THE WHITE HOUSE
WASHINGTON

DATE: 09/02/93

TO:
THE VICE PRESIDENT
MACK MCLARTY
DAVE GERGEN
GEORGE STEPHANOPOULOS
MARK GEARAN
HOWARD PASTER
DEE DEE MYERS

FROM: JOHN D. PODESTA
Assistant to the President and Staff Secretary

The attached has been forwarded to the President.

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

THE DIRECTOR

September 2, 1993 93 SEP 2 P2:07

MEMORANDUM FOR THE PRESIDENT

FROM: Leon E. Panetta

SUBJECT: FY 1994 Appropriations Update -- Looking Ahead to September/October

This memorandum: summarizes the status of FY 1994 appropriations; reviews progress on your investment proposals; reviews progress on your non-defense discretionary savings proposals; and briefly discusses issues such as implementing the pay freeze and developing a strategy for following up on the commitment to further spending reductions in the Fall.

Status of FY 1994 Appropriations

Public Law - Only one of the thirteen bills has been signed into law, Legislative Branch.

House - The House has passed 11 of the thirteen bills. Defense will be marked up in Subcommittee the week of September 7th and be on the floor on September 23rd. Transportation will be on the floor whenever the Speaker finds a way to resolve the Mineta-Carr dispute over earmarked highway projects.

Senate - The Senate has passed five of the thirteen bills.

602(b)s - Byrd and Natcher are expected to try to reach agreement on a conference 602 (b) allocation during the week of September 13th so that conferences can begin that week. Decisions on how (or whether) to allocate any excess budget authority to domestic bills that is left on the table by Foreign Operations and Defense will likely be deferred.

Conference - Three bills are ready for conference (Treasury/Postal, DC and Commerce/Justice/State). The Agriculture conference report is pending in the Senate with the wool/mohair and honey subsidies open to debate.

Continuing Resolution - There are only 11 legislative days in September and it is quite possible that five or more bills will be covered by a short term CR, probably through October 8th or 15th. Defense, Labor/HHS/Ed, Transportation, Military Construction and Energy and Water are most likely to be covered under a temporary CR.

Investment Proposals

Based on House action to date, 56% of the total investment request has been approved ($9.4 billion out of $16.7 billion). For the Senate bills that have been acted on so far, the investment proposals have been funded at a level $205 million higher than the House.

The two bills with most of the investments, VA-HUD and Labor/HHS/Ed, are expected to be marked up in the Senate Subcommittees on September 8th and 14th or 15th respectively.

Savings Proposals

Based on House action to date, 70% of the total proposed for savings that can be tracked have been approved ($5.8 billion out of $8.3 billion). Senate action has slightly less savings.

The response to the effort to reduce earmarked projects has been mixed. While HUD and SBA earmarked projects have been eliminated, Chairman Carr has continued the DOT earmarks and Chairmen Bumpers and Durbin continued USDA research earmarks.

Spending Reductions

If you want the spending reduction effort to be visible, the best option is to wait for the FY 1994 appropriations process to be completed in mid-October and then send up a package of specific rescission proposals. By waiting until the FY 1994 bills are done, we will have the opportunity to propose rescissions from reforms that are in the NPR and from lower priority programs approved by Congress. If we propose reductions while the bills are still under development, the appropriators would likely reduce some of our investment proposals.

Such a bill could include a reduction in the FY 1994 cap in order to capture budget authority savings already achieved through the budget resolution as well as any additional savings we might achieve through rescissions (though sixty votes might be required in the Senate to make cap adjustments).

Implementing the Pay Freeze

A decision will need to be made in early September on how to implement your pay freeze proposals. The budget assumed no ECI-based pay raise or locality-based pay raise in January 1994. The Committees have been marking up their bills based on the assumptions in the budget. The cost of the two raises for FY 1994 is estimated to be $3.2 billion (including DoD and non-DoD civilians) and another $1 billion for DoD military. Absent legislative action to freeze pay, these costs would have to be absorbed with a potential for RIFs and furloughs.

In the past, the Treasury/Postal bill, which includes government-wide general provisions, has been used for pay issues. However, the bill is in conference and neither the House nor Senate versions of the bill have pay freeze language. It should be noted that the Chairman in the House is Steny Hoyer and Rep. Wolf and Senator Mikulski will be on the conference. This will not be the best place to legislate a pay freeze.

Other options would be to include legislation to freeze pay on either the temporary continuing resolution or on an omnibus rescission bill (if there is one). Regardless, the pay freeze should be negotiated with the leadership, Byrd and Natcher and the authorizers, not with the Treasury/Postal Subcommittees.

<u>Other Major Issues</u>

There are a number of other major issues that will be debated in the appropriations process in September/October including:

- o Russian aid - The House Foreign Operations bill includes $2.5 billion for the New Independent States but defense funding issues have not been resolved in the Senate with Chairmen Inouye and Leahy.

- o Abortion - Chairman Harkin is expected to drop all abortion restrictions from the Labor/HHS/Ed bill and deal with amendments on the Senate floor.

- o Senator Bumpers is expected to offer amendments to strike funding for the Space Station and the Superconducting Super Collider. Senator Johnston has been delaying the Energy and Water bill in hopes that prospects for the SSC improve.

THE WHITE HOUSE
WASHINGTON

DATE: 09/02/93

NOTE FOR: HOWARD PASTER

The President has reviewed the attached, and it is forwarded to you for your:

Information	☐
Action	☒

Thank you.

JOHN D. PODESTA
Assistant to the President
and Staff Secretary
(x2702)

cc:

THE PRESIDENT HAS SEEN
9-2-93

THE WHITE HOUSE

WASHINGTON

September 2, 1993

93 SEP 2 P12:22

Memorandum for The President

From: Howard Paster HP

Subject: Congressional schedule

In each of the two previous Congresses since he became Majority Leader Senator Mitchell has pressed successfully to adjourn the first session by Thanksgiving. In 1989 and 1991, respectively, Congress finished its business on November 22 and November 27. In both instances the House was happy to participate in meeting that schedule.

If a similar approach is followed this year the adjournment target would be November 19, the Friday before Thanksgiving. Suffice to say that would be extremely harmful to our plans for health care, NAFTA and the rest of your substantial agenda. (Attached is a private list I have given to Mack and others.)

My recommendation is that you ask Senator Mitchell and Speaker Foley to announce a December 17 target date for adjournment, with the sweetener that the entire week of Thanksgiving be set aside for a break. This effectively gives us three weeks more of session than a Thanksgiving adjournment.

If you agree I will convey your views to the Hill, although it may be necessary for you to reiterate this personally.

Agree ✓ Disagree____ Discuss____

POST-LABOR DAY CONGRESSIONAL ACTIVITY LIST

Administration major initiatives
- National Performance Review
- NAFTA
- Health care reform

September (short month, back on 7th, Jewish holidays)
- Elders, National Service in Senate
- Defense authorization - House and Senate floors
  - possible amendments on gays in military
  - possible amendments affecting Somalia and Bosnia
- Defense appropriations with same set of issues
- Senate has seven other appropriations bills - we'll face
  - abortion amendments
  - superconducting supercollider
  - space station
  - Russian aid
  - amendments limiting reinventing government authority
- Continuing Resolution for appropriations bill pending 9/30

- Reauthorization of extended unemployment benefits - how pay

October and beyond
- Complete unfinished appropriations
- Additional spending cuts - Administration to submit ideas
- Travel Office GAO report due, possible hearings even floor
- Increased pace of nominations (Neel has list of some fights)
- Crime
- Immigration
- EPA elevation
- Education - Goals 2000
- Campaign finance
- Lobby reform
- Senate under pressure to do striker replacement
- CD bank

THE WHITE HOUSE
WASHINGTON

DATE: 09/02/93

NOTE FOR: BOB RUBIN

The President has reviewed the attached, and it is forwarded to you for your:

Information ☐

Action ☒X

See President's note --

"Have this
reviewed
Advise"

Thank you.

JOHN D. PODESTA
Assistant to the President
and Staff Secretary
(x2702)

cc:

Bill,
Worth taking a lot at in conjunction with report of your official commission
— Derek

Rubin
Harry Thm
[illegible]
[illegible]
B.

THE PRESIDENT HAS SEEN 9/2

The Future of the Airline Industry

ESI

Economic Strategy Institute

Economic Strategy Institute • 1100 Connecticut Ave. NW, Suite 1300 • Washington, D.C. 20036

July 1993

The Economic Strategy Institute was founded to define a new American agenda for the twenty-first century. By challenging outmoded doctrines and examining the links between domestic and international economic policies, technological prowess, and global security issues, ESI aims to develop an integrated strategy that will halt erosion of the U.S. economic base and assure America's unique promise. The Economic Strategy Institute is a nonprofit, tax exempt research center under Section 501(c)3 of the Internal Revenue Code.

PARTICPANTS

Clyde V. Prestowitz, Jr.
Scott C. Gibson
Paul Willen
Saul Goldstein

ESI VIEWS ON FOREIGN PARTICIPATION IN THE US AIRLINE INDUSTRY

- Investment by foreign airlines in U.S. airlines should be prohibited until reciprocal access of roughly equal value is obtained.

- Code-sharing and market access pacts between U.S. and foreign airlines involving the U.S. market should be prohibited until such reciprocal access is obtained.

- The U.S. should pursue "open skies", but must negotiate on a broad front:

  - U.S. companies must have the right to acquire foreign airlines.

  - U.S. airlines must have the right to open a base of operations (i.e. build a hub) in a foreign country serving international and domestic markets.

  - U.S. airlines must have the right to conduct business in a foreign nation without restrictions (frequent flier programs, price setting capability, computer reservations systems, ability to self handle passengers, etc.)

  - U.S. airlines must have access to scarce infrastructure (including airport slots and facilities)

- Once such "open skies" access is obtained, there should be no limitation on ownership of or market access agreements with U.S. airlines by foreign airline investors as long as the investor is a public company potentially subject to reciprocal investment.

- Benefits exchanged must be of equal value. The U.S. domestic market should not be exchanged unless rights of roughly comparable value accrue to U.S. airlines.

  - Bilateral agreements with European nations no longer make sense when discussing U.S. access (whether through ownership, expansion, or market access/code-sharing arrangements). The size of the entire intra-European market is only 26% that of the U.S. domestic market. Thus, the only deal that makes sense is gaining access not only to all Europe (which only the EC, not individual nations, can deliver) but also from Europe to Africa, Asia and the Mid East.

- Enforcement of existing bilateral agreements is essential. The U.S. adheres to agreements once made and actions by foreign nations in not living up to the terms is tantamount to renunciation. History over the past 12 years has led many foreign nations to believe that the U.S. will not fight to protect its negotiated rights.

  - In most cases, the U.S. should suspend all air service with nations that renounce bilateral agreements and fail to reach a new agreement with the U.S. prior to expiration of the old agreement.

FOREIGN OPPORTUNITY

o ESI forecasts that the U.S. domestic excess capacity situation will continue.

o International markets could absorb much of this excess capacity and U.S. airlines are the world's low cost producers which only enhances the opportunity overseas.

o Gaining share as a result of "open skies" agreements can provide:

- $2.5 billion/year in TransAtlantic markets

- $2.2 billion/year in TransPacific markets

o Gaining access to Europe offers great potential:

- The intra-European market (includes domestic) was 97.5 billion revenue passenger miles (RPMs) in 1992

- Europe-Asia/Africa/MidEast was 85.1 billion RPMs in 1992

- Thus, all of Europe represented 182.6 billion RPMs in 1992--just 53% of the entire U.S. domestic market of 347.9 billion RPMs.

- Unfilled available seat miles (ASMs) operated by U.S. airlines domestically were 209.6 billion in 1992. This does not take into account the vast number of aircraft grounded by both existing and liquidated U.S. airlines.

- Thus, U.S. excess capacity could literally (although difficult practically) absorb all demand within and from Europe.

- The U.S. carrier average cost for 1991 was 9.3 cents per ASM as compared to 13.7 cents for British Airways (the most cost efficient European carrier) and an average of 18.6 cents per ASM for all European carriers.

o The international market is one where U.S. airlines can win. It is growing and could absorb much of our excess capacity.

Table of Contents

The Future of the Airline Industry

The Economic Strategy Institute's study of the airline industry parallels the President's National Commission To Ensure a Strong, Competitive Airline Industry. We examined the airline industry and the events leading to its current financial and structural situation and offer several possible policy alternatives.

I. A Strategic Industry

- The U.S. government has played a critical role in fostering the airline industry since its inception. Beginning in the 1920s, the U.S. government decided to use the airlines as a vehicle to promote economic growth, provide jobs, and tie the nation together.

- The industry has enhanced U.S. leadership in aircraft, engines, computer/telecommunications systems and software.

- Direct employment in the airline industry is 670,000 workers. Another 2.5 million are indirectly employed.

- The U.S. airline industry reduces the trade deficit by more than $10 billion per year.

II. A Troubled Industry

A. Financial

In the last three years, profitability has deteriorated and losses have soared.

- Airlines have lost a total of $10 billion--more than the industry has made in its entire history.

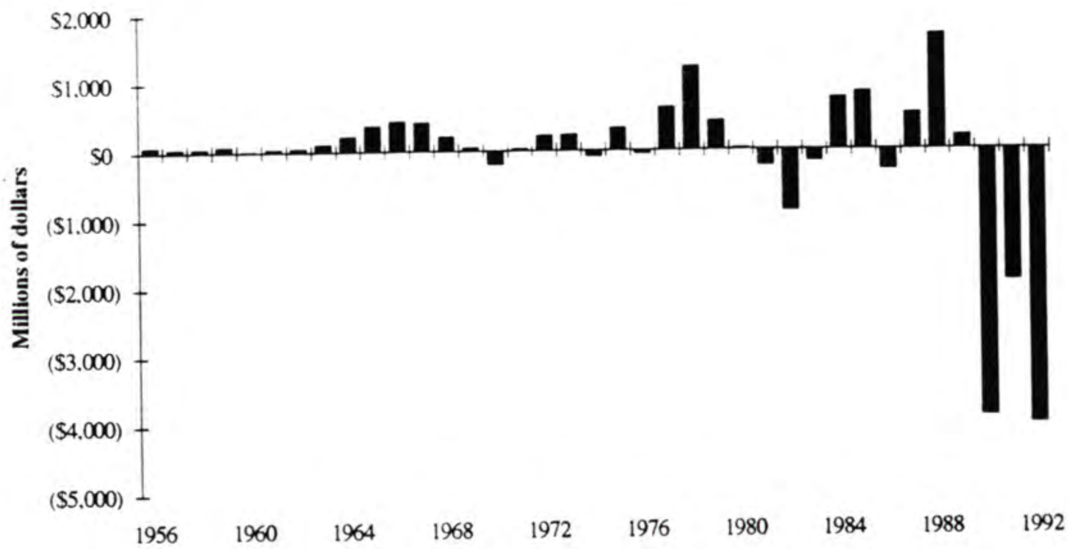


Figure 2.1. Net income, in millions of dollars Source: Air Transport Association

- In the past, because of huge depreciation allowances, airline cash flow covered financial losses. The severity of this change is illustrated by the fact that now, carriers are forced to borrow funds to cover operating losses.

Table 2.1 Retained Cash Flow as a Percentage of Debt Source: Company Reports

	1986	*1987*	*1988*	*1989*	*1990*	*1991*
Southwest	36.84	17.46	34.16	34.97	26.02	11.98
AMR	30.04	26.47	36.52	40.55	12.87	8.62
Delta	36.11	57.30	63.80	100.57	50.34	3.26
UAL	26.50	70.58	62.53	32.90	19.77	9.72
US Air	55.90	19.12	29.90	12.01	(9.67)	(4.49)
TWA	5.60	14.17	7.57	(0.60)	(9.84)	(22.19)
America West	7.33	(5.08)	10.10	14.24	(1.96)	(4.45)
Continental	5.20	2.28	(0.86)	(13.22)	(9.90)	(5.49)
Average	28.27	18.29	32.03	23.57	5.46	(0.60)

- The borrowing has weakened airline balance sheets. Debt to equity ratios have soared and credit ratings have been downgraded.

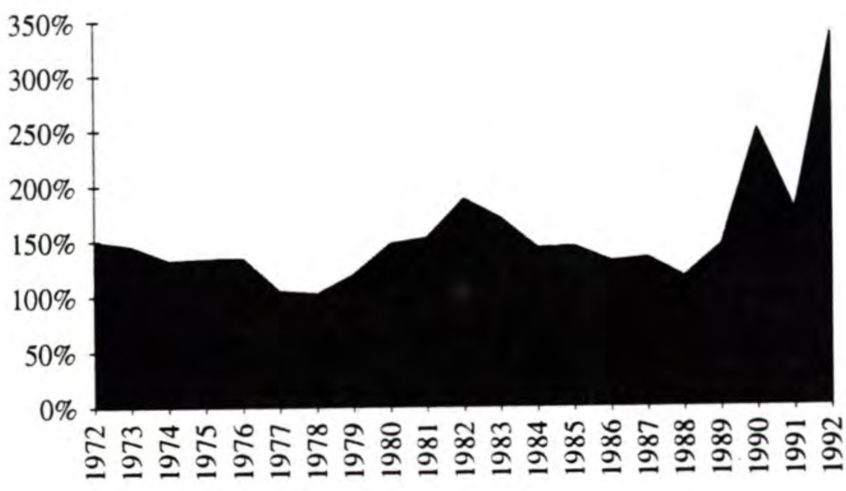


Figure 2.2 Total Noncurrent Liabilities as a Percentage of Stockholder's Equity Source: Company Reports

Table 2.2 Airline Credit Rating History Source: Moody's

	1993		*1992*		*1991*		*1990*		*1989*	
Southwest	Baa1		Baa1		Baa1		Baa1		Baa1	
AMR	Baa3	↓	Baa2	↓	Baa1		Baa1	↓	A3	
Delta	Baa3	↓	Baa2	↓	Baa1	↓	A3	↓	A2	
UAL	Baa3		Baa3		Baa3	↓	B1	↓	Ba2	↓
US Air	Ba3		Ba3	↓	Ba1	↓	Baa2	↓	Baa1	
TWA	Caa		Caa		Caa	↓	B3		B3	
America West	Ca		Ca		Ca	↓	B2		B2	
Continental	Ca		Ca		Caa		Caa	↓	B3	↓

B. Business

- Capacity and demand have not changed substantially between 1988 (the best year) and 1992 (the worst year). Domestic capacity grew 3.8 percent and traffic (revenue passenger miles) grew by 5.5 percent from 1988 to 1992.

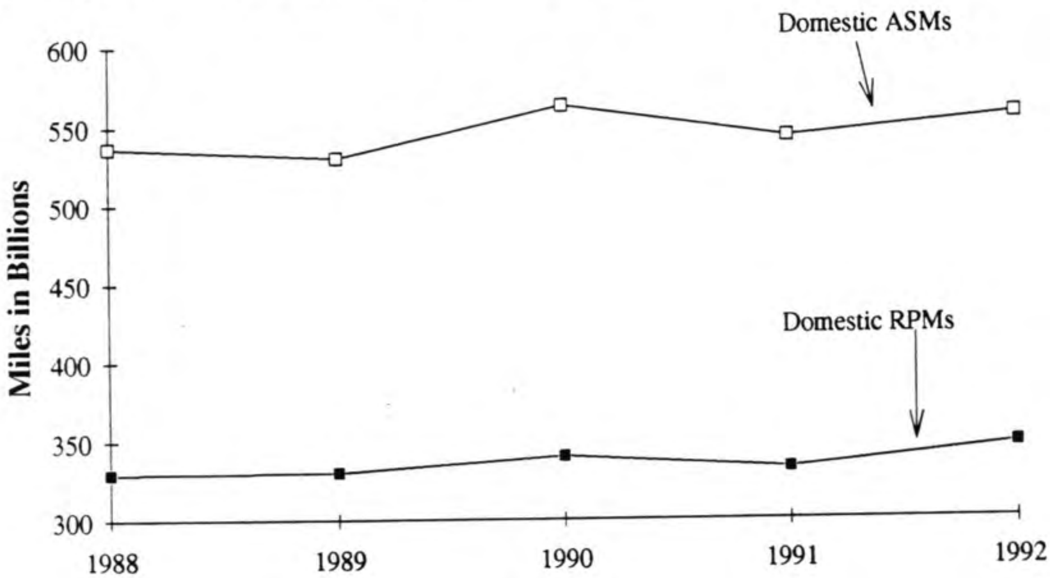


Figure 2.3 Domestic Capacity and Traffic, in billions of miles Source: Company Reports

- In real terms, average revenues per passenger mile (hereafter referred to as RPMs) have declined by 14 percent since 1988 while costs per available seat mile (hereafter referred to as ASMs) have declined by just one percent.

