Community Reinvestment Act was their original motivation to explore these markets. But now that these lenders have developed the expertise, market knowledge and experience to serve these customers, they are staying for the business opportunities. This is the same approach that a savvy business person would take with any new market.

Since 1993, access to the home mortgage market for lower-income persons, for lower-income communities and for minorities has increased dramatically compared to the market as a whole. As shown in Table 1, total conventional mortgage loans nationwide increased by 33 percent between 1993 and 1997. In contrast, loans to census tracts where the median income is less than 80 percent of the median income of the metropolitan area increased much more rapidly than the average, by 45.1 percent. Similarly, loans to African Americans and Hispanics grew by 71.6 percent and 45.4 percent, respectively, over that period, also much faster than the average.

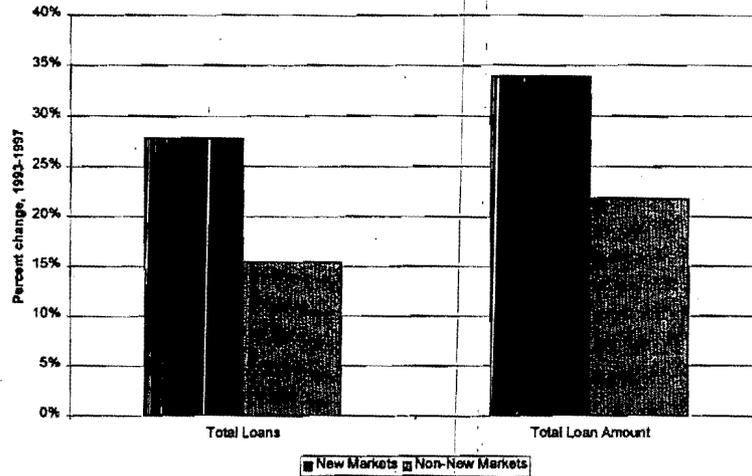
Table 1. Conventional Home Loans, 1993-1997

	<u>Percent change</u>
Total U.S. Market	33.0
<i><u>By race or ethnicity:</u></i>	
African American	71.6
Hispanic	45.4
<i><u>By income of borrower</u></i>	
<i><u>(% of MSA median):</u></i>	
Less than 80	40.3
80-99	30.0
100-119	24.6
120 or more	31.7
<i><u>By income of census tract:</u></i>	
Low or moderate	45.1
Middle	32.0
Upper	31.5

Source: Federal Financial Institutions Examination Council, August 24, 1998.

The same pattern holds true in New Markets areas. According to a Federal Reserve analysis, from 1993 to 1997, total home mortgage loans increased 28 percent in New Markets central cities, and only 15 percent in non-New Markets central cities. During the same period, loan amounts have also increased in these areas, with New Markets central cities increasing by 34 percent in loan amount, while loan amounts in non-New Markets central cities increased by only 22 percent.

Home Mortgage Lending Growing More Rapidly in New Markets, 1993-1997



Source: Federal Reserve Home Mortgage data, 1993-1997

Successful lenders are making these loans profitably, and consistent with safe and sound banking practice. Banks report strong performance of loans in the low- to moderate-income housing market. For example, Bank of America in San Francisco has profitably lent more than \$10 billion as part of its Neighborhood Advantage program -- a system of low- and moderate-income home loans -- to borrowers throughout the western United States.¹² BankBoston lent \$140 million to low- and moderate-income borrowers and found performance to be no different than in its regular mortgage portfolio.¹³ From 1996 through 1998, Chase Manhattan Bank financed the development of more than 1.6 million square feet of commercial space and the development of 20,271 units of affordable housing to benefit the stability, growth and economic expansion of lower-income communities. Chase Manhattan Bank "made these loans at market rate and found these activities to be a profitable business for Chase and the performance of these loans to be excellent."¹⁴ First National Bank of Chicago found that by increasing the availability of its consumer and mortgage lending products, and introducing flexible underwriting criteria, the bank's penetration in low- and moderate-income community markets grew.¹⁵

¹² Cited by Secretary Robert E. Rubin, at the National Community Reinvestment Coalition Annual Conference, March 19, 1998.

¹³ Success in Community Development Lending: 33 Examples from around the Country, The Federal Reserve Bank of Philadelphia, 1993.

¹⁴ Chase Community Development Success Stories, 1998.

¹⁵ Community Reinvestment Advocates, The Federal Reserve Bank of Philadelphia, 1993, p. 19.

The Deputy Secretary of the Treasury

September 2, 1999

NOTE FOR CLIFF KELLOGG
Senior Policy Advisor

ALAN BERUBE
Policy Analyst, Office of
Community Development Policy

FROM: STUART E. EIZENSTAT

SUBJECT: New Evidence on the Advantages of
New Markets

Your August 5 memo on the shortages of New Markets is fascinating. This initiative of the President's, which Secretary Summers as stressed, has tremendous potential for good.

Attachment

cc: Karen Kornbluh

Room 3326

622-1080