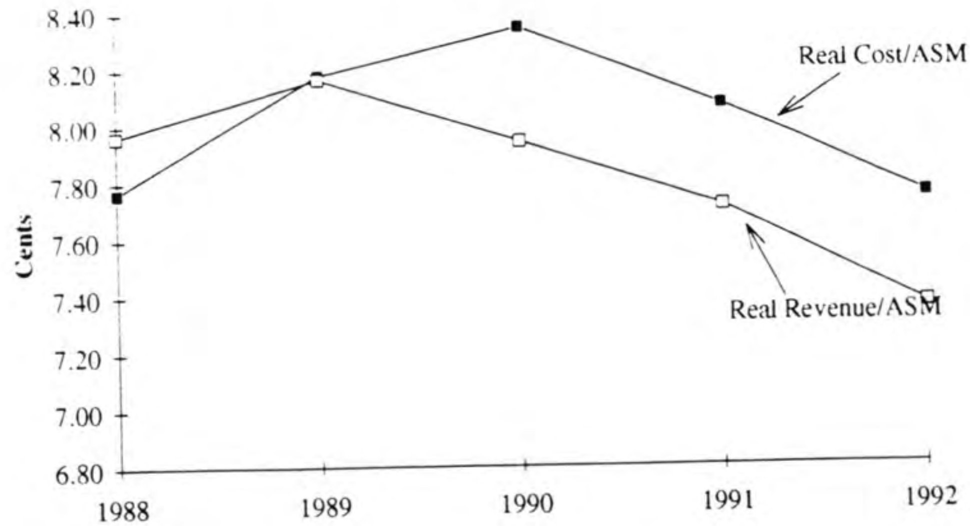


Figure 2.4 Real Cost Versus Real Revenue for Airlines Source: Company Reports

- Break-even load factor has soared as the price-cost gap has widened.

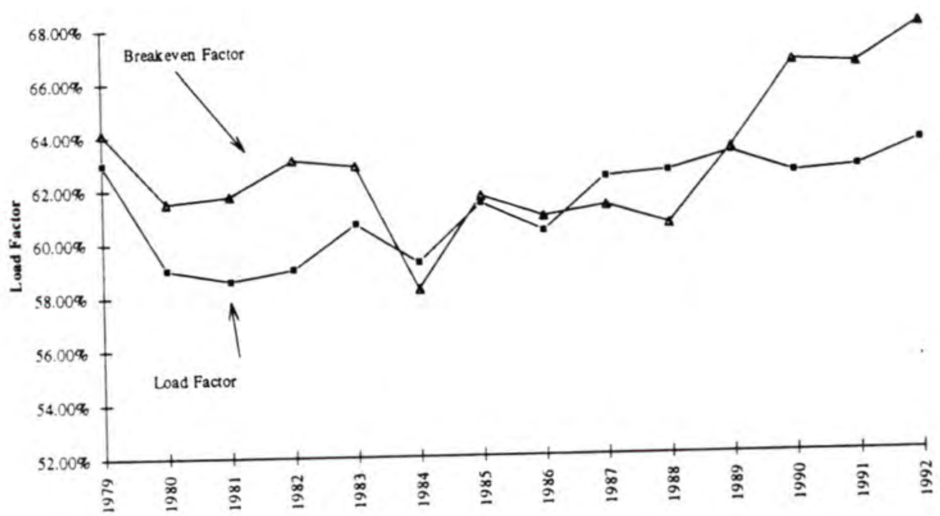


Figure 2.5 Passenger Breakeven Compared to Actual Load Factor Source: Company Reports

- **Hence, there is excess capacity in the market given the current revenue and cost structure.**

Table 2.3 Excess Capacity: ASM Reduction Required to Achieve Breakeven Point Source: ESI Estimates

	1990	1991	1992
ASMs in Excess (in millions)	4.58	4.16	4.87
Excess ASMs as a percentage of total ASMs	6.25%	5.8%	6.5%

III. What Happened?

•If the situation that existed in 1988 had continued, ESI estimates that the industry should have earned $4.2 billion in the 1990-1992 period, but instead it lost $10 billion. This swing of $14.2 billion can be explained as follows:

A. Non-structural problems in the industry

- Several events -- the Gulf War, the recession, and several government actions -- adversely affected the financial performance of the airlines during the last three years.
- According to ESI estimates, the fuel price explosion in the wake of the Gulf War cost airlines more than $2 billion.

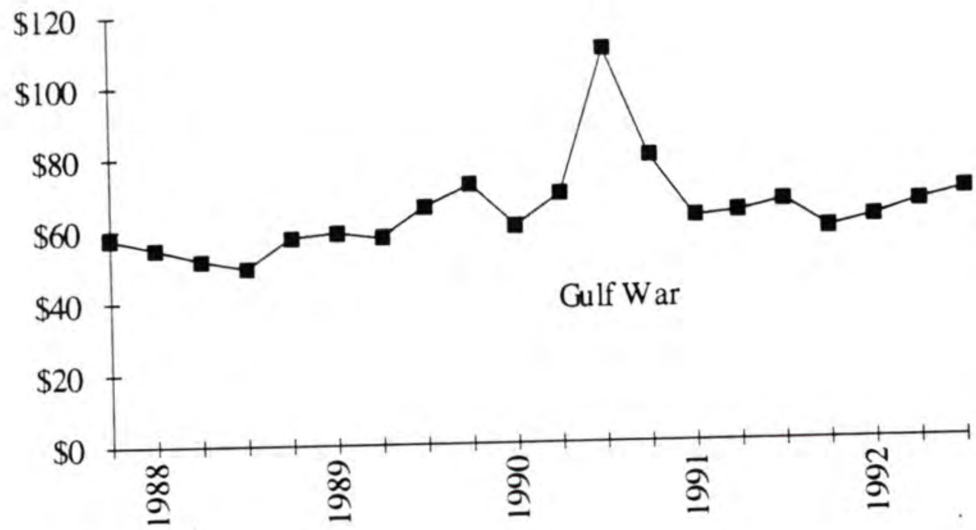


Figure 3.1 Airline Fuel Cost per Gallon Source: Air Transport Association

- The recession and the period of weak growth that ensued affected the airlines as well; in fact we estimate that 1991 financial problems were due, in large part, to the recession. ESI estimates that the recession cost $3 billion in revenue during 1990 and 1991.
- The ticket tax was increased in late 1990 from 8 percent to 10 percent and has been absorbed by the airlines, costing approximately $2 billion over two years.

- Had revenues and costs stayed at trend level in 1992, ESI estimates that the airlines would have made money on an operating basis (but would have lost money overall because of an accounting change and debt service costs).

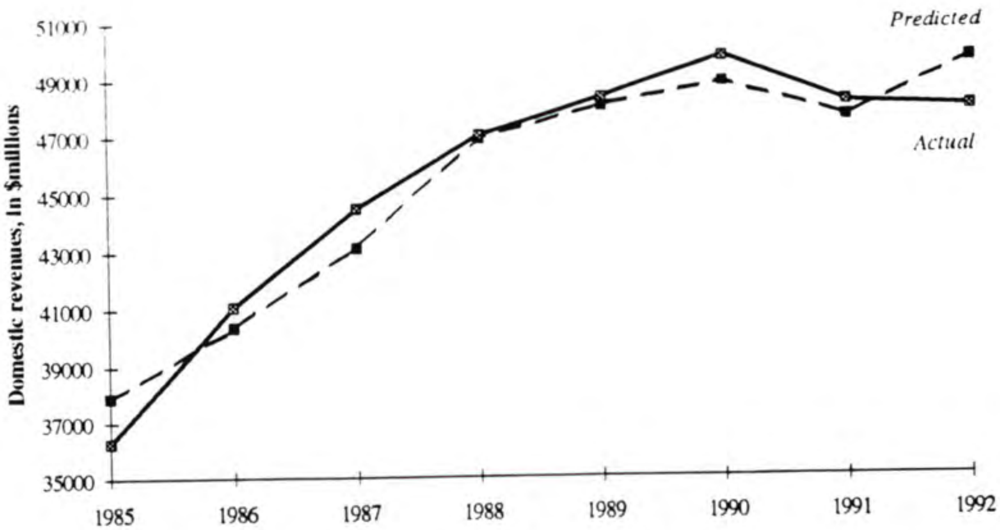


Figure 3.2 Predicted Revenue Trend Source: ESI Estimates

- Roughly $2 billion in 1992 losses can be directly attributed to changes in accounting practices, related to the provision of future pension and health care benefits. This resulted in a one time major loss for the carriers.

Table 3.1 Non Structural Cost to Airlines 1990-1992 Source: Industry Data and ESI estimates

Fuel - Gulf War	$2 billion
Ticket tax increase	$2 billion
Recession	$3 billion
Accounting change for pension and health benefits	$2 billion
TOTAL	**$ 9 billion**

B. Structural problems

Understanding the structural problems in the industry today requires an understanding of the trends that took place following deregulation in 1978.

1. Effects of deregulation

a. New Entrants Challenge the Status Quo

- After Congress deregulated the industry in 1978, new airlines entered high volume point to point markets with costs 30-40 percent lower than the established carriers, largely driven by low cost non-union labor and the wide availability of inexpensive used aircraft. This first wave of new entrants concentrated on challenging the established players who operated large point-to-point networks that concentrated on directly linking cities with non-stop flights.

Table 3.2 Cost Per ASM -- 1982 Source: Department of Transportation

PEOPLExpress	5.7
American	8.5
United	7.6

b. Response by the majors

- The established airlines, led by American, responded with a full gamut of innovative airline management techniques and used size to their advantage. They established hub and spoke networks, offered a wide diversity of prices using yield management systems; set up frequent-flier programs; established commission override programs, and moved to two tiered wage scales. With the exception of yield management, these tools brought greater benefit to the established carriers. For example, a frequent-flier program is only useful if one can fly all over the country on that airline.

- The most important development was the adoption of the hub-and-spoke network which allowed the airlines to reduce the number of flights required to provide universal coverage throughout their network. In turn this reduced their cost, which was passed on to the consumer in the form of lower fares. (see explanation below)

- The majors also developed sophisticated fare strategies using yield management systems to price discriminate in order to separate business travelers -- who want flexibility -- and leisure travelers -- who want a low price. By doing this, airlines maximize revenue per seat (which is known in industry parlance as the yield).

- The adoption of yield management systems was particularly devastating. Yield management allows airlines to measure demand in real time, and thereby set discount fares to attract discretionary travelers. The system ensures that seats are preserved to meet demand of high fare travelers, like businessmen. Excess seats are sold at low prices. The key attraction of new carriers was the low fares, offered due to their low costs. Established carriers responded by creating advanced-purchase fares which were competitive with the new entrants. The restrictions set on low fares allowed the established carriers to price discriminate by market segment, charging high fares to business men who valued the flexibility and geographic spread of the large carriers while competing for leisure travelers with low fares.

- Another management tool was frequent flier programs, now familiar to everyone. By giving an incentive to travelers to stick with one airline, they created brand identity in an almost undifferentiated market.

- To encourage travel agent loyalty with a particular airline, the carriers offered commission overrides which are frequent-flier programs for travel agents. By booking a certain percentage of their business with a particular airline, agents get a bonus above and beyond their normal commission.

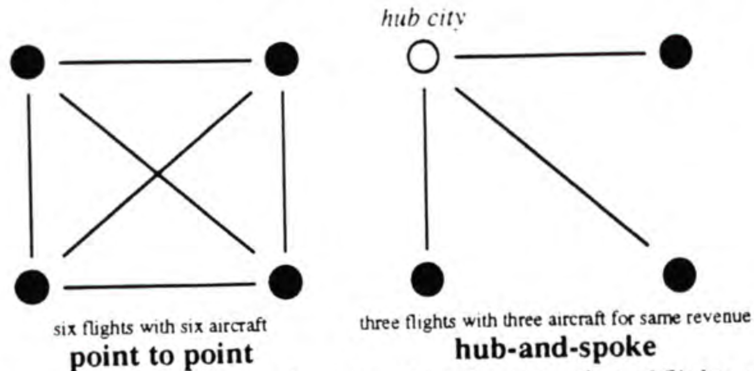
- Finally, another factor that helped the established carriers drive the upstarts out of the business was a reduction in their costs. In 1983 American Airlines adopted a two tier wage scale that helped lower labor costs per Available Seat Mile (ASM) and was soon followed by the other carriers. American's nominal cost per ASM dropped from 8.17 cents in 1983 to 7.28 cents in 1986.

- Particularly important was the fact that the gap between actual load factor and break-even load factors for the established carriers narrowed as costs declined. Because the established carriers enjoyed a substantial revenue premium compared to new entrants, they could make money while the new entrants (squeezed by discretionary pricing) could not.

2. Explanation of Hub and Spoke

Hub and spoke networks represented a new way of organizing travel after deregulation. Consumers base their flying decisions on three parameters: 1) price; 2) travel time; 3) frequency and convenience of departure times. According to various studies, leisure travelers place weight in this order: price, travel time, frequency/convenience. Business travelers are different, they weight the parameters as follows: frequency/convenience, travel time, price.

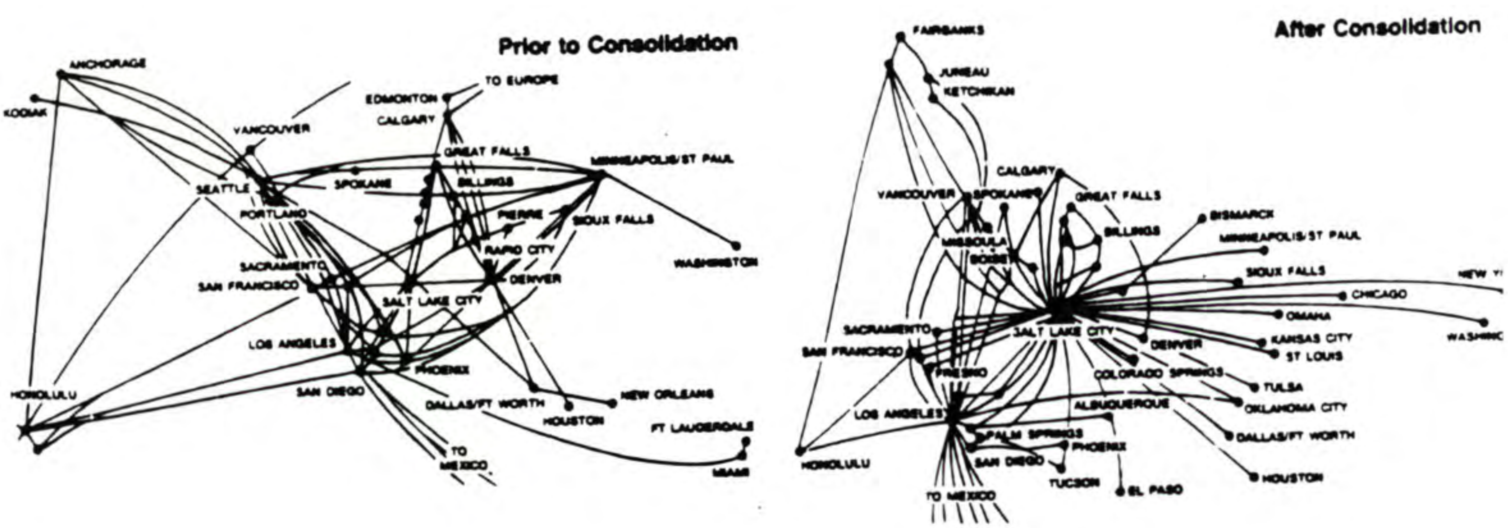
There are two fundamental methods of flight-planning: point-to-point and hub-and spoke. Point-to-point means that flights directly connect a passenger's origin and destination. So for four cities, point-to-point requires six roundtrips to offer universal service. In a hub and spoke system, all flights go into one place where passengers switch planes and go out to their destination. A hub and spoke system for four cities requires only three roundtrips. As the number of cities increases, there is a dramatic reduction in the required number of aircraft For a system of 25 cities, point to point requires 300 roundtrips; hub-and-spoke requires only 24. Airlines can use this windfall in several ways. They can offer increased frequency for business travelers, move aircraft to tap new markets, or they can use bigger planes to increase efficiency resulting in lower costs.



Two networks: *Hub and spoke system dramatically reduces number of flights required for coverage.*

Hub-and-spoke will be more efficient unless the volume on a particular route is extremely heavy. In that case, a firm can run a high frequency pattern and match the service of the hub system. This occurs in some short haul markets dominated by Southwest, but also in some long haul markets such as New York-Los Angeles served by the established carriers with large, wide body aircraft.

This chart shows the change in route networks from point to point coverage to hub and spoke coverage. The illustration is the Western Airlines route map.



- All these new management techniques naturally conferred advantage on the larger companies by allowing them to use their size as a weapon against the smaller upstart firms. Their response destroyed the new entrants; and by 1986, most carriers of the post-deregulation era were gone and the industry stabilized. With the first round of consolidation over, the industry had its most profitable year ever in 1988 when net profits exceeded $1.6 billion.

c. The next round

- The elimination of the new entrants did not end competition. Once American Airlines decided to expand to national coverage with an enlarged hub and spoke network, the rest of the industry had to follow suit by completing national networks and by purchasing large numbers of new aircraft to support their expansion. The hub-and-spoke carriers, having vanquished the new entrants, went after each other. Competition intensified as hub carriers connected new cities to their networks.

- Between 1988 and 1990, U.S. carrier's jet fleets increased, and those of American, Delta, and United increased by more than 60 percent. To fund this growth, the airlines began to lease aircraft in increasing numbers. Aircraft rental expenses increased (in nominal terms) from $5.8 billion in 1988 to $8.8 billion in 1992.

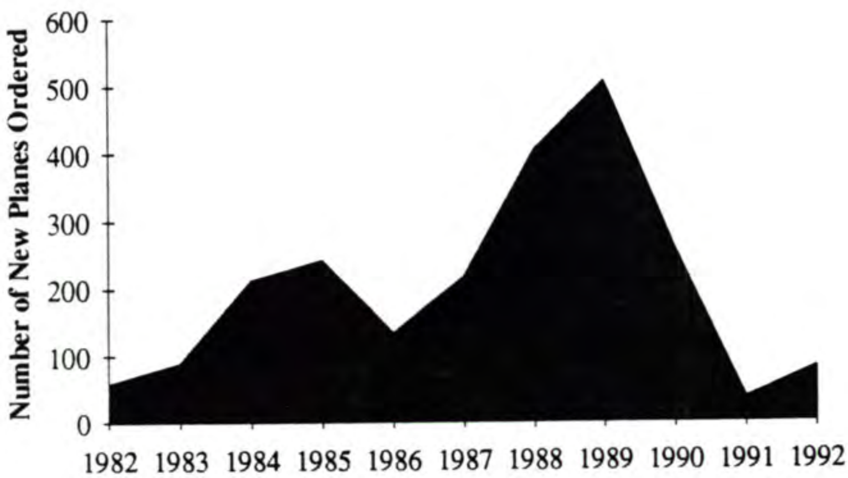


Figure 3.3 Aircraft Orders by U.S. Customers Source: Air Transport Association

- Airline borrowing to acquire new aircraft (both loans and lease commitments) and to cover losses in combination with the poor outlook for future profitability has caused rating agencies to downgrade airline credit ratings to "junk" status.

Table 3.3 Airline Credit Rating History Source: Finanical Reporting Companies

	1993	*1992*	*1991*	*1990*	*1989*
Southwest	Baa1	Baa1	Baa1	Baa1	Baa1
AMR	Baa3 ↓	Baa2 ↓	Baa1	Baa1 ↓	A3
Delta	Baa3 ↓	Baa2 ↓	Baa1 ↓	A3 ↓	A2
UAL	Baa3	Baa3	Baa3 ↓	B1 ↓	Ba2 ↓
US Air	Ba3	Ba3 ↓	Ba1 ↓	Baa2 ↓	Baa1
TWA	Caa	Caa	Caa ↓	B3	B3
America West	Ca	Ca	Ca ↓	B2	B2
Continental	Ca	Ca	Caa	Caa ↓	B3 ↓

- Business travel began a steady decline in 1986 and is unlikely to return to previous levels. The advent of teleconferencing, affordability of telecommunications, the reduction of the white collar workforce, and corporate cost cutting have all contributed to this trend.

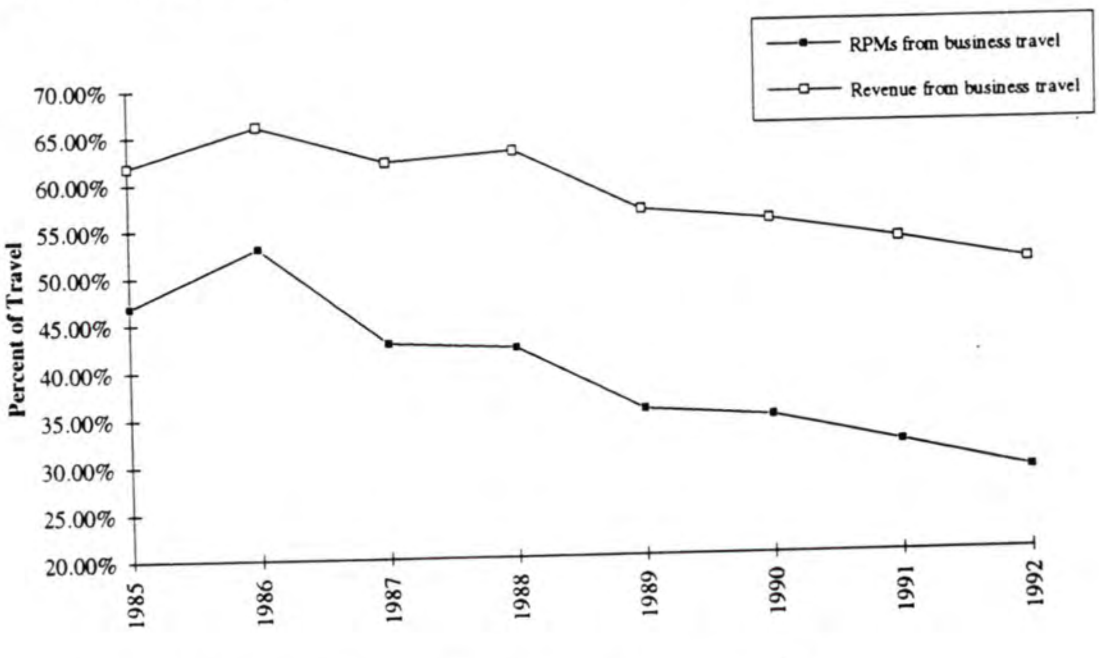


Figure 3.4 Decline of Business Travel Source: Industry Data

- Price wars are a manifestation of excess capacity as airlines chase revenue to fill empty seats. In 1992, for example, business fares were reduced by 40 percent and this was followed by a summer half-price sale which spurred traffic demand, but reduced yields. These actions cost the industry $2 billion losses in 1992.

- Southwest Airlines, created in the early 1970s in the Texas intra-state market was free from Federal regulations. In order to compete, it had to find a way to produce seats at far lower costs than the established carriers, which it accomplished through greater productivity.

- Point-to-point travel is more efficient than hub and spoke networks for short distance, very high-volume city-pairs where there is enough business to support frequent, jet service. The Southwest Airlines strategy is to set low prices to build high demand that supports their high frequency approach in short haul markets. Its labor force (although unionized) works more hours and the work rules permit fewer employees to accomplish tasks. Southwest aircraft operate 11 hours a day versus 8-9 hours for hub and spoke carriers. To achieve this, Southwest does not have a hub so their aircraft do not have to wait for passengers and bags from other flights. Southwest aircraft can land and take-off again after a fifteen minute wait, thereby allowing a tremendous utilization which extends to its facilities.

Table 3.4 Boeing 737 Aircraft Operating Cost--Second Quarter 1992 ($/block hour) Source: Department of Transportation

		New Wave Carriers		**Mega Carriers**	
		America West	Southwest	Delta	United
Flying Operations	**Crew Cost**	**199**	**328**	**555**	**510**
	Fuel & Oil	445	477	457	445
	Rentals	551	133	568	447
	Insurance. & Tax	43	8	30	38
	Total	*1240*	*947*	*1608*	*1441*
Direct Maintenance	Airframes	62	137	124	99
	Engines	16	148	102	23
	Total	*78*	*286*	*226*	*122*
	Maintenance Burden	96	47	181	199
	Total Maintenance Cost	*174*	*333*	*407*	*321*
Depreciation		62	135	28	109
Other		77	22	130	4
Total Direct Cost per Block Hour		**1585**	**1437**	**2173**	**1875**

- The effect of Southwest, while noticeable, was not large in the 1990-1992 period. ESI estimates that the impact on the established hub carriers in this time was about $200 million, but the effect is growing. Southwest's expansion in California is causing American and United to exit markets. The potential impact of Southwest going forward is significant, impacting billions of dollars in revenue for the established carriers which will either drive existing carriers out of the market or force major cost restructuring.

Table 3.5 Total Structual Costs to Airlines 1990-1992 Source: Industry Data and ESI Estimates

Fare Wars	$2 billion
Business Travel Decline	$3 billion
Southwest Effect	$0.2 billion
TOTAL	**$5.2 billion**

- The combination of both structural and non-structural issues cost the industry $14.2 billion in the 1990-1992 period.

IV. The Burden of Bankruptcy

- The result of rising debt and aircraft lease costs, price wars and declining business traffic was bankruptcy. By 1992 three major carriers, Midway, Pan Am and Eastern, had been liquidated, and America West, Continental and TWA were in bankruptcy. The effect of the continuing operation of bankrupt carriers on the system was such that bankruptcy laws themselves became an issue of hot debate The bankruptcy laws were, of course, established to give companies a second chance through restructuring. But in the case of airlines, there were suggestions that, at least in some cases, the bankruptcy law was being gamed. In some instances, airlines continued to fly for as long as two years in bankruptcy which in effect could constitute a backdoor government subsidy for an uncompetitive airline. The debate, of course, has pros and cons. Some airlines have been able to successfully restructure themselves. Others have seen the value of their estate evaporate to almost nothing prior to finally liquidating. On the other hand, bankruptcy is not without costs. For example:

Table 4.1 Legal Costs of Airline Backruptcy Source: Company Reports and ESI Estimates

Cost for Six Airlines Between 1989 and 1992	$255.42 million

- Continuing operations by bankrupt carriers put enormous pressure on the other airlines. Had the bankrupt carriers been liquidated, the industry would have been at least $3.0 billion better off (we assumed no yield improvement resulting from the capacity reduction). But this would not have entirely offset the industry's cumulative losses.

Table 4.2 Effect of Bankrupt Carriers on the Industry Source: Company Reports and ESI estimates

	1990	1991	1992	3 year total
Percent of ASMs operated by bankrupt airlines	3.8	23.9	17.8	
Improvement to industry profits if all bankrupt carriers liquidated in millions*	$1,125.9	$1,126.8	$748.9	$3,001.6

*Assumes no change in industry traffic or yields due to liquidation of bankrupt carriers

V. The Added Burden of the Federal Aviation Administration

- The Airport and Airway Trust Fund was established in 1970 to help defray the Federal Aviation Administration's (FAA) funding for operation and improvement of the national airport and airway systems. Despite the establishment of the trust fund, the FAA has been unable to secure long term funding authorization which would allow the rapid improvement of the airway system.

- Revenues for the trust fund are obtained from two sources: aviation user taxes and interest on existing trust fund cash balances. Since its inception more than 20 years ago the trust fund has accumulated a $6.9 billion surplus. Until 1990 the trust fund accounted for 58 percent of the FAA's budget, at which time the percentage was increased to 75 percent. Furthermore, the 1991 increases in the cargo tax (from 5 to 6.5 percent) and passenger tax (from 8 to 10 percent) resulted in a peak surplus of $7.7 billion in 1992. This unspent balance has been lent to the Treasury Department in order to help defray the cost of the overall budget deficit, which reduces the incentive to spend the fund on its intended purpose.

Table 5.1 Budget of the Aviation Trust Fund FY 1991 (in millions of dollars)
Source: Department of Transportation

Beginning Balance	$7,436
Revenues	$6,241
FAA Expenditures	($6,103)
Other Expenditures	($63)
Adjustments	$200
Ending Balance	$7,711

Table 5.2 Budget of the Federal Aviation Administration (in millions of dollars) Source: Federal Aviation Administration

From Trust Fund:	
Airport Grants	$1,800
Facilities and Equipment	$2,095
Research, Engineering, and Development	$205
Operations and Maintenance	$2,003
Trust Fund Total	**$6,103**
From General Fund:	
Operations and Maintenance	$2,034
Total Budget	**$8,137**

- There are three groups which use the services provided by the FAA: air carriers, general aviation, and the public sector. When estimating the costs burden for each group, it is clear that domestic air carriers are subsidizing the others. The cost of providing service for a Boeing 747 jumbo jet is approximately the same as those of a tiny Piper. Thus, taxes which apply to general aviation are not sufficient to cover their costs. In fact general aviation contributes less than 2 percent of the FAA budget, but uses more than 26 percent of the services. Only 16 percent of commuter carrier costs are recovered by the FAA. The chart below shows the cost and recovery from the FAA's budget for each user group.

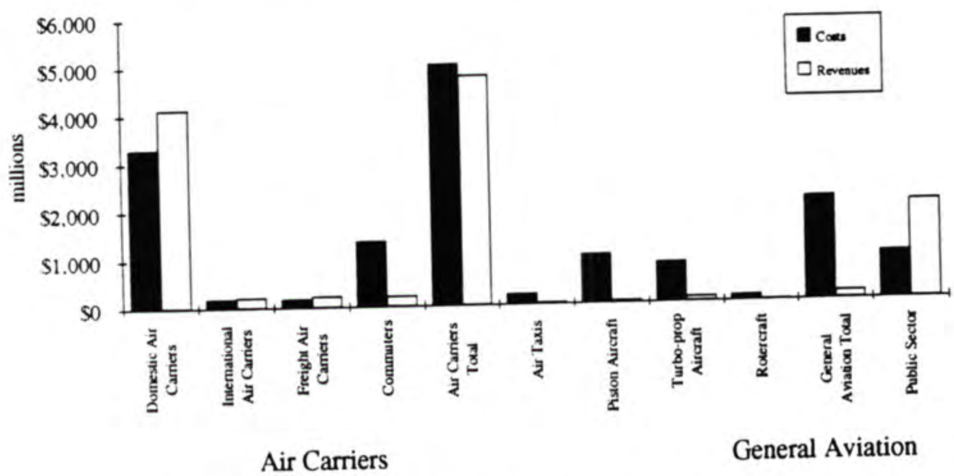


Figure 5.1 Revenue and Cost Allocation by User Groups in 1991 Source: FAA and Department of Transportation

- The cost/recovery imbalance seen above is a result of the user tax system. The largest share of revenue for the trust fund is derived from ticket taxes. Hence, the domestic air carriers bear a disproportionate burden. Air freight and carriers also pay more than their fair share of the burden through the freight waybill (130% of their costs). General aviation contributes to the trust fund through the aviation gas and jet fuel tax, and based on the costs incurred by this group, this amount is not sufficient to cover their costs.

Table 5.3 Aviation User Taxes and Trust Fund Revenue Source: FAA and Department of Transportation

Tax Type	**User Tax Rates**	
	previous	*current as 12/1/90*
Passenger Ticket Tax	8.00%	10.00%
Freight Waybill	5.00%	6.25%
International Enplanement.	$6/enplanement	$3/enplanement 1/1/90
Aviation gas	$.12/gallon	$.15/gallon
Jet Fuel	$.14/gallon	$.175/gallon

Revenue (billions)				**Revenue with no Tax Increases**		
	1990	*1991*	1992	*1991*	1992	***Net Difference***
Passenger Ticket Tax	$3,219	$4,341	$4,567	$3,256	$3,426	**$2,227**
Freight Waybill	$178	$222	$237	$166	$178	**$115**
International Enplanement	$181	$218	$260	$109	$130	**$239**
Aviation gas	$40	$41	$39	$31	$29	**$20**
Jet Fuel	$78	$89	$89	$67	$67	**$45**
Interest	$1,245	$1,331	$1,344	$1,331	$1,344	**$0**
Total	**$4,940**	**$6,241**	**$6,536**	**$4,959**	**$5,173**	**$2,645**

- With the domestic carriers losing money, it is both unreasonable and economically inefficient for them to subsidize general aviation use. Furthermore, FAA appropriations have been growing as airline profits have been decreasing.

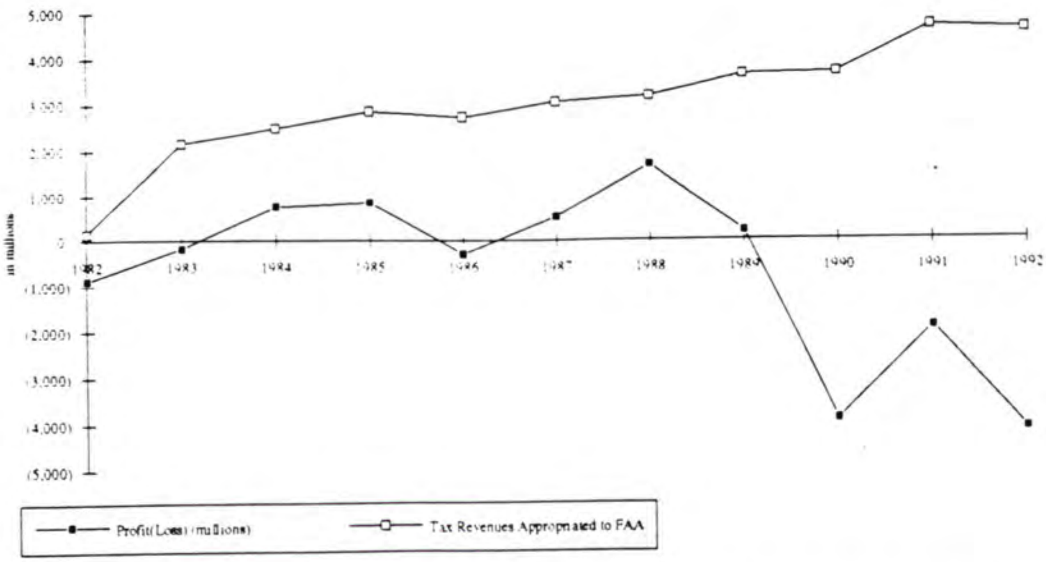


Figure 5.2 Airline Profit and FAA Trust Fund Appropriations Source: FAA

- Another factor to consider is the user fees paid by competing industries. Amtrak, a fierce competitor of short distance travelers not only gets subsidized by the federal government ($331 million in FY 1993) but is also exempt from any local or state taxes

- Completion of the FAA's new navigation system (ATC) will save the industry more than $713 million per year by reducing system delays. Infrastructure modernization helps, but does not solve industry structural problems. The system has been delayed by institutional problems and the lack of long term funding plans.

Table 5.4 Cost of Delays Due to ATC Source: Industry and ESI estimates

	Cost/minute	**Delay minutes (000)**	**Total Cost (millions)**
Crew			
Cockpit	$3.18	25,004	$79,513
Cabin	$1.61	22,930	$36,917
Fuel			
In air	$14.89	5,123	$76,281
Taxi	$4.36	17,802	$77,617
Utilization*	$17.24	25,004	$431,069
	Cost/Cancel	**Number of Cancel**	**Total Cost (millions)**
Cancellation	$4,974	2,413	$12,002
Total			**$713,399**

* Based on 9.7 hours/day utilization rate and an average annual carrying cost of $3.66 million. Our estimates do not include consumer time or weather related delay costs.

- As it is currently structured, the FAA is a drag for the major domestic carriers. The airlines paid $1 billion more than their costs in each of 1991 and 1992. At the same time, the new ATC system which could save the industry $700 million annually is still not operational.

VI. Forecast

A. Further consolidation of hub and spoke

- There are too many hubs and many cities cannot support the level of service in place. For a hub to succeed, it requires a large base of local traffic traveling to and from the hub city. This traffic tends to pay higher prices than the long haul connecting traffic that flows over the hub since business travelers (who pay higher fares) choose non-stop flights over connecting flights. The general rule of thumb is that a hub requires at least 150 jet flights per day with each plane carrying roughly 25 local origin destination passengers per trip in addition to connecting passengers. Cities that cannot support the hubs in place include: Baltimore, Charlotte, Cincinnati, Memphis, Pittsburgh, Raleigh and Salt Lake City. Delta and USAir are the most exposed in this category, both having several hubs in locations that cannot support the cost with the existing revenue base.

B. Growth of the new point to point carriers will continue

- Southwest and other new mode point to point carriers will expand until they saturate the point to point market.

- The Southwest system, while very successful, is only applicable to shorter haul routes that have high volume Southwest is highly competitive on the highly-traveled Phoenix-Los Angeles route. It, however, cannot compete on the more lightly traveled Baltimore-Tucson route.

- The established airlines also serve local point to point markets as part of their hub systems which includes routes of less than 500 miles, precisely the niche that Southwest targets. The hub carriers generate 12 percent of their RPMs from these point to point markets which provide more than $9.1 billion to their overall $45 billion domestic passenger revenue base. It is this revenue which is vulnerable to the new mode point to point carriers and Southwest.

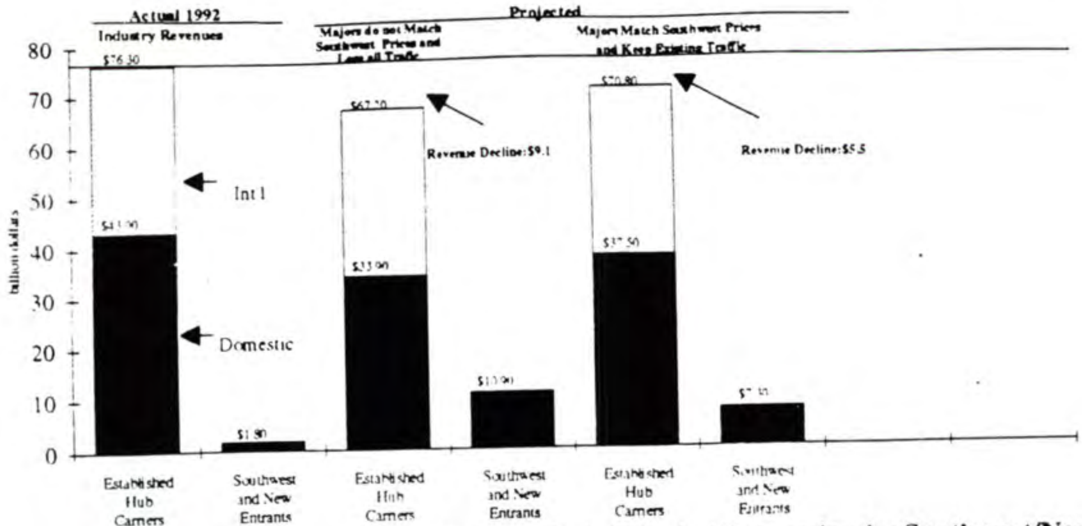


Figure 6.1 Potential Impact of Point-to-Point Market Saturation by Southwest/New Entrant Carriers on Hub Carrier Revenues Source: ESI Estimates *(Assumes Southwest and New Entrants would have had sufficient capacity to carry this traffic and that there would be no corresponding decrease in hub carrier capacity. Also assumes 1992 revenue and costs are constant)*

- Expansion of Southwest (and other point to point airlines) will deprive the established hub carriers of revenues. This will either force hub carriers to exit the market (by liquidating or reducing capacity) and/or restructure their costs--primarily labor.

- Existing airlines cannot match Southwest costs largely because their union contracts will not permit the productivity levels of Southwest. In addition, aircraft fleets are configured with two classes of service and galleys to serve the meals that passengers on longer flights demand. This takes up space that Southwest uses for seats. Furthermore, established hub carrier pilot union contracts have clauses that prevent the formation of subsidiaries or new owned entities that could duplicate Southwest's style of operation.

C. Labor costs differentials will also pressure established carriers

- With the return of Continental, America West, and TWA, and the labor cost reductions recently achieved by Northwest, the difference in overall cost rates resulting from the lower labor costs will pressure the other hub carriers to restructure their own labor costs.

- In the future, as differences between the airlines narrow, the issue of labor costs is going to become more and more problematic, as demonstrated by the wide differences in labor costs, which often represent more 30 percent of total operating expenses.

Table 6.1 Labor Cost Per Available Seat Mile -- 1992 (Cost per ASM in Cents) Source: Merrill Lynch

Continental*	1.89
*TWA (est.)**	*1.92*
Southwest	2.27
American	2.91
United	3.08
Delta	3.47
USAir	3.85

* Restructured by Bankruptcy

- Established airlines will focus primarily on pilot costs as these represent a third of hub carrier labor costs despite representing less than 10 percent of the work force. Pilots are paid significantly more than other airline employee groups.

Table 6.2 1991 Average Annual Earning for Airline Jobs Source: Department of Transportation

Pilots	$82,650
Flight Attendants	$24,552
Reservation Agents	$23,657
Ticket Agents	$28,491
Aircraft Mechanics	$48,413
Ramp Service Workers	$39,283

- In addition, pilot productivity varies widely placing additional cost pressure on the established hub carriers.

Table 6.3 Pilot Labor Cost Source: Merrill Lynch

Carrier	Average Annual Salary	Monthly Hours	Cost per Hour
American	$108,000	48	$187.50
United	$109,000	50	$181.67
Southwest	$93,000	70	$110.71

- **In the absence of a reduction in capacity or a significant change in the cost structure, it is clear that the slow growth and continued expansion of the new mode point to point carriers in combination with reconstituted airlines like Continental, TWA, and America West will maintain the same kind of over capacity in the domestic market that we have seen. This will lead to continued fare wars, industry losses, and probably more bankruptcies.**

- **There is a potential solution to this problem and it is to be found in the growing international markets. Because the U.S. domestic market suffers from excess capacity and low growth, growing international markets offer an opportunity. Aircraft resources are totally mobile and could easily be redeployed in international markets where U.S. companies enjoy large cost advantages.**

VII. International Growth Opportunity

A. The Opportunity

- International markets are growing more rapidly than U.S. domestic ones for U.S. airlines.

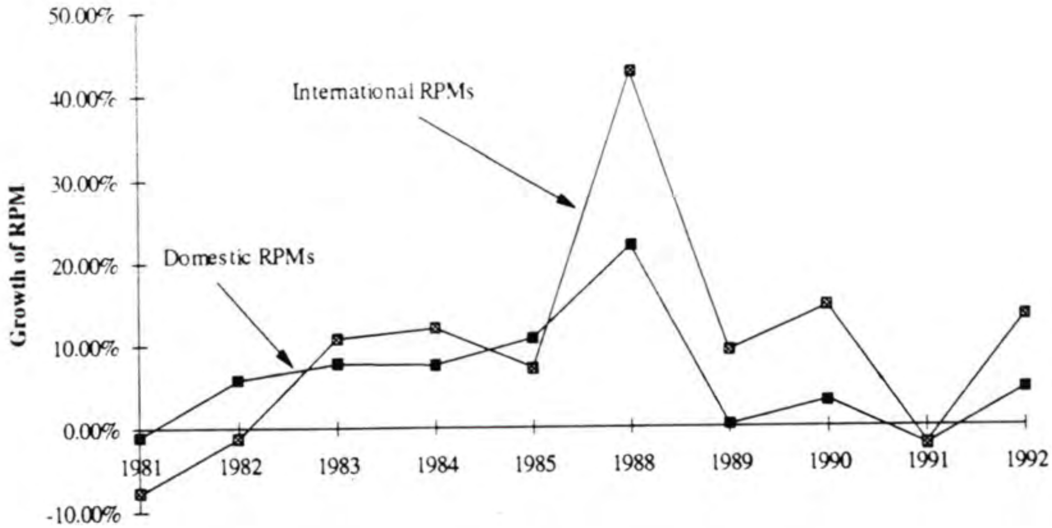


Figure 7.1 Comparison of Growth in International and Domestic Markets Source: Air Transport Association

- Growth in foreign markets will be strong while growth in the U.S. domestic air travel market will be weak.

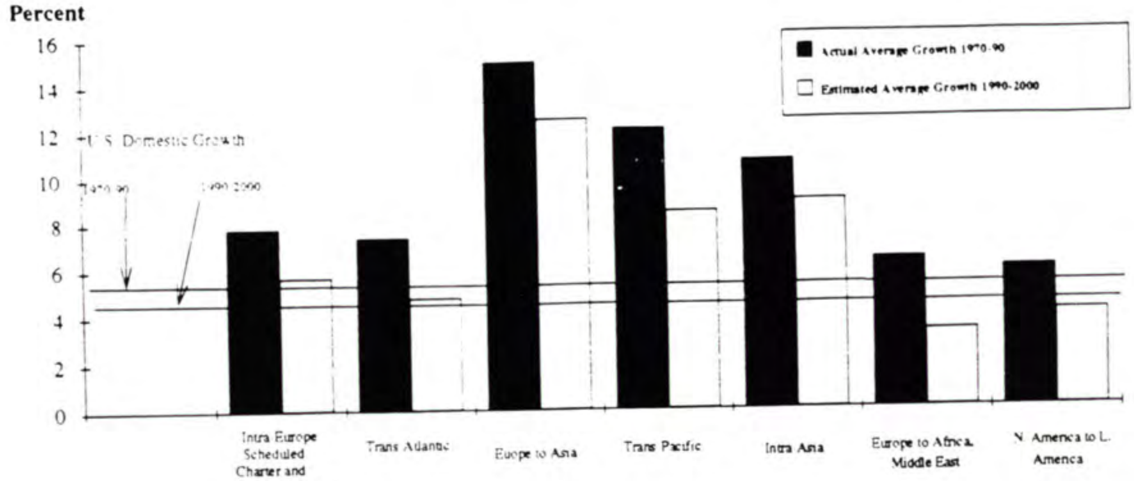


Figure 7.2 Average Annual Growth Rates for Major World Air Travel Markets
Source: Boeing

- U.S. airlines are the world's low cost producers.

Table 7.1 Global Cost Comparison Source: ICAO

	Airline	1991 Revenue Ton-Kilometer (thousands)	% of World Total	1991 Cost/ASM
US Carriers	United	14,296		9.8
	American	13,658		9.1
	Delta	11,248		9.3
	Northwest	10,735		9.3
	Continental	7,210		8.2
	USAir	5,400		10.7
	TWA	4,921		9
	Total	**67,468**	**29.3**	**9.3**
European Airlines	Lufthansa	8,417		21.2
	British Airways	8,313		13.6
	Air France	6,426		20
	KLM	4,810		17.1
	Alitalia	2,908		27
	Iberia	2,509		16.3
	Total	**33,383**	**14.5**	**18.6**
Asian Airlines*	JAL	6,017		23.8
	Singapore Airlines	5,006		8.9
	Cathay	3,875		10.5
	Qantas	3,668		10.2
	THAI	2,566		10.4
	Total	**21,132**	**9.2**	**13.8**
Latin American Carriers	Varig	1,752		15.7
	Aeromexico	720		8.7
	Total	**2,472**	**1.1**	**13.6**
Total World		**230,472**	**100**	**12.7**

*Asian carriers' cost per ASM reflects long haul trans-Pacific flying as these carriers do not operate large domestic networks. These airlines should have the lowest costs because of their operation, but they do not.

- U.S. carriers have increased their share of key international markets.

Table 7.2 Number of Passengers Flown by U.S. and Foreign Carriers
Source: ICAO

Area	Country	1981	1991
		Percent US Flag	**Percent US Flag**
All Countries		48.12%	52.66%
Central America		55.40%	56.23%
Caribbean		68.97%	71.04%
South America		43.55%	47.84%
Europe		41.02%	45.05%
	Austria	23.65%	15.21%
	Belgium	39.60%	54.06%
	Denmark	9.16%	11.25%
	France	47.55%	62.60%
	Germany	46.54%	54.25%
	Ireland	23.90%	19.60%
	Italy	55.97%	50.15%
	Netherlands	6.91%	22.36%
	Spain	36.26%	56.14%
	Sweden	32.84%	65.05%
	Switzerland	8.10%	23.70%
	USSR	0.00%	18.65%
	UK	50.30%	45.56%
		37.79%	54.98%
Far East	China/Taiwan	14.57%	38.46%
	Hong Kong	73.08%	55.27%
	Japan	39.45%	61.60%
	Korea-South	20.24%	48.48%
	Singapore	4.71%	12.11%
	Thailand	5.99%	14.96%
		45.40%	53.49%
Oceania	Australia	39.48%	57.29%
	New Zealand	39.17%	61.25%

- U.S. market share of international routes is high and U.S. airlines are continuing to gain market share through effective marketing, sales, management, and lower costs.

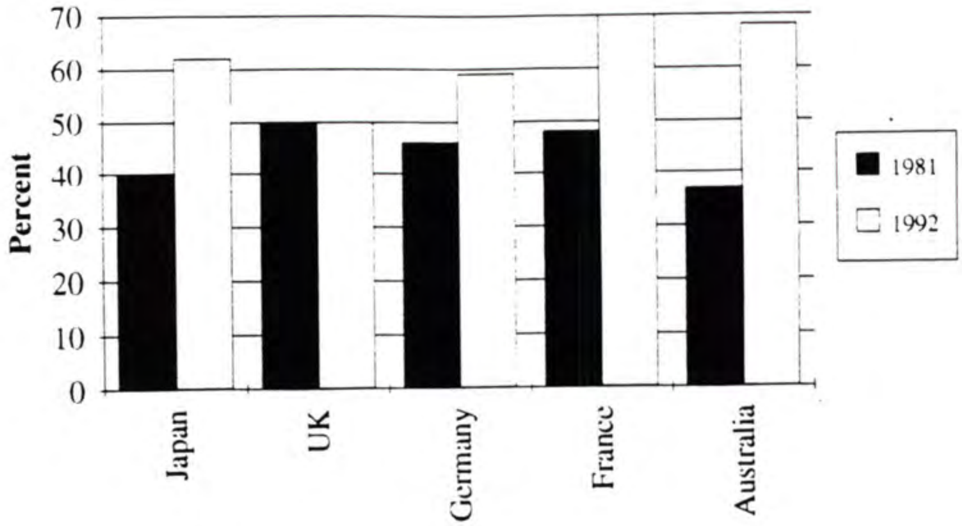


Figure 7.3 U.S. Carriers Market Share to Selected Foreign Destinations Source: Department of Transportation

- The success of U.S. carriers in international markets threatens certain foreign airlines and as a result several foreign governments have renounced their bilateral aviation agreements with the United States and others are threatening to do so to protect their airlines. France and Thailand have renounced their bilateral agreements with the United States while Australia, Germany, and Japan threaten to do the same.

- Two major market opportunities exist: Europe and the Pacific.

B. Trans-Atlantic Potential

- Trans-Atlantic service brought $6.5 billion in revenue to the majors in 1992. With a forecasted average annual trans-Atlantic growth rate of 4.8 percent for the next five years, even if the market share for the US airlines remains constant, their revenue will grow by $315 million per year In 1992 U.S. airlines were holding 45 percent of the trans-Atlantic market (up from 41 percent in 1981) and we expect their market share to continue to grow, further boosting revenues.

- The potential revenue that US airlines can accumulate by dominating as low cost producers in an open trans-Atlantic market is a total of $13 billion. While U.S. carriers will never achieve 100 percent market share, we think it is reasonable to expect the U.S. airlines to achieve a 70 percent share of this market. This is similar to the level already achieved in the U.S.-France market by U.S. airlines under one of the least restrictive bilateral aviation agreements with Europe. Revenue would then be $9.0 billion (an improvement of $2.5 billion compared with today which translates into 25,000 jobs)

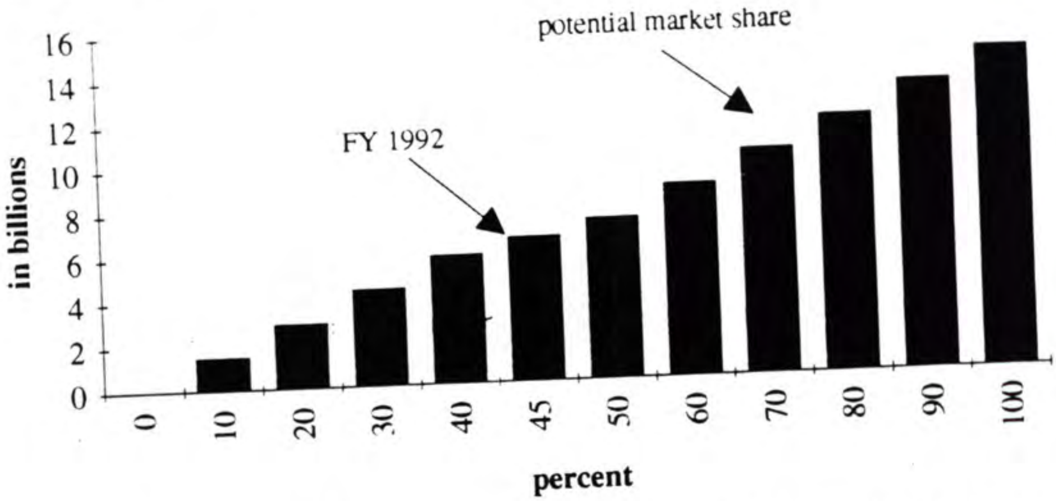


Figure 7.4 Potential Revenue from Transatlantic Traffic Source: ESI Estimates

C. Trans-Pacific Potential

- With forecasts for trans Pacific growth rates in excess of 12 percent for the next five years, this $14 billion market in 1992 presents an even greater opportunity for U.S. airlines.
- In 1992, U.S. airlines were holding 55 percent market share on trans Pacific routes, up from 39 percent in 1981.
- U.S. carrier costs are, on average, 33 percent lower than Asian carriers and Japan Air Lines has costs 160 percent higher than the U.S. average. Even the most cost efficient Asian carrier, Singapore Airlines, has higher costs than U.S. carriers on comparable routes using comparable aircraft.

- The potential revenue that U.S. airlines can accumulate by dominating as the low cost producers in the trans Pacific market is a total of $14 billion. A more likely market share that the U.S. could easily achieve is in excess of the 70 percent achieved in Japan, which has one of the most restrictive bilateral aviation agreements. A 70 percent market share would result in $9.8 billion in 1992 revenues (an improvement of $2.2 billion compared with 1992 actual revenue and an additional 22,000 jobs).

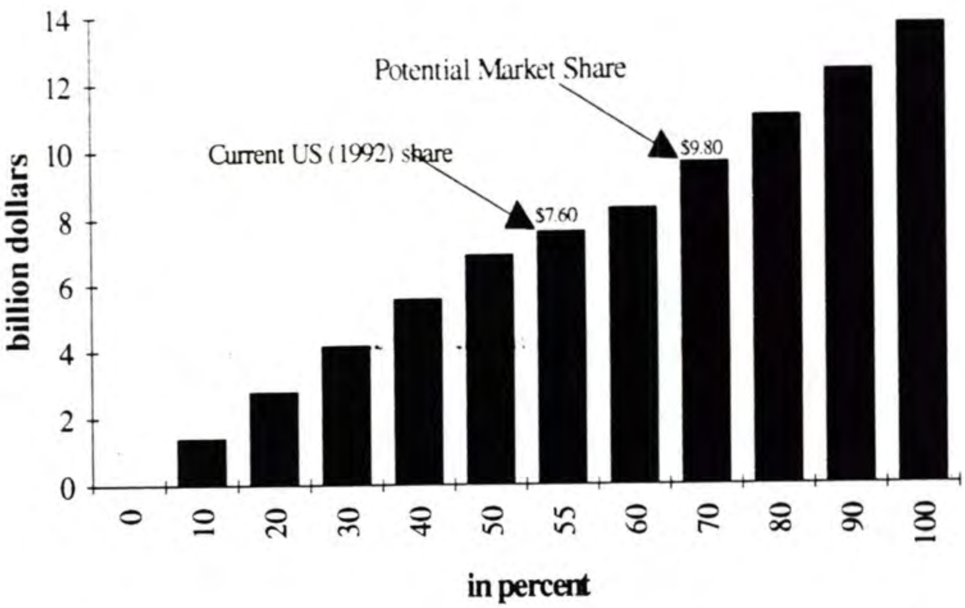


Figure 7.5 Potential Revenue from Trans-Pacific Traffic Source: ESI Estimates

- **ESI estimates that at least $4.7 billion in trans-Atlantic and trans-Pacific revenue would shift to U.S. airlines in a less restrictive regime based on a reasonable and achievable 70 percent market share. This would produce an additional 47,000 jobs.**

D. Intra European Opportunity Under Open Skies

- Current bilateral negotiations with the Europeans have focused on trading widespread U.S. access for "open skies" with individual nations that provide little incremental opportunity for U.S. airlines (the recent agreement with the Netherlands is a case in point).

- A broader approach of opening access to the entire U.S. market (including ownership) in return for reciprocal access within Europe and beyond would provide a more balanced opportunity for both U.S. and European airlines. Noting that the intra-European market is only 26 percent of the size of the U.S. domestic market, the more equitable trade should include Europe to Africa, Asia, and the Middle East as well -- routes that only the EC (not individual nations) can deliver.

- All European RPMs could literally (although not practically) be accommodated by excess U.S. domestic ASMs.

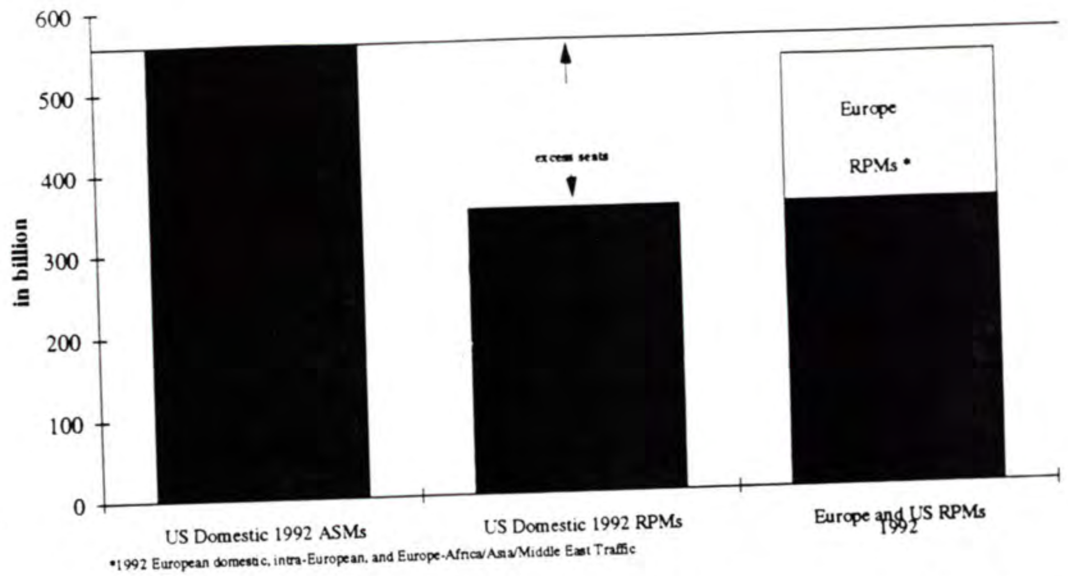


Figure 7.6 U.S. Carrier Access Within Europe Could Absorb Excess Capacity
Source: Boeing Current Market Outlook

E. The foreign investment paradox

- **The current turmoil in the U.S. airline industry has raised the cost of capital and equity market funding is unavailable. Desperate for cash, the weaker U.S. airlines have become strategic opportunities for foreign airlines seeking to acquire access to the large domestic U.S. market from protected bases. As a result, the reverse of what should happen is happening. The high cost producers are dominating the low cost producers.**

- Strategic investment by foreign airlines threatens the ability to maintain or gain additional access for U.S. airlines abroad and at the same time, erodes the U.S. industry's competitive position and destroys U.S. jobs.

- For example, British Airways (BA) has invested in USAir. As a high cost producer, BA is only able to invest in USAir because of its protected base in Europe. ESI estimates that once BA has access to the entire USAir domestic network of 190 cities (which BA does not already serve) this will shift $350 million annually to BA from U.S. airlines, potentially costing the U.S. economy 3500 jobs.

- Here's how this will happen. Suppose someone wanted to travel from Columbus, Ohio to London.

With BA only

Routing	*Carrier*	*Share*
Columbus — Chicago — London	*American Airlines*	24%
Columbus — New York — London	*TWA*	24%
Columbus — Newark — London	*Continental*	24%
Columbus — Cincinnati — London	*Delta*	24%
Columbus — Connect — Philadelphia — London	*With anyU.S. airline*	4%

- Passengers usually choose "single carrier" service. Thus four U.S. airlines split the Columbus-London market. British Airways' only access is a connection on a U.S. domestic carrier. Travel agency computer screens bias towards through flights and on-line service -- neither of which British Airways can do.

- Now with code sharing, British Airways can operate a "single carrier" one-stop flight in conjunction with USAir. It shows up at the top of travel agency computer screens.

With BA/USAir

Routing			*Carrier*	*Share*
Columbus	Chicago	London	*American*	20%
Columbus	New York	London	*TWA*	20%
Columbus	Newark	London	*Continental*	20%
Columbus	Cincinnati	London	*Delta*	20%
Columbus	Philadelphia	London	*British Airways*	20%

Each U.S. airline loses 4% and BA gains 16%.

- The investment represents a method of gaining access to U.S. markets without giving American firms access to British home market sanctuaries. American carriers cannot buy in to Britain even if they so desired. British law also has a 25 percent ownership limitation, and any such purchase jeopardizes BA's intra-European authority. The EC must review any foreign investment in an EC airline, and it is unlikely to allow any American investment that potentially threatens the control of an airline.

- Allowing BA access to the U.S. without corresponding access in the U.K. will give BA a major advantage as it would be the only airline with broad networks on both sides of the Atlantic. BA serves 149 cities, most of which, U.S. airlines do not and many they cannot serve.

- The combined network of BA and USAir can mitigate the cost disadvantage that both carriers have compared with their U.S. rivals.

- Another example is the KLM investment in Northwest which is designed to access Northwest's domestic network, resulting in the transfers of $150 million in annual revenues and 1500 jobs from other U.S. airlines that previously carried the traffic.

- Despite the fact that Northwest is the lower cost producer, KLM still chooses to operate its own aircraft on almost all joint routes to Europe. Thus, European owners are diverting U.S. profits and jobs to protect European revenues and jobs.

- **Taken to its full potential, if Air France, Alitalia, Iberia, Lufthansa, SAS and Swissair all had the ability to code share over the entire U.S. market, the cost to U.S. airlines in diverted trans Atlantic revenues is $1.1 billion with the loss of 11,000 jobs. This is 17 percent of total U.S. carrier's trans Atlantic revenue and would threaten the viability of their trans Atlantic networks. The irony is that the high cost carriers are the winners and the U.S. excess capacity situation becomes worse, not better.**

- **The impact of opening the U.S. market to all foreign airlines is that a total of $4 billion in revenue is diverted from U.S. airlines which jeopardizes 40,000 American jobs.**

  $1.6 billion to all European, African, and Mid-Eastern carriers
  $1.9 billion to Asia Pacific carriers
  $0.5 billion to Latin American carriers

- **Essentially, foreign investment is buying access to the U.S. market that is otherwise not available. To the extent that other countries are unwilling to open their markets, the investments circumvent the current bilateral negotiating system, thereby depriving U.S. companies of opportunities to compete in an open market. The foreign market remains relatively closed, protecting the foreign company's profits that are used to enter the U.S. market.**

VIII. Implications of the ESI Forecast

- The U.S. domestic market is likely to remain troubled due to chronic excess capacity and weak demand.

- Certain U.S. carriers are particularly vulnerable. Those who have a poor cash position, a limited, non-national network and high costs are most at risk and their survival is threatened. In particular, TWA (limited hub, low cash), USAir (limited scope, high costs--very exposed to Southwest competition given heavy point to point presence) and Northwest (a bit of all three, but with some likely relief on the cost side) appear particularly vulnerable.

- Some cities will lose their hubs and thus some of their non-stop service. Point to point carriers will provide replacement service in higher volume short haul markets that do not connect to another hub city. This downsizing will result in excess aircraft that must either be grounded or used in new markets.

- Given the competitiveness of U.S. carriers, the logical way to reduce the excess capacity is by expanding internationally. Investment in U.S. carriers by foreign airlines, however, and could inhibit the U.S. government's ability to open markets to provide new growth opportunities. Unless foreign investment in U.S. carriers can be adequately reciprocated, the United States could potentially lose control of its international markets, despite being the low cost producer.

- The current cost structure will be only marginally profitable under present capacity conditions. If the cost structure were to decline sufficiently, airlines could return to adequate levels of profitability even with no change in capacity. Labor, representing 34% of operating expenses, is the largest discretionary expense category (and pilots are almost a third of all labor costs) causing management to focus its attention on this cost category. There are three methods of restructuring labor costs:

    - Bankruptcy
    - Government mandate
    - Voluntary reductions associated with employee ownership.

IX. To Intervene or Not to Intervene?

- The plight of the U.S. airlines has given rise to calls for massive government intervention. In considering whether such intervention is necessary, we have asked ourselves the following questions; Will the public be affected? Will the environment be affected? and finally, will aircraft producers be affected? In each case our answer was no. Hence, we believe that massive government intervention should not occur, but there is a role for government action.

A. Will public convenience be impacted if carriers exit the market?

- This does not appear likely. If TWA were to cease to operate, the bulk of their traffic could easily be accommodated on the existing networks of other airlines. St. Louis would lose nonstop service to many cities, but those with enough volume would eventually get replacement service from Southwest or one of the other majors.

- Even if two majors were to exit, the remaining airline industry has enough excess capacity to absorb the demand.

- In some isolated instances prices might rise, but as a rule, the many alternative routings via a variety of airlines and a variety of hubs will keep prices in check.

B. Will this impact the environment?

- Again, not likely. Airlines may already have difficulty in meeting the new Stage III regulations. At worst, aircraft would be retired without replacement. This will reduce capacity, beneficial for the industry but injurious to the competitive position of airlines with old fleets (only Northwest and TWA).

C. Will this affect aircraft companies?

- The financial health of the industry has already caused a major cancellation of aircraft orders. Fewer numbers of airlines does not necessarily mean fewer new orders. In fact, the converse may be true. If TWA were to go out of business, most of its fleet being older Stage II would largely be grounded and other airlines would order new aircraft to provide some extra capacity.

X. Potential Options That ESI Does Not Recommend

A. Reregulate the airlines?

- Not a workable alternative as neither price controls nor entry restrictions guarantee profitability and are so cumbersome that they would likely destroy the cost discipline the industry has achieved.

B. Provide loan guarantees?

- Airlines need capital and access to cash. Although loan guarantees would help the airlines raise money by improving their credit rating, a loan guarantee would be extremely risky and costly for the U.S. Treasury given that some carriers will go bankrupt and be liquidated. In addition, there are other less costly and more efficient actions that the U.S. government can take.

XI. ESI Recommendations

A. Institute a coordinated policy to open international markets to U.S. airlines.

- Government can help U.S. carriers take advantage of their world wide cost advantage in international markets by aggressively negotiating the bilateral agreements in international markets that are growing at a rapid rate.

- True open skies, including the right for a U.S. airline to open a base of operations in a foreign country serving international (and possibly domestic markets) should be a priority. Unilaterally opening U.S. international markets without reciprocal access would cost the U.S. airline industry $4 billion and 40,000 jobs.

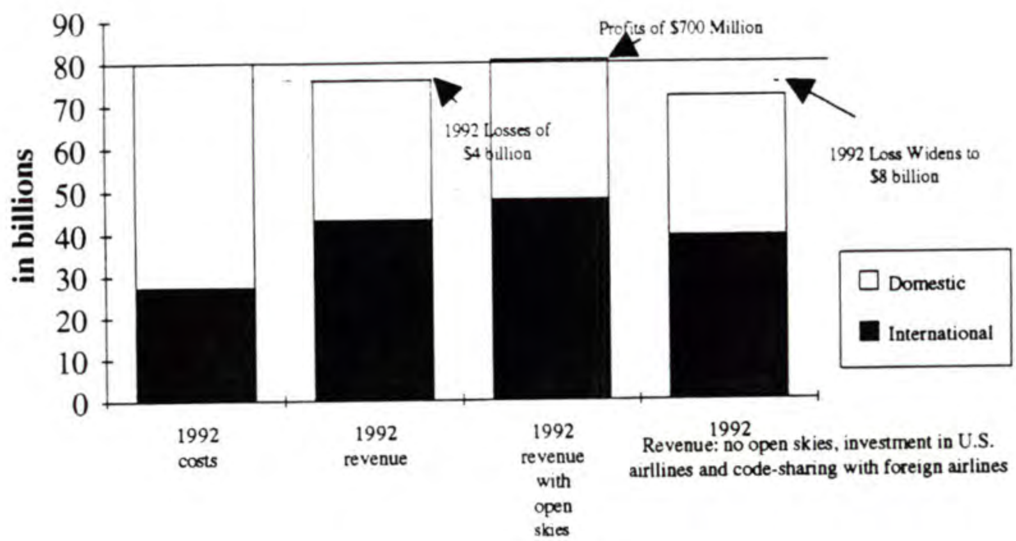


Figure 11.1 TransAtlantic and TransPacific Open Skies effect on 1992 Losses
Source: ESI Estimates

- Foreign airlines should be prevented from investing in or code-sharing with U.S. airlines until reciprocal rights combined with open skies can be implemented. Other foreign investors (banks, investment houses, individuals) should be able to invest without restriction. Once real reciprocity is obtained, there should be no restriction on foreign investment or code sharing.

- Government must focus on all barriers to entry taking into account foreign infrastructure constraints and doing business issues (the right to price, offer frequent flier programs, computer reservations systems, etc.) as part of a comprehensive market opening approach.

- The practice of automatically providing slots at congested U.S. airports (by removing them from domestic airline operations) should be eliminated, unless similar reciprocal access exists at the foreign airport.

- Enforcement of existing bilateral agreements is essential. The United States must take quick retaliatory action for transgressions and should suspend all air service with any nation that renounces a bilateral agreement and fails to renegotiate a new agreement before expiration of the existing agreement.

- Negotiations should ensure equal exchange of opportunity. In the case of Europe, the entire intra-European market is only 26 percent of the U.S. domestic market. No one country in Europe can deliver more than a fraction. Thus, negotiations need to be with the EC, providing access to all Europe and beyond it to the world in return for access to the United States.

B. Privatize the FAA or turn it into a quasi-government organization that is accountable for developing and managing the air traffic control system.

- Create a board which includes users to determine budgets and set appropriate fees for each user category based on planned capital and operating expenditures.

- Create a cost justified, responsive management approach. Advancement of the new air traffic control system will save airlines $713 million per year.

- Separate funding to allow true capital infrastructure planning and cost effective development.

- The ticket tax really is a user fee, however, airlines are paying a disproportionate share, estimated at $900 million annually. The 1989 increase to the ticket tax not only occurred at an inopportune time, but cost the industry roughly $1 billion per year--about the same as the over assessed burden . A rollback in the ticket tax to 8 percent is appropriate in conjunction with true cost management at the FAA.

C. Provide a one time incentive to retire old aircraft.

- Not only does this help reduce over capacity, but could encourage the replacement of existing aircraft with new aircraft, thereby helping airline operating costs as well as aircraft manufacturers.

- Tax credit that must apply to owners of non stage III aircraft (airlines, leasing companies, etc.)

- For airlines, credit would be applied against AMT payments, thus providing a real cash infusion to airline balance sheets.

- Aircraft must be permanently retired from the U.S. domestic market. They cannot be brought back into service by any U.S. operator.

- Incentive would be of limited duration and apply to retirements not previously announced or implemented, that occur within one year of the program's inception.

- Since the airlines have been unnecessarily affected by the AMT and other government induced problems, a tax credit incentive could be justified. Although this does impact the U.S. Treasury, since U.S. airlines were overburdened with excessive Federal taxes in the past, ESI believes this action is not inappropriate.

- In addition, retiring old aircraft would be good for the environment affecting both noise and air quality.

D. Airlines should be exempt from AMT in situations where cash flow drops below a reasonable coverage level.

- Alternative Minimum Tax (AMT) cost the airlines over $600 million in cash since 1991. The AMT was designed to tax companies with large cash flows sheltered by high depreciation rates. It is ironic that because of negative cash flows, the airlines actually had to borrow money to pay their AMTs during a period with the worst losses ever.

E. Provide an tax incentive to capital providers for conversion of debt into equity.

- Provides vitally needed help with balance sheet repair.

- Immediate impact on lowering debt service costs.

- The incentive should be in the form of a one time transfer of Net Operating Loss (NOL) carry forwards from airlines to capital providers. Since airlines would be able to use these to reduce taxes against future profits, this does not cost the Treasury in the long run, but advances the impact date.

F. Encourage ESOPs

- In conjunction with permanent employee cost savings and productivity improvements

- Adjust tax savings to apply to future AMT payments made when airlines are cash flow positive, but still have NOLs to write off.

G. Institute rigorous review of new airline/ownership fitness and of acquisitions and enforcement of anti-trust and competition statutes by the Department of Justice.

- New airlines must have appropriate cash resources.
- New owners (LBO) and acquisitions must meet a financial test to avoid undue financial leverage not involved in capital procurement.
- Mergers and acquisitions need to meet a competition and anti-trust test to preserve a dynamic market. The test should be administered prior to approval and apply equally to U.S. and foreign acquirers.
- Vigorous enforcement against action predatory pricing and anti-competitive behavior must be a government priority. Since airline costs are heavily marginal, the litmus test for predatory pricing should be whether the airline initiating the move will increase its own revenue.

H. A time limit on operation under Bankruptcy Chapter 11 should be set.

- Current system is costly, some $250 million in legal fees alone from 1989-1992.
- There is no incentive for debtors or for creditors to compromise, creating constant delays in reorganization.
- The constant extensions for submission of a viable plan of reorganization can allow liquidation of certain assets to fund deteriorating operations, leading to an almost total loss of value of the estate (as in the case of Eastern) upon cessation of operations and in the process weakens the financial situation of the rest of the industry.

Also available from the Economic Strategy Institute:

Studies:

Toward A New Trade Consensus
Highlights of an ESI/PBEC Conference, March 17-18, 1993 ($19.95)

Play to Win: Toward a New Paradigm for USAF Research and Development
January 1993 ($9.95)

The Uruguay Round and the United States: A Critical Analysis
January 1993 ($9.95)

NAFTA: Making It Better
December 1992 ($9.95)

The Future of the Auto Industry: It Can Compete, Can It Survive?
June 1992 ($25.00)

Special Reports

The Export Finance Crisis
July 1992 ($4.95)

The Impact of Broadband Communications on the U.S. Economy and on Competitiveness
March 1992 ($4.95)

Foreign Direct Investment in the United States: Unencumbered Access
May 1991 ($25.00)

Investment: The Fast Track to a Strong Recovery
April 1991 ($4.95)

Looking to the 21st Century
May 1990 ($4.95)

Include $2.50 per item for mailing in the U.S.; $5.00 per item for mailing overseas. Send check or money order in U.S. funds (payable to "ESI") to the address listed below.

Economic Strategy Institute

1100 Connecticut Avenue, NW ♦ Suite 1300 ♦ Washington, DC 20036
Telephone: 202/728-0993 ♦ Facsimile: 202/728-0998

THE WHITE HOUSE
WASHINGTON

DATE: 9/2

NOTE FOR: Danetta Lake Paster

The President has reviewed the attached, and it is forwarded to you for your:

Information ☑

Action ☐

Thank you.

JOHN D. PODESTA
Assistant to the President
and Staff Secretary
(x2702)

cc:

20973 9/2

THE WHITE HOUSE

WASHINGTON

September 2, 1993

93 SEP 2 A8:53

ACTION

MEMORANDUM FOR THE PRESIDENT

FROM: LEON PANETTA
ANTHONY LAKE
HOWARD PASTER

SUBJECT: Short-term Peacekeeping Funding Plan

As you know, we are at work on both long-term and short-term strategies for addressing our existing arrearages and projected bills for UN peacekeeping assessments. We now have arrived at a proposed strategy for addressing the short-term problem.

We estimate that by the end of FY 1993 the US will be roughly $350 million in arrears in its UN assessments for peacekeeping. Without a short-term solution, that figure could reach $500 million by the end of CY 1993 and more than $1 billion by the end of FY 1994. We propose three steps to address these potential arrearages:

1. We expect Congress to appropriate roughly $420 million to State for peacekeeping in the FY 94 budget. Once this appropriations bill passes (hopefully in September), we would proceed to write a check to the UN as early as possible in FY 94 for all current peacekeeping arrearages (estimated at roughly $350 million), plus the roughly $25 million in peacekeeping arrearages the U.S. agreed to pay off over five years starting in 1991. This payment will make the U.S. roughly current sometime in October (there is a 15 day waiting period after notification to the Congress).

2. There was a one-year-only provision in the FY 93 Defense Authorization bill that permitted DoD to pay the UN up to $300 million in peacekeeping bills. This provision was not usable in FY 93; however, State and Defense, NSC and OMB are agreed to support its extension by Congress through FY 94, and then to use that authority, with DoD agreeing to identify the offsets and make these funds available sometime this Fall. This payment will keep us up to date through the end of the calendar year.

3. We would seek a supplemental appropriation early in calendar 1994 for the approximately $700 million in peacekeeping bills we expect to incur between January 1 and September 30 of 1994. (In addition, should there be a Bosnian peacekeeping operation, we might want to use that supplemental to seek the additional funds -- perhaps $2-3 billion -- required.) Although it would be

desirable to present this supplemental as an "emergency", given the political sentiment in the Congress, we will probably have to offset it. State and Defense have agreed to work on identifying such offsets as part of shaping a supplemental package.

Secretaries Aspin and Christopher have agreed to this approach, which would allow us to stay current with our peacekeeping obligations over the next 15 months and would allow you to make a strong presentation to the UNGA at the end of this month. We will continue working with them and others to develop our strategy to address long-term (FY 95 and beyond) peacekeeping funding needs.

Approve ___✓___ Disapprove ______

cc: Vice President
Chief of Staff

THE WHITE HOUSE
WASHINGTON

DATE: 09/02/93

NOTE FOR: ROY NEEL

The President has reviewed the attached, and it is forwarded to you for your:

Information ☒ X

Action ☐

Thank you.

JOHN D. PODESTA
Assistant to the President
and Staff Secretary
(x2702)

cc:

THE PRESIDENT HAS SEEN 9/2

THE WHITE HOUSE

WASHINGTON '93 AUG 31 P7:11

August 31, 1993

Memorandum to the President

From: Roy Neel

Re: Gov. Ariyoshi's offer to promote US trade in Japan, etc.

Per your note/question, I talked to Gov. Ariyoshi last week and offered to arrange a meeting for him with Ambassador Mondale during the Governor's next trip to Tokyo in September. I will speak to Amb. Mondale about the Governor's interest during Mondale's visit to the White House before his own departure to Japan next week. (We will probably arrange a drop-by for you to see him before he leaves.)

Gov. Ariyoshi is pleased with your responsiveness and offer to help him play a role in U.S. - Japan trade.

cc: Tony Lake

Thanks

THE WHITE HOUSE
WASHINGTON

DATE: 09/02/93

NOTE FOR: BOB RUBIN

The President has reviewed the attached, and it is forwarded to you for your:

Information ☒

Action ☐

Thank you.

JOHN D. PODESTA
Assistant to the President
and Staff Secretary
(x2702)

cc: Bernie Nussbaum

[redacted]

THE WHITE HOUSE

WASHINGTON

3 SEP 1 A10 : 32

[redacted]

Rubin

If this letter is accurate, we better be careful w/ the Barclay issue —

BC

[redacted]

THE WHITE HOUSE

WASHINGTON

Dear Byron:

Thank you for your letter on the __Barclays__ matter. I appreciate your timely comments concerning the problem of multinational taxation.

As you know, the Supreme Court has recently requested the United States to submit a brief in the __Barclays__ case. The Justice Department will be preparing that brief in the near future, and I have therefore forwarded your letter to the Solicitor General for his attention.

Once again, thank you for your letter. Please feel free to send me any further information you may have on this matter.

Sincerely,

Bill

The Honorable Byron L. Dorgan
United States Senate
Washington, D.C. 20510

ID# 029109

THE WHITE HOUSE
CORRESPONDENCE TRACKING WORKSHEET

INCOMING

DATE RECEIVED: JULY 22, 1993

NAME OF CORRESPONDENT: THE HONORABLE BYRON L. DORGAN

SUBJECT: DISCUSSES THE BARCLAYS BANK CASE

ROUTE TO: OFFICE/AGENCY (STAFF NAME)	ACTION: ACT CODE	ACTION: DATE YY/MM/DD	DISPOSITION: TYPE RESP	DISPOSITION: C D	DISPOSITION: COMPLETED YY/MM/DD
HOWARD PASTER	ORG	93/07/21	HP	A	93/07/21
REFERRAL NOTE:					
HOWARD PASTER	RSA	93/07/22			/ /
REFERRAL NOTE:					
		/ /			/ /
REFERRAL NOTE:					
		/ /			/ /
REFERRAL NOTE:					
		/ /			/ /
REFERRAL NOTE:					

COMMENTS:

ADDITIONAL CORRESPONDENTS: MEDIA:L INDIVIDUAL CODES: 1210

__ MAIL USER CODES: (A)D_ND______ (B)__________ (C)__________

*ACTION CODES:
*A-APPROPRIATE ACTION
*C-COMMENT/RECOM
*D-DRAFT RESPONSE
*F-FURNISH FACT SHEET
*I-INFO COPY/NO ACT NEC
*R-DIRECT REPLY W/COPY
*S-FOR-SIGNATURE
*X-INTERIM REPLY

*DISPOSITION
*A-ANSWERED
*B-NON-SPEC-REFERRAL
*C-COMPLETED
*S-SUSPENDED

*OUTGOING
*CORRESPONDENCE:
*TYPE RESP=INITIALS OF SIGNER
* CODE = A
*COMPLETED = DATE OF OUTGOING

REFER QUESTIONS AND ROUTING UPDATES TO CENTRAL REFERENCE (ROOM 75,OEOB) EXT-2590
KEEP THIS WORKSHEET ATTACHED TO THE ORIGINAL INCOMING LETTER AT ALL TIMES AND SEND COMPLETED RECORD TO RECORDS MANAGEMENT.

SCANNED

029109

BYRON DORGAN
NORTH DAKOTA

93 JUL 20 P5:49

United States Senate

WASHINGTON, DC 20510-3405

July 14, 1993

The Honorable William J. Clinton
The White House
1600 Pennsylvania Avenue, N.W.
Washington, D.C. 20500

Dear Mr. President:

Your decision earlier this year in the Barclays Bank case to support the ability of states to effectively determine the income of foreign multinationals was encouraging to all of us concerned about fair tax treatment of American business. I'm writing to bring to your attention new information that reinforces the wisdom of that decision, especially as it concerns our efforts to give American-based producers a level playing field in our own market.

A few weeks ago, the Ernst & Young accounting firm released Internal Revenue Service data obtained under the Freedom of Information Act concerning audit actions made under the authority of Section 482 of the Internal Revenue Code (which deals with the juggling of income between subsidiaries in a corporate group). The data shows that, for audits of tax returns completed in fiscal year 1992, U.S. subsidiaries of United Kingdom multinationals were underreporting their income to a greater extent than were the subsidiaries of multinationals based in any other country -- an average $2 million per audited return. U.S. subsidiaries of Japanese multinationals ranked second.

This data suggests that British multinational firms may well be the worst abusers of what the experts call "transfer pricing." It is particularly ironic, therefore, that the government of the United Kingdom has taken the lead against a method of tax accounting that effectively combats this tax avoidance strategy - a method called "formula apportionment," which is at issue in the Barclay's case.

The explanation seems simple: their own multinationals have been able to shift their American profits back to the United Kingdom. Income that should be reported here, gets reported instead in the U.K. -- or nowhere at all. This is an under-the-table foreign aid program that is unfair to our domestic producers and that we cannot afford -- especially when it places American companies paying taxes at a competitive disadvantage with U.K.-owned subsidiaries operating here.

This new evidence of transfer-pricing abuses by U.K.-based multinationals underlines the need for the Administration to continue its position in the Barclays case. I look forward to your continued support of the interests of American states, businesses and taxpayers on this issue.

Sincerely,

Byron

Byron L. Dorgan
U.S. Senator

BLD:ach

THE WHITE HOUSE

WASHINGTON

July 21, 1993

Dear Senator Dorgan:

Thank you for your letter regarding the Barclays Bank case. I appreciate your informing the President of your concerns.

The President has been advised of your interest in this matter, and you will receive a response from him in the near future. In the meantime, if I can be of assistance to you, do not hesitate to contact my office.

Best wishes.

Sincerely,

Howard G. Paster
Assistant to the President
for Legislative Affairs

The Honorable Byron Dorgan
United States Senate
Washington, D.C. 20510

THE WHITE HOUSE

WASHINGTON

July 21, 1993

MEMORANDUM FOR SHEILA ANTHONY

FROM: HOWARD G. PASTER
LEGISLATIVE AFFAIRS

SUBJECT: Barclays Bank Case

Enclosed please find a copy of the letter that was sent to the President from Senator Byron Dorgan (D-ND). I have also enclosed a copy of the acknowledgement letter I sent to him.

The President has requested that he see and sign every letter going to Capitol Hill. We did not want to fully answer the issues addressed in the Senator's letter without advice from your department; therefore, I am requesting that your office draft a response and return it to LeeAnn Inadomi (WH-East Wing) within 48 hours. She will then print the letter in final form and have President Clinton sign the letter.

Thank you very much for your assistance with this matter. If you have any questions, please feel free to call LeeAnn at 456-7500.

Enclosure

THE PRESIDENT HAS SEEN 9/2

THE WHITE HOUSE

WASHINGTON

August 30, 1993

93 SEP 1 A9:27

MEMORANDUM FOR THE PRESIDENT

FROM: BERNARD W. NUSSBAUM
COUNSEL

BETH NOLAN BN
ASSOCIATE COUNSEL

SUBJECT: Request for Waiver under 18 U.S.C. § 208(b)(1) from Chairman Levitt

Chairman Levitt has requested a waiver under 18 U.S.C. § 208(b)(1). Under § 208, a federal employee may not participate in an official capacity in a particular matter having a direct and predictable effect on his financial interests. Section 208 has no automatic exception for de minimis interests, but § 208(b)(1) permits the appointing official to waive the restrictions of this prohibition when the financial interest in a matter is not so substantial as to be deemed likely to affect the integrity of the services which the Government may expect from the official.

Chairman Levitt has vested pension interests in the American Stock Exchange. Chairman Levitt has disqualified himself from participating in any particular matter which is likely to have a direct and predictable effect on the American Stock Exchange. This disqualification policy should resolve nearly all conflicts of interest that might arise as a result of his financial interests. It is possible, however, although not likely, that some matters might arise that would constitute particular matters and would have a generalized effect on self-regulated organizations or the markets. Chairman Levitt is seeking this waiver so that he may participate in matters of general applicability which are likely to affect all self-regulatory organizations or the markets in general. That is, the waiver would apply to matters, including matters in which the American Exchange is a party, when all self-regulatory organizations or the markets are affected similarly, but not to matters having a sole or particularized effect on the American Stock Exchange (e.g., examination, inspection, or rule filing affecting solely the American Stock Exchange).

The Designated Agency Ethics Official of the Securities and Exchange Commission has recommended that Chairman Levitt's waiver be granted. That official advised the Senate Committee and the Office of Government Ethics at the time of Chairman Levitt's confirmation of Chairman Levitt's decision to seek this waiver.

It is possible, and perhaps even likely, that the need for this waiver will not arise. Moreover, Chairman Levitt could terminate his pension interest rather than seek a waiver. On the other hand, this financial interest is not one thought likely to create a conflict of interest, and thus it seems appropriate for a waiver rather than termination. The waiver would permit Chairman Levitt to participate in general policy matters without having to assess whether there might be some technical violation of § 208. It would therefore assist Chairman Levitt in conducting his official responsibilities, while assuring that he would still be disqualified when a matter had any particular, nongeneralized effect on his financial interest.

Recommendation

We recommend that you grant Chairman Levitt's request for a waiver, by signing the appropriate line granting the waiver on the attached memorandum to you from Chairman Levitt.

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

OFFICE OF THE
GENERAL COUNSEL

93 AUG 13 P5:43

August 13, 1993

BY HAND

Bernard W. Nussbaum, Esq.
Special Counsel to the President
136 Old Executive Office Building
Washington, D.C.

Re: Arthur Levitt, Jr., Chairman
Securities and Exchange Commission
Request for Presidential Waiver

Dear Mr. Nussbaum:

Enclosed is a memorandum from Chairman Levitt, requesting a Presidential Waiver of any financial interest he may have in the American Stock Exchange. I concur that a waiver would be appropriate under these circumstances.

Please feel free to call me at 272-2471, or Lyn Blatch, the Commission's Ethics Counsel, at 272-2437, with any comments or questions.

Sincerely,

Paul Gonson

Paul Gonson
Acting General Counsel

Enclosures

cc: Stephen D. Potts, Director
U.S. Office of Government Ethics

August 13, 1993

MEMORANDUM FOR THE PRESIDENT

FROM: Arthur Levitt, Jr.
Chairman, Securities and Exchange Commission

SUBJECT: Request for Conflict-of-Interest Waiver

As Chairman of the Securities and Exchange Commission it is my wish to participate in as many important policy issues as is consistent with applicable statutes and regulations concerning conflicts of interest and standards of conduct. Therefore, to ensure my ability to participate in important policy issues, particularly issues relating to the American Stock Exchange and stock exchanges generally, I have taken several steps to sever my ties to the American Stock Exchange. I have arranged for my retirement benefits under the two Supplemental Executive Retirement Plans maintained by the Exchange to be converted into lump-sum payment (using actuarial and present value discounted methodology), such that I will receive no ongoing payments from the current earnings of the American Stock Exchange. As it has for other executives, the American Stock Exchange continued to provide medical insurance and term life insurance to me through its group policies after my retirement. I have agreed to voluntarily relinquish the medical coverage provided me by the Exchange and purchased, at my own expense, medical coverage through one of the plans available to government employees. In addition, I have arranged to have the group term life insurance converted into universal life insurance, and I will voluntarily pay the insurance premium myself. This universal life insurance will in no way be dependent on the fortunes of the American Stock Exchange.

In addition, I have vested qualified defined benefit pension plan benefits from-the American Stock Exchange which are fully funded and independently maintained and managed. To avoid any appearance of a conflict of interest, I will purchase "back-up," supplemental insurance coverage that will ensure the continuation of my pension benefits in the exceedingly remote event that the qualified plan becomes under-funded and the American Stock Exchange becomes financially unable to make additional contributions to the qualified plan.

I have been advised that my vested benefits in the qualified pension plan could prohibit me under 18 U.S.C. § 208(a) from participating personally and substantially in certain matters affecting or involving the American Stock Exchange. However, you may grant a waiver of the prohibition of 18 U.S.C. § 208(a) upon your written determination that because of the backup supplemental insurance coverage the financial interest is not so substantial as to be deemed likely to affect the integrity of the services that the Government may expect of me. I am requesting that you grant such a waiver. I am disqualifying myself from participating in any examination, inspection, rule filing, and any other particular matter involving specific parties in which the American Stock Exchange is a party, except when such matters could reasonably be expected to have a substantial impact on the other self-regulatory organizations or the markets in general. In addition, I intend to disqualify myself from any particular matters involving specific parties in which I participated while I was at the American Stock Exchange, or about which I gained confidential information while at the American Stock Exchange. The limited waiver I am requesting would permit me to participate in matters of general applicability which are likely to affect all self-regulatory organizations or the markets in general.

If you approve this waiver, I will, of course, in the interest of comity, promptly advise the Senate Committee on Banking, Housing and Urban Affairs, that, during the course of my confirmation process, was fully apprised of my undertakings with respect to my financial interests, including my intention to request this waiver.

DECISION:

✓ __________ Waiver granted based upon my determination that the financial interests described are not so substantial as to be deemed likely to affect the integrity of the services the Government may expect from you as Chairman of the Securities Exchange Commission.

__________ Waiver denied.

William J. Clinton

William J. Clinton, President

Date: 9-2-93

Chron
copy

THE WHITE HOUSE

WASHINGTON

September 2, 1993

Mr. Tom Shields
Jury Commissioner
Franklin County Municipal Court
375 High Street, 9th Floor
Columbus, OH 43215

Dear Mr. Shields:

As you may know, President Clinton has asked former Governor Celeste to direct the National Health Care Campaign. This task will require him to spend a great deal of time away from his home during the next few months.

It would be extremely helpful to the President if you would defer Governor Celeste's jury service until the completion of this important national project.

Thank you for your consideration of this request.

Sincerely,

John Podesta
Assistant to the President
and Staff Secretary

cc
Bill Burton

From the Office of the Chief of Staff

Phone: 202/456-6797 Fax: 202/456-1121

Date: 8/30/93 Response needed by: ASAP

COS Office Contact: Bill Burton

3 AUG 30 PM 4:38

	Action	FYI		Action	FYI
Joan Baggett			Leon Panetta		
Rahm Emanuel			Howard Paster		
Mark Gearan			John Podesta	✓	
David Gergen			Jack Quinn		
Jack Gibbons			Carol Rasco		
Marcia Hale		✓	Bob Rubin		
Alexis Herman			Eli Segal		
Nancy Hernreich			Ricki Seidman		
Tony Lake			George Stephanopoulos		
Bruce Lindsey			Christine Varney		
Katie McGinty			David Watkins		
Regina Montoya			Maggie Williams		
Dee Dee Myers					
Roy Neel					
Bernie Nussbaum					

Remarks:
John - Rather than a letter asking that a Presidential appointee be excused from jury service, could you not simply do a letter, over your signature, acknowledging to the jury commission that Celeste was appointed to the NHCC? Thanks.

Response:

Celeste & Sabety Ltd.

August 30, 1993

TELEFAX

TO: Betty Mitchell
Personal Secretary to The President

FAX: 202/456-2883

FROM: Dick Celeste

Dear Betty:

I was scheduled for Jury Duty the weeks of August 30 and September 6, but have been excused due to chairing the NHCC. Even though the Jury Commissioner has already excused me, he asked for a letter from The President. Is there any chance we can get The President to sign something like the attached note?

Many thanks.

Love you.......Dick

240 North Fifth Street, Suite 380, Columbus, Ohio U.S.A., 43215 Phone (614) 224-3300 Fax (614) 224-3350

FRANKLIN COUNTY MUNICIPAL COURT
JURY COMMISSIONER'S OFFICE
375 - S. High Street • 9th Floor
Columbus, Ohio 43215

614/645-7726

JURY SUMMONS

THE STATE OF OHIO
FRANKLIN COUNTY
CITY OF COLUMBUS

TO RICHARD F. CELESTE
322 W SEVENTH AVENUE
COLUMBUS OH 43201

SIR -- MADAM:

I am commanded to summon you to report for Jury Duty for a period of two (2) weeks commencing AUGUST 30, 19 93. You are to report to the Jury Commissioner's Office, 9th Floor, Franklin County Municipal Court, 375 South High Street, at 8:45 A.M., and to remain in the Court until dismissed for the day. Duty will be limited to five (5) days, Monday through Friday of each week. Failure to appear will subject you to the penalty provided by law.

Respectfully yours,

Franklin County Municipal Court
and the seal of said Court at

(SEAL)

Columbus, Ohio AUGUST 9, 19 93

Tom Shields

Jury Commissioner

PLEASE CALL 645-7726 UPON RECEIPT ****

645-7726

THE STATE OF OHIO
FRANKLIN COUNTY
CITY OF COLUMBUS

I certify this to be a true copy of the Original Summons

Deputy Bailiff

MC-79-JC-04

Celeste & Sabety Ltd.

FACSIMILE COVER SHEET

From: DICK CELESTE

Fax: (614) 224-3350

Date: 8/30/93

To: BETTY CURRIE
OFFICE OF THE PRESIDENT

Fax: 202/456-2883

Number of pages: Cover + 3. If there are any problems in transmitting this document or you do not receive all pages, please contact us at (614) 224-3300.

Message:

240 North Fifth Street, Suite 380, Columbus, Ohio U.S.A., 43215 Phone (614) 224-3300 Fax (614) 224-3350

THE WHITE HOUSE
WASHINGTON

DATE: 9/1

NOTE FOR: Billy Webster, D of Ed.

The President has reviewed the attached, and it is forwarded to you for your:

- Information ☐
- Action ☑

See President's note --
"Make sure Billy Webster sees that this is looked into."

Thank you.

JOHN D. PODESTA
Assistant to the President
and Staff Secretary
(x2702)

cc:

~~Have the~~

Make sure Billy Wilson

~~[illegible]~~

sees that stair is locked

with—

THE WHITE HOUSE

WASHINGTON

September 1, 1993

Mike Willbanks
2104 Broadview
Conway, Arkansas 72032

Dear Mike:

Thanks for your letter. I appreciate your words of support and encouragement.

I also appreciate your letting me know of your problems with Sallie Mae and its Loan Servicing Center. I have taken the liberty of forwarding your letter to Richard Riley, Secretary of Education.

Sincerely,

Bill Clinton

August 24, 1993

President Bill Clinton
The White House
1600 Pennsylvania Avenue NW
Washington, DC 20500-2000

Mr. President:

Please let me take this opportunity to encourage you in your efforts to bring the kind of change to the federal government as you did here in Arkansas. Just keep moving in a new direction, and hold no fear of failure. It is those who fear failure who never try to change. Your efforts for the continuous improvement of our government may not bring the success you seek, but at least you are making the effort. If we were all like Bob Dole, we would find ourselves tomorrow where we were yesterday.

I want to ask you to forward the rest of this letter to your staff person who is most interested in my opinion and problems with the Sallie Mae student loan program. In short, ever since the local banks were allowed to sell our loans to Sallie Mae institutions, borrowers have had hell to pay.

Both my wife and I are repaying loans acquired through the Perkins Loan program. The Sallie Mae, Loan Servicing Center (LSC), Panama City, Florida, collects and manages our loans. We have been in repayment for over a year now. In the brief period we have been dealing with LSC, we have seen the absolute most mismanaged, inconsiderate, and ludicrous behavior we have ever experienced in our 27 years of marriage. A few examples:

- telephoning us to tell us we were uncooperative by not revealing our change of address when, in fact, we have lived at the same address for 5 years.
- calling my wife a liar when she answered a question regarding her graduation date.
- sending billing threats to take us to court over a $0.00 past due amount.
- acknowledging receipt of payment in one sentence, then threatening to sue us if we didn't send in the same payment acknowledged.
- starting my wife's repayment date months before she finished her course of study, and refusing to correct it according to the 6 month period after graduation allowed by law.

In short, these people exhibit an inferior ability to manage the information system necessary to meet their responsibilities. The Sallie Mae program is totally out of touch with the borrower. There is no way to develop a professional or customer relationship as we can with local lenders. They are, therefore, a non-contributor to local economic growth.

Sir, the biggest burn over the Sallie Mae issue is that we, the borrower and citizenry, have absolutely no choice in the matter at all, except to chose not to participate in the Perkins Loan program.

Mr. President, please do away with the Sallie Mae program and put the Perkins Loan program back in the hands of local lenders and local communities where it belongs.

Thank you for your attention.

Respectfully,

Mike

Mike Willbanks
2104 Broadview
Conway, Arkansas 72032

THE WHITE HOUSE
WASHINGTON

DATE: 9/1

NOTE FOR: Kristine Gebbie

The President has reviewed the attached, and it is forwarded to you for your:

Information ☐

Action ☑

Re the President's note:
Please follow up &
let me know the outcome
Thanks.

John

Thank you.

JOHN D. PODESTA
Assistant to the President
and Staff Secretary
(x2702)

cc:

To Wexler
cc: Kristine Gebbie,
Director, Office of
Nat'l AIDS Policy
Kimbu
Pls. contact him
importance to me
B.

THE WHITE HOUSE

WASHINGTON

September 1, 1993

Randall Jacobs, M.D.
Port Townsend Family Physicians
934 Sheridan Avenue
Port Townsend, Washington 98368

Dear Randy:

Thank you for your letter and for sending the photographs from Boys Nation. It was kind of you.

I appreciate your offer of help on our AIDS policy, and I have taken the liberty of sharing your letter with Kristine Gebbie, Director of the Office of National AIDS Policy.

I want you to know that you and Mary are in our prayers. We will be thinking of you in the days to come.

Sincerely,

Bill

Trey

port townsend
family physicians, inc., p.s.

DIPLOMATES, AMERICAN BOARD OF FAMILY PRACTICE

J. RANDALL JACOBS, M.D. DOUGLAS KURATA, M.D. ANNE E. BIEDEL, M.D.

August 26, 1993

William J. Clinton
President of the United States
1600 Pennsylvania Avenue
Washington D.C. 20500

Dear Bill,

Thank you for your note and great alumni picture from last month's 1963 Boys Nation reunion in the Rose Garden. I found a couple of old snapshots I had taken in 1963 of you, and obviously you haven't changed a bit! These prints are yours to keep.

As you know, my wife Mary is in the last stage of her battle with AIDS. Since our visit last month, she has become bedfast, requiring continual bedside care. The dementia complex has advanced to the point where we have had to heavily tranquilize her. Fortunately, I've been able to take some leave from my practice to help her and our three children thru this difficult time. God has answered every need and for that we are grateful. I doubt she has more than a few more weeks with us. We simply trust God and His plan for her.

As a physician, I've had significant clinical experience with AIDS patients. As a husband and father, I've been taught a great deal more about the illness and about life itself. If I can ever be of any assistance to you or your staff in support of AIDS policy and legislation promoting research and human services please let me know. I would consider it an honor to be called upon.

Thank you again for your compassion and personal interest. I hope your vacation was renewing for you and your family.

Respectfully,

Bob Jacobs

Randall Jacobs, M.D.

934 SHERIDAN, PORT TOWNSEND, WASHINGTON 98368

TELEPHONE 385-3500 AFTER HOURS BUSINESS OFFICE

THE WHITE HOUSE
WASHINGTON

DATE: 9/1

NOTE FOR: Carol Rasco

The President has reviewed the attached, and it is forwarded to you for your:

Information ☑

Action ☐

Carol —
I'll have correspondence do a ty
JDP

Thank you.

JOHN D. PODESTA
Assistant to the President
and Staff Secretary
(x2702)

cc: Tim Dorskin

8/31

THE PRESIDENT'S COMMITTEE ON
EMPLOYMENT OF PEOPLE WITH DISABILITIES
1331 F STREET, N.W., WASHINGTON, D.C. 20004-1107
(202) 376-6200 VOICE (202) 376-6205 TDD (202) 376-6219 FAX

93 AUG 16 A10 : 31

CHAIRMAN

Chano FYI- Hello Roselle

August 10, 1993

Mr. John Podesta
Staff Secretary
The White House
Washington, DC 20500

Dear Mr. Podesta:

I was moved by the actions of the President and the Attorney General in observance of the third anniversary of the signing of ADA. The policy discussions with the leadership of the disability community, the cutting edge appointments, the policy statements, were magnificent. Finally people with disabilities are beginning to be included as real citizens. This is people first change, people first democracy at its best.

Enclosed is a copy of a special report of these happenings which I wrote. It has been sent to more than three thousand disability community leaders throughout the nation, and to many abroad.

I appreciate your personal contributions to the progressive disability policy of the Clinton Administration.

Sincerely,

Justin Dart

I believe these events indicate progress for disability rights. Congratulations! Justin

President's Committee on Employment of People with Disabilities

Washington FAX

An update of activities, programs and projects of the President's Committee

August 1993 **Special ADA Anniversary Issue** **Vol. 1, No. 9**

by
Justin Dart

HISTORIC FACE-TO-FACE DIALOGUES WITH PRESIDENT AND ATTORNEY GENERAL, LANDMARK PRESIDENTIAL APPOINTMENTS, NEW YORK MARCH, MAJOR MEDIA FOCUS, VICTORY FOR AIRLINE ACCESS HIGHLIGHT NATIONWIDE ADA BIRTHDAY CELEBRATIONS

Colleagues, ADA had a great third birthday party. President Clinton and Attorney General Reno came through for justice. Many major media entities came through for justice. Most importantly, thousands of you came through for justice. People with disabilities still face a long, perilous march to the promised land of full equality and full empowerment. But the last few days have demonstrated once again the potential of united advocacy and people first democracy. My mind and spirit are lifted from the cloudy probable to the shining possible.

I could not begin to list all of your magnificent ADA birthday events; this is a summary of happenings in which I was privileged to participate -- or of which I have personal knowledge.

JULY 23, PRESIDENT CLINTON ISSUES A SPECIAL HAPPY BIRTHDAY ADA MESSAGE TO THE NATION: "Our country doesn't have a single person to waste, and we must invest in each person's enormous potential by fully implementing the Americans with Disabilities Act. . . . My Administration is committed to shifting disability policy away from exclusion, towards inclusion; away from dependence, towards independence; away from paternalism and towards empowerment."

JULY 26, THE PRESIDENT ADDRESSES A CHICAGO CONFERENCE ON THE WORKPLACE OF THE FUTURE: "There is one group of American workers I really want to acknowledge today. This is the third anniversary of one of our most important civil rights laws, the Americans with Disabilities Act. For more than 40 million people, the law is clearing the barriers to full participation in American life. . . ." Marca Bristo, National Council on Disability Chairperson-Designate, was chosen to be one of 12 Americans serving with the President on the gathering's showcase panel.

JULY 26, THE PRESIDENT ANNOUNCES A LANDMARK APPOINTMENT: BOB

WILLIAMS TO BE COMMISSIONER, ADMINISTRATION ON DEVELOPMENTAL DISABILITIES AT HHS. Bob, widely recognized as one of America's most brilliant disability rights leaders, is a UCPA public policy expert, a former Senate aide, a hero of ADA and numerous other battles in Congress. He is the first Presidential appointee in history who uses an augmentative communication device to speak.

JULY 27, THE PRESIDENT ANNOUNCES ANOTHER OUTSTANDING APPOINTMENT: LONGTIME DISABILITY RIGHTS LEADER BOBBY SIMPSON TO BE COMMISSIONER OF THE REHABILITATION SERVICES ADMINISTRATION. Bobby is a former President of the Coalition of Texans with Disabilities, Chairman of the Texas Governor's Committee and Director of the Austin Center for Independent Living. He currently serves as Director of the state vocational rehabilitation program in Arkansas.

JULY 27, THE PRESIDENT HOLDS AN HISTORIC WHITE HOUSE DIALOGUE WITH LEADERS OF MAJOR DISABILITY RIGHTS CONSTITUENCIES. The 45-minute gathering in the Roosevelt Room was dominated by discussion of ADA implementation, health care, long term services reform, and ongoing visible Presidential leadership for disability rights. The President reinforced past pledges of full support for ADA. He expressed general support for the entire disability rights agenda, but cited political and economic barriers. He appealed to the disability rights movement to support his agenda to remove those barriers. The President was enthusiastic and attentive. He took notes.

Before the arrival of President Clinton, statements were made by Senator Tom Harkin, Rep. Steny Hoyer, and White House Deputy Chief of Staff Roy Neel. The President initiated the meeting by using the ADA mandated relay telephone service to call Iowa and speak with Tom Harkin's brother, Frank, who is deaf.

Presenting positions on behalf of the disability community were: Bobby Simpson; Pat Wright, DREDF; Paul Marchand, The ARC and CCD; Joe Rogers, National Mental Health Consumer Self Help Clearing House; Ed Smith, Civil Rights Department, North Carolina; Denise Figueroa, NCIL; Ed Roberts, World Institute on Disability; Marca Bristo, National Council on Disability; I. King Jordan, Gallaudet University; and Mike Auberger, ADAPT.

Others participating included: Daniel Bross, AIDS Action Council; Judi Chamberlin, National Association of Psychiatric Survivors; Laurie Flynn, NAMI; Donald Galloway, Disabled International USA; James Gashel, NFB; Fernando Torres Gil, HHS; Linda Gonzales, Rural Independent Living; Judy Heumann, DOE; John Kemp, UCPA; Oral Miller, ACB; Minion Moore, Democratic National Committee (DNC); Ben Soukup, NAD; Max Starkloff, Paraquad; Hardy Stone, Head Injury Survivors; Anne Vinup, Learning Disability Association of America; Nancy Ward, National Self Advocacy Steering Committee; Bob Williams, and myself. White House staff Mike Lux, Paul Miller, and Debbie Fine, and Robert Sevigny, DNC, also attending, deserve congratulations for arranging the event.

This truly was an historic gathering. I am not aware of any previous policy dialogue with the President that included such a broad representation of the major disability rights constituencies. Oft excluded groups like psychiatric and head injury survivors and people labeled mentally retarded were represented by people with those disabilities. ADAPT was present and speaking. This was people first democracy at its best.

JULY 26, ATTORNEY GENERAL JANET RENO DEVOTES DAY TO ADA. Beginning with a strong ADA editorial she wrote in *USA TODAY*: "As of today, the Americans with Disabilities Act's three year phase-in period is over. It is time to finish the job of turning the Act's promise into reality. . . . We are earnest about our enforcement responsibilities."

--At 11:30 a.m. the Attorney General discussed ADA with a delegation of about 20 disability rights leaders, led by Pat Wright, and including many of us who were to meet with the President the next day. There was detailed discussion of implementation problems and opportunities, with special focus on the need to communicate accurate information about ADA rights and obligations and to convince the nation that the government is serious about enforcement. The Attorney General promised vigorous implementation and enforcement of ADA. She solicited recommendations as to how DOJ activities and staffing related to disability rights can be refined. She announced the assignment of five additional attorneys to ADA enforcement and $2.5 million in ADA technical assistance grants. She appealed to the disability rights organizations to work in partnership with DOJ to keep the promise of ADA.

--At 1:30 p.m. the Attorney General met with leaders of the business community to appeal for voluntary compliance with ADA. She asked them to spread the word that implementation need not be painful, and to seek accurate information from appropriate government agencies and credible sources in the disability community.

--At 2:45 p.m. the Attorney General toured small businesses in Takoma Park, MD, to congratulate them on making their facilities accessible. She was accompanied by a small number of disability community leaders.

--At 3:30 p.m., immediately following the tour, she addressed a group of citizens in a nearby park. "What we see on the main street of this small town is how easy and important it is to comply with the law," she said. She spoke of the ADA as being the means "to break down not only physical barriers but social barriers as well." She urged voluntary compliance, but also said, "Let me make clear that. . . we will take people to court when they thumb their nose at us." The Attorney General was introduced by Pat Wright, and joined on the podium by ADA architect Bob Silverstein, who read a powerful message from Senator Tom Harkin.

JULY 24-27, THE DISABILITY COMMUNITY ORGANIZES ADA BIRTHDAY EVENTS ACROSS THE NATION. A San Diego Disability Pride Parade attracted major media attention. An ADAPT crawl-in to inaccessible restaurants in Austin, TX, resulted in a great *New York Times* photo of Bob Kafka dragging his body across the floor of a fashionable eatery. Perhaps most prominent among the ADA birthday celebrations was a Disability Independence Day march down Madison Avenue in New York by about 2,000 disability rights advocates. Speakers at the subsequent rally included Marca Bristo, Frank Bowe, Judy Heumann, Paul Hearne, Denise Figueroa, Greg Hlibok, Ottmar Miles-Paul, and myself. This event, "to celebrate the ADA, and advocate for universal health care and universal communications," was covered by major national TV and print media. Congratulations to organizer Daniel Robert and his colleagues.

JULY 30, FORMER PRESIDENT BUSH MEETS IN KENNEBUNKPORT WITH DISABILITY COMMUNITY LEADERS AND ADMINISTRATION COLLEAGUES WHO WORKED ON ADA. The bipartisan group of about 35 persons celebrated the third anniversary of ADA and discussed opportunities for Mr. Bush to support disability rights in the future. He was presented with the first Bush Medal for historic contributions to disability rights -- an award which had been announced at a Washington event earlier in the year. After lunch at a local hotel, the group moved to the nearby Bush home. Participants included former Attorney General Dick Thornburgh, former White House General Counsel C. Boyden Gray, Lex Frieden, Evan Kemp, Max Starkloff, Oral Miller, Paul Hearne, Osborne Day, Judi Chamberlin, Steve Tremblay, and myself.

JULY 22-31, NATIONAL AND LOCAL MEDIA LIGHT HUNDREDS OF CANDLES FOR THE ADA BIRTHDAY CAKE. There were prominent and generally positive articles about the law and its impact in *The Wall Street Journal*, *USA TODAY*, *The Washington Post*, *The New York Times*, *The Chicago Tribune*, and many other newspapers. There were numerous similar focuses on ADA by television and radio. On July 22, Pat Wright and I were guests on NBC's "Today Show." Pat rattled hostess Katie Couric and NBC management by pointing out on live camera that the studio was inaccessible -- in violation of ADA, -- and questioning the number of employees with disabilities. I added that "we are no longer your eternal children, your pet dogs and cats. . . ." According to "reliable sources," the show was followed by all-day management meetings focused on accessibility and diversity in employment.

JULY 31, THE FIREWORKS GRAND FINALE VICTORY OF ADA'S THIRD BIRTHDAY PARTY started when United Express refused to assist President's Committee Director Rick Douglas to board its commuter flight from Washington's Dulles Airport to Allentown, PA. Rick's wife Nancy Flinn got a picture of him crawling up the steps that appeared in major newspapers across the nation and on major TV networks. A front page *Washington Post* article was entitled "Crawling Before He Can Fly." In a prominent editorial *USA TODAY* said, "All Americans should be embarrassed that things like this still happen. . . . Complying with rules is not the point. . . . Local governments and businesses should act aggressively to provide access to disabled employees, customers and clients. Not just because it's a civil rights law. Or because it can be good business. They should make new opportunities for people with disabilities because it is the right thing to do." After meeting with Rick on August 4, United Airlines chief Stephen Wolf announced that henceforth United would "work closely with its commuter carriers to ensure that every reasonable effort is made to accommodate and assist customers with dsabilities who travel on small aircraft."

IT WAS A HAPPY THIRD BIRTHDAY PARTY FOR ADA. Congratulations to all who worked to brighten the torch for democracy. Now we must unite to keep the promise of ADA to the millions who will never attend a White House meeting or appear on television, who remain imprisoned every hour of every day by environments, attitudes and policies that violate the most fundamental rights of human beings. It's going to be a long, hard struggle, but I believe we will win -- because I believe in you. And I love you. Together we have overcome. Together we shall overcome.

THE WHITE HOUSE
WASHINGTON

DATE: 9/1

NOTE FOR: Carol Rasco

The President has reviewed the attached, and it is forwarded to you for your:

Information ☐

Action ☑

Thank you.

JOHN D. PODESTA
Assistant to the President
and Staff Secretary
(x2702)

cc:

G SEP 1 A8:13

DO NOT
SEND THIS
LETTER — SEND
TO C. RASCO
INSTEAD —

BC

Do Not,
Send – instead
Send to
Crane

Is this
importance
enough?
is he right?
Sound,
Serious Advice

THE WHITE HOUSE

WASHINGTON

Dear Representative McMillan:

Thank you for your letter regarding the budget implications of a final Medicaid regulation published by the Health Care Financing Administration (HCFA). Your point about the need to be mindful of the budgetary effects of regulatory changes in well taken.

The final regulation, implementing "The Medicaid Voluntary Contribution and Provider-Specific Tax Amendments of 1991," was published on August 13, 1993. It incorporated revisions made to the interim regulation [published on November 24, 1992] as a result of numerous public comments received during an open comment period. The specific change you mentioned, permitting states with low spending on disproportionate share hospitals (low-DSH states) to increase this spending by a growth factor, is consistent with the law. Additionally, while the revisions may have a budgetary effect, they were designed to balance the need to be sensitive to the federal budget with the desire to be responsive to state concerns.

Like you, I am acutely aware of the burden the budget deficit places on our economy and society. My commitment to reducing the deficit is evidenced by the $496 billion deficit reduction package I signed into law earlier this month. As you noted, current law does not require regulatory changes to be scored. This allows the federal government to achieve both marginal savings and marginal costs through regulations. At this time, I believe the current Budget Enforcement Act strikes the proper balance between discretionary and entitlement expenditures in its mechanisms to control federal spending.

I am equally concerned about the rising costs of Medicaid and Medicare, and the effect health care spending in general is having on the nation.

I am looking forward to sending to Congress my health care reform proposal which will address these and many other issues. Our country cannot afford to let the status quo continue.

Sincerely,

Bill

The Honorable J. Alex McMillan
House of Representatives
Washington, D.C. 20515

THE WHITE HOUSE

WASHINGTON

Dear Representative Kasich:

Thank you for your letter regarding the budget implications of a final Medicaid regulation published by the Health Care Financing Administration (HCFA). Your point about the need to be mindful of the budgetary effects of regulatory changes in well taken.

The final regulation, implementing "The Medicaid Voluntary Contribution and Provider-Specific Tax Amendments of 1991," was published on August 13, 1993. It incorporated revisions made to the interim regulation [published on November 24, 1992] as a result of numerous public comments received during an open comment period. The specific change you mentioned, permitting states with low spending on disproportionate share hospitals (low-DSH states) to increase this spending by a growth factor, is consistent with the law. Additionally, while the revisions may have a budgetary effect, they were designed to balance the need to be sensitive to the federal budget with the desire to be responsive to state concerns.

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I am equally concerned about the rising costs of Medicaid and Medicare, and the effect health care spending in general is having on the nation.

I am looking forward to sending to Congress my health care reform proposal which will address these and many other issues. Our country cannot afford to let the status quo continue.

Sincerely,

The Honorable John R. Kasich
House of Representatives
Washington, D.C. 20515

ID# 030811

THE WHITE HOUSE
CORRESPONDENCE TRACKING WORKSHEET

INCOMING

DATE RECEIVED: AUGUST 03, 1993

NAME OF CORRESPONDENT: THE HONORABLE ALEX MCMILLAN

SUBJECT: DISCUSSES CONCERN REGARDING THEV BUDGET IMPLICATIONS OF A HCFA (HEALTH CARE FINANCING ADMINISTRATION)

ROUTE TO: OFFICE/AGENCY (STAFF NAME)	ACTION: ACT CODE	ACTION: DATE YY/MM/DD	DISPOSITION: TYPE RESP	DISPOSITION: C D	DISPOSITION: COMPLETED YY/MM/DD
HOWARD PASTER	ORG	93/07/29	HP	A	93/07/29
REFERRAL NOTE: DI					
HOWARD PASTER	RSA	93/08/03			/ /
REFERRAL NOTE:					
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COMMENTS:

ADDITIONAL CORRESPONDENTS: MEDIA:L INDIVIDUAL CODES: 1240

__ MAIL USER CODES: (A)R NC______ (B)__________ (C)__________

*ACTION CODES:	*DISPOSITION	*OUTGOING CORRESPONDENCE:
*A-APPROPRIATE ACTION	*A-ANSWERED	*TYPE RESP=INITIALS OF SIGNER
*C-COMMENT/RECOM	*B-NON-SPEC-REFERRAL	CODE = A
*D-DRAFT RESPONSE	*C-COMPLETED	*COMPLETED = DATE OF OUTGOING
*F-FURNISH FACT SHEET	*S-SUSPENDED	
*I-INFO COPY/NO ACT NEC		
*R-DIRECT REPLY W/COPY		
*S-FOR-SIGNATURE		
*X-INTERIM REPLY		

REFER QUESTIONS AND ROUTING UPDATES TO CENTRAL REFERENCE (ROOM 75,OEOB) EXT-2590
KEEP THIS WORKSHEET ATTACHED TO THE ORIGINAL INCOMING LETTER AT ALL TIMES AND SEND COMPLETED RECORD TO RECORDS MANAGEMENT.

SCANNED

ALEX McMILLAN
9TH DISTRICT
NORTH CAROLINA

DSX 11

COMMITTEE ASSIGNMENT
ENERGY AND COMMERCE COMMITTEE
BUDGET COMMITTEE
REPUBLICAN LEADER'S TASK FORCE ON HEALTH
REPUBLICAN LEADER'S TASK FORCE ON THE ECONOMY

Congress of the United States
House of Representatives
Washington, DC 20515-3309

93 JUL 29 P4:04

July 28, 1993

William J. Clinton
President
The White House
1600 Pennsylvania Ave. NW
Washington, DC 20500

Dear Mr. President:

We are writing you with grave concern about the budget implications of a HCFA regulation due out in September of this year as a result of a recent agreement between your Administration and the National Governor's Association on the so-called "Low-Disproportionate Share" (low-DSH) state issue.

We understand that this agreement was a result of negotiations and information presented during an open comment period between the time the first interim regulation was issued on November 24, 1993. The issue at stake had to do with whether or not the low-DSH states were constrained from receiving a suitable growth rate under the Medicaid disproportionate share program relative to the high-DSH state because of the 12% aggregate cap.

Our purpose in this letter is not to confirm or deny the need for revisions to the interim rule. In fact, parts of the agreement relating to states' flexibility should proceed as quickly as possible. However, our intent is to use this regulatory change as a prime example of why you and this Congress must pass a budget enforcement law similar to the one introduced by Congressman Alex McMillan, HR 2172, The Health Care Reform Budget Enforcement Act of 1993 in order to get a firm handle on entitlement spending that is completely out-of-control.

According to various sources, the Administration reached a deal with the National Governors Association in late May, 1993 which will increase Medicaid spending by close to $700 million in the first year and possibly up to $5 billion in the fifth year through increased payments to the 31 "low-DSH" states and the District of Columbia without providing the means to pay for it. This regulation, to be issued by HHS in September, we are told, clearly identifies the acute need for passing a bill such as HR 2172 because it would prevent Congress, the Administration, the federal agencies and the nation's governors from passing amendments or bills or regulations that increase spending <u>without some corresponding offsetting savings in existing programs or revenue measures to pay for them in the current</u>

fiscal period.

As current budget law now stands, regulations such as this one on "low-DSH" states are not explicitly scored by CBO since it is a regulatory change, not a statutory change, even though the change will definitely have a significant impact on the already exploding Medicaid baseline. If some current estimates of this one change are to be believed, this one change could increase the Medicaid baseline by up to $10 billion over the next five years. If we think the current budget reconciliation process had problems dealing with reductions in the Medicaid program, try to imagine explaining to the American people next year why the Medicaid baseline is up $10 billion because of this one regulatory change alone and nothing was done at the time of agreement or implementation to pay for it.

We are asking you to do one of the following alternatives to rectify this situation. One, we would like to work with you and your staff to come up with off-setting spending reductions in other Medicaid programs to pay for the cost of this new regulation. At least under this option, we will be returning the Medicaid baseline to what it would have been without this change so that next year, we won't have a extra $10 billion mountain to climb during the budget process.

Second, in the absence of finding the spending reductions to offset this cost, we would like to ask you to withhold the issuance of the regulation until such spending reductions can be found. We think it is only fair to the American taxpayer that more spending be put on hold until a way is found to pay for it.

Third, if you do not agree that any spending reductions need to be found to offset the increase in the low-DSH regulation, we suggest that you ask for specific additional revenues to be passed in order to pay for the increase in spending. It is unreasonable to engage in the polemics of deficit-reduction on the one hand while on the other, efforts by your Administration are underway to increase the size of future deficits that can't be scored by the current CBO process. Such is Kafkaesque budgeting, at best.

Thank you for taking our serious concerns into your consideration. We want to help reduce the burden that continued budget deficits place on our economy and society and we urge you in the strongest way possible to take steps to correct the imbalance in the budget that will occur as a result of this soon-to-be-issued regulation on low-DSH states.

Sincerely,

Alex McMillan
Member of Congress

John Kasich
Member of Congress

THE WHITE HOUSE

WASHINGTON

July 29, 1993

Dear Representative McMillan:

Thank you very much for your letter to President Clinton concerning the proposed regulation of the Health Care Financing Adminstration.

The President has been advised of your interest in this matter and you should be hearing from him in the near future.

If I can be of further assistance, please do not hesitate to contact me.

With best wishes,

Sincerely,

Howard G. Paster
Assistant to the President
for Legislative Affairs

The Honorable Alex McMillan
House of Representatives
Washington, D.C. 20515

THE WHITE HOUSE

WASHINGTON

July 29, 1993

MEMORANDUM FOR CLAUDIA COOLEY

FROM: HOWARD G. PASTER HP

SUBJECT: PRESIDENTIAL CORRESPONDENCE

Attached is a copy of a letter that was sent to the President from Alex McMillan (R-NC) and John Kasich (R-OH). I have also enclosed a copy of my acknowledgement letter to him as well.

The President has requested that he see and sign every letter going to Capitol Hill. We did not want to fully answer the questions addressed in this letter without assistance from your office; therefore, I would appreciate your office drafting a response and returning it to LeeAnn Inadomi (WH-East Wing) within 48 hours. She will then print the letter in final form and have the President sign the letter.

Thank you very much for your assistance. If you have any questions, please feel free to call LeeAnn at 456-7500.

Attachments

THE WHITE HOUSE
WASHINGTON

DATE: 9/1

NOTE FOR: George S., Tony Lake

The President has reviewed the attached, and it is forwarded to you for your:

Information ✓
Action ✓

Will - can you do a quick reply

Thank you.

JOHN D. PODESTA
Assistant to the President
and Staff Secretary
(x2702)

cc: Will Itoh

9/1

THE WHITE HOUSE

WASHINGTON

93 AUG 31 P12:27

MEMORANDUM TO THE PRESIDENT

FROM GEORGE STEPHANOPOULOS

SUBJECT ATTACHED MEMO FROM LLOYD N. HAND

Would you like me to follow up on the attached memo from Lloyd N. Hand regarding strengthening the Administration's relations with accredited Chiefs of Foreign Missions?

I've already passed it on to Molly Raiser, Warren Christopher and Tony Lake. Would you like any other special handling?

No but
Tony should program
a report to me —
This is interesting

LAW OFFICES
VERNER, LIIPFERT, BERNHARD, McPHERSON AND HAND
CHARTERED
SUITE 700
901-15TH STREET, N.W.
WASHINGTON, D.C. 20005-2301
(202) 371-6000
TELECOPIER: (202) 371-6279

MEMORANDUM

TO: *The President*
ATTN: *George Stephanopolous*

FROM: *Lloyd N. Hand* Lloyd

RE: *Strengthening Relations With Accredited Chiefs of Foreign Missions*

DATE: *August 17, 1993*

During dinner at the White House recently, you asked me to describe some of the specific ways in which I think you can both develop and sustain stronger and more useful relations with the diplomatic community – and do it efficiently. Although most of these suggestions are drawn from my experience as LBJ's Chief of Protocol, I realize that the size of the diplomatic community has grown substantially (from about 125 then to about 165 today) – and new initiatives are more costly and more difficult now than in those days.

I was pleased to hear the high value you place on the quality of the relationships between the diplomats and the White House because currently, as you probably know, there are rumors abounding within the diplomatic community that you hold a different view, e.g., you intend to discontinue state dinners, White House staff is unconcerned about slow pace for accrediting foreign diplomats, expectations that the Blair House will not be offered to visiting foreign chiefs of state and heads of government, etc., etc. I doubt that any of this is true, but if it is, I hope to have the opportunity to speak with you or your staff before any of these measures are implemented. If the value of good relationships with the diplomats justifies the expenditure of your time, its important to avoid an unintended signal to the contrary, as some of the foregoing may indicate. I know you recognize, Mr. President, by your *comments to me, that with rare exception only the most senior and capable foreign diplomats are posted to Washington as the personal representatives of their sovereigns. Moreover, when many of them return home they undertake senior assignments within their government, e.g., Foreign Minister, Prime Minister, and some, President (for example, President Thomas Klestil of Austria). In addition, these foreign diplomats, while assigned here, are considered useful "sources" by our domestic and foreign press regarding foreign policy initiatives, or even on your performance on domestic policy as well as foreign policy. They also serve as important communication links with their Presidents and Prime Ministers, and are often opinion makers within their respective countries. Any one of the foregoing justifies, the use of your time and your staff's, albeit efficiently, to cultivate and maintain as good a relation with the diplomats as possible.*

Here are some of the activities we undertook during the Johnson years which may be worth considering:

(1) With assistance of the relevant State Department desk officer, I would identify four or five diplomats with common interests, to invite to the Fish Room (now Roosevelt Room) for an "informal lunch with the President," his assistant (usually Jack Valenti), the Assistant Secretary for the region represented and me. No others. The "informal lunch" consisted of President Johnson participating in the entire luncheon, (or one or two bites of a hamburger, or stopping in for dessert and coffee – from 5 minutes to 45 minutes) focusing on those things of interest to the diplomats. Most often he would drop in at the beginning or at the end of lunch, perhaps only for coffee, bringing with him whichever visitor happened to be in the Oval Office at the moment – Chairman of Joint Chiefs, visiting Foreign Dignitaries, et al. Whether he spent five minutes or forty-five minutes, it was a spectacular success in drawing closer to him each of those Ambassadors. We had ways of knowing that when they cabled their foreign office immediately following the lunch, it was reported as "I had lunch with the President today." Whether the subject chosen was desalinization affecting Middle Easterners or African food shortages, or whatever, made little difference. The Ambassadors relished the opportunity for a personal visit with the President. The same would be for you. On a number of these occasions, President Johnson would announce that he was dispatching me and Valenti in Air Force One to take as many of the diplomats as the plane would hold to visit the desalting plants in Texas, or perhaps a space launch from Cape Canaveral, or a visit to a site of some activity relating to the topic or topics of interest to the members of the Diplomatic Corps. While the topics of today will undoubtedly be different, the fact that you display sensitivity and respond to their needs and concerns and are willing to share U.S. resources and know how, sends a powerful positive signal.

(2) On several occasions, we would divide up the Diplomatic Corps into several groups for a cruise down the Potomac aboard the Sequoia (gone, of course, thanks to President Carter). While I realize the Sequoia and the Honey Fitz are no

longer available, the Chief of Naval Operations has other boats – and there are other ways, with the imagination and resoursefulness of your able staff to demonstrate your interest in getting to know these diplomats on a personal basis.

(3) LBJ engaged in brief, private chats with the diplomats either in the Lincoln Treaty Room or the Red Room, following the formal accreditation process. They loved it. He could ask about their children, about their lives before diplomacy, their Chief of State or head of government, or (although discouraged by State) about substantive policy matters between the two countries. While this requires some preparation, it makes a lasting impact. Since you are without peer in one-on-one meetings, I know that this would be a particularly productive opportunity for you to impress upon a new Ambassador your interest in him, his country, and our bilateral relationship. [Note: In addition to the value of establishing personal relationships with Foreign Ambassadors (and photographing same) it's equally important to establish the same rapport between you and the Ambassadors you appoint to represent you abroad enabling them to display at their residence and Embassy informal photos of the Ambassador and his wife with you and Hillary. This sends a mighty strong signal of support.]

(4) Although it was never publicized, I would occasionally, at LBJ's urging, bring a diplomat in through the southwest entrance and up to the family quarters for a private meeting when an issue arose requiring a very personal and direct message from the President through that Ambassador to his sovereign. It was an effective way for unabridged communication. Not used often, but when used, used effectively. As you know, members of the Diplomatic Corp are very sensitive to the amount of time each is accorded by the President, and they monitor the time spent with others to ensure they are afforded equal treatment. Treating each exactly alike is simply not practical but, nonetheless, an expectation to which great care and sensitivity is required by the White House – and the Chief of Protocol.

Some of the things that we didn't do, but which I think are deserving of consideration, space and time permitting, are the following:

(a) Inviting the Diplomatic Corps to the Rose Garden whenever you have announcements on foreign policy initiatives of particular significance, to ensure that the diplomats get the flavor and the body language as well as the printed word from a press release. The press briefing room in EOB is too limited to permit this but on occasion, when the message and circumstances warrant it, it's an effective way, again, of signaling to them you consider them important links to their countries, and important sources of information.

(b) Ensure that your Chief of Protocol (your personal Ambassador) while attending the never ending round of national day receptions, dinners, etc., conveys *from you personally some brief but personal message about your view of the value of your relationship with the country whose Embassy is being visited and its Ambassador. This can also be done in the form of mementos, gifts, etc., but this gets both expensive and somewhat hokey. This need not be a substantive message that impinges on the responsibility of the State Department, but something of a personal nature.*

(c) Ensure that the Chief of Protocol, when organizing the details of the state or official visit understands and communicates the policy consequences of that visit. This can be an effective and efficient way to reinforce the official policy line that is bound to be reiterated during the course of the visit itself. Often times the Chief of Protocol spends more time with the President or Prime Minister visiting than with any other government official, including yourself. Not to use that opportunity for a substantive interaction is inefficient and fails to avail you and State of an important opportunity. (Note, in this regard, President Johnson insisted that I receive a copy of the very same briefing book that was prepared by State and NSC for him and the Secretary of State.) It was very helpful to understand what were the substantive objectives to be accomplished during the course of a state, official, or working visit.

Mr. President, I hope these thoughts and suggestions will be useful to you and to your staff in developing closer ties with foreign diplomats posted here. If scheduled and managed properly, they should entail a minimal use of your time with high leverage results. If I can expand on any of these individual suggestions, or assist you or your staff in any way, it would please me to do so.

Again, Ann and I thoroughly enjoyed our evening at the White House with you and Hillary, and it was good to chat with you at Jim Blanchard's swearing in ceremony. I can't remember when a U.S. Ambassador was sworn in at the White House with the President and Vice President presiding. I hope the Canadians got the powerful message that was intended by holding Jim's swearing-in at the White House – and also by your eloquent remarks underscoring the importance of strong Canadian - U.S. relations.

Still hoping to join you on the links one of these days!

THE WHITE HOUSE
WASHINGTON

DATE: 09/01/93

NOTE FOR: KATIE MCGINTY

The President has reviewed the attached, and it is forwarded to you for your:

Information ☐

Action XX

Thank you.

JOHN D. PODESTA
Assistant to the President
and Staff Secretary
(x2702)

cc:

THE PRESIDENT HAS SEEN 8/31

THE WHITE HOUSE

WASHINGTON

August 19, 1993

93 AUG 19 P12:55

Who will brief Breaux, Bumpers, Mathews about this — Pryor too. Get a news story at least & a heads up

MEMORANDUM FOR THE PRESIDENT

FROM: Katie McGinty

SUBJECT: Administration Wetlands Policy Initiative

I. **ACTION-FORCING EVENT:** The Interagency Working Group on Federal Wetlands Policy, chaired by OEP, has completed a review of wetlands policy. The group has reached consensus on all issues contained in the attached package. **The historic significance of this fact should not be underestimated. Like the forest issue, this is one on which the agencies have been bitterly divided for years.**

We are required to submit one provision of this package to the Federal Register on August 23 to comply with the settlement of a court case. It will be available to the public on August 24. That provision will expand the scope of activities regulated under the Federal government's wetlands regulatory program. In the current climate, there is a general consensus that it would be a political mistake for the Administration's first public action on this issue to be an expansion of the regulatory program. **Therefore, I recommend that we release our whole package of initiatives on August 24, in order to give equal attention to the regulatory reforms contained in the proposal.**

II. **BACKGROUND/ANALYSIS:** On April 28, 1993, you received a letter from seven Members of the U.S. Senate asking that you establish a working group on federal wetlands policy (Breaux, Pryor, Bumpers, Johnston, Mathews, Sasser, and Ford). Attached to the letter from the Senators was an excerpt from a Mississippi Delta Commission report concerning wetlands policy that you released in 1990.

We agreed to this request and established the Interagency Working Group. The working group sought the views of a broad range of stakeholders representing all perspectives in the wetlands debate. Presentations were received from: a bipartisan group of eight members of the U.S. Congress; representatives of state and local government; environmentalists; the development community; agricultural interests; scientists and others.

After listening to all sides, the working group drafted the attached document which has been approved by all of the participating agencies. It has also been reviewed and approved by CEA, NEC, and DPC. I believe that the working group has crafted a proposal that is sound policy and the best politics achievable, given the political volatility of the issue.

Balance in this package is achieved by way of a two-pronged policy approach: (1) we demonstrate strong support for the protection of America's wetlands by maintaining the heart of the current regulatory program; and (2) we identify meaningful improvements in the implementation of that regulatory program to make it more fair, flexible, efficient, responsive, and predictable.

III. Stakeholders

A. National Governors' Association

The NGA adopted a comprehensive wetlands policy last year which is to a very large extent consistent with this proposal. We have been consulting with them regularly and believe that they will be prepared to endorse it in congressional hearings later this fall. Securing the support of the NGA is one of the important components of our overall political strategy.

B. Congressional Supporters of Wetlands Programs

We also expect strong support from Congressional supporters of wetlands protection. OEP has kept in close touch with the Congressional committees of jurisdiction during the formulation of the proposed Administration policy. This package is quite similar to S. 1304, a wetlands bill introduced by Sens. Baucus and Chafee. We expect support from Sens. Baucus, Chafee, Graham (Senate Environment and Public Works) and Leahy (Senate Agriculture). We also expect the support of Rep. Mineta (House Public Works) and Rep. Studds (House Merchant Marine).

C. Congressional Critics of Wetlands Programs

Congressional critics of the current wetlands regulatory approach will find things to like and dislike in our proposal. We have not abandoned the current regulatory approach, as they have suggested, but we have embraced a number of proposals that they should be pleased with, such as instituting an appeals process for permit denials, imposing deadlines on the permit review and approval process that will lend certainty to the process and speed government action, mitigation banking, and flexibility guidance.

The two major concerns that we have not met are takings and categorization. We declined to endorse their takings legislative proposal on the grounds that these questions are extremely fact specific and are best decided in the courts rather than through legislative fiat. Categorization, as they see it, involves classifying all wetlands as high, medium or low value, and would require Federal purchase of all high value wetlands. The working group concluded that this is technically impossible, scientifically unsound, and fiscally prohibitive. The CBO estimated the cost of their plan would range from $10 billion to $45 billion.

D. **Agriculture**

Our package should address the major concerns of agriculture. We have excluded prior converted cropland from regulation, we have put the Soil Conservation Service in charge of wetlands determinations on agricultural land, and we support the Wetlands Reserve program. I do not, however, expect ringing endorsements from the agricultural community because they, like some Congressional critics, would support a dramatic weakening of the wetlands protection regime.

E. **Environmentalists**

Our proposal should receive a qualified endorsement from the environmental community. Some will be very nervous about some of the regulatory reform measures because they are concerned that we are opening loopholes that will result in weaker wetlands protection. Overall, however, because of pressures to completely dismantle the wetlands program, the environmental community will be relieved if we are able to maintain -- as we do here -- the basic structure of the program.

F. **Developers, Realtors and Homebuilders**

Like the wetlands critics in Congress, developers, realtors, and homebuilders will have mixed feelings about the package. They still will be required to engage in compensatory mitigation when their activities damage wetlands. At the same time, however, the regulatory reforms will be appealing to them; our efforts to increase certainty and eliminate inefficiency in the administration of the program will be very welcome.

IV. **Mississippi Delta Commission Report**

For the record, the Mississippi Delta Commission Report states that "(t)he national wetlands policy has created significant problems for agriculture, aquaculture and commercial and industrial development." The problems referred to in the Report specifically relate to the 1989 "delineation manual" that was used by the Corps and EPA to identify wetland areas. The approach endorsed here addresses this concern by reverting to the use of the 1987 manual until an on-going National Academy of Sciences study is complete. And then, the 1987 manual will be amended through a fully public rulemaking process. The Delta Commission Report also contained a number of policy recommendations, many of which are included in our package and none of which conflict.

The policy positions contained in the attached paper strongly support the effective protection and restoration of the Nation's wetlands, while advocating much-needed reforms that increase the fairness and flexibility of wetlands regulatory programs. Aside from the governors, no interest group will be entirely satisfied with this package. However, I believe that this package will be grudgingly admired from almost all sides as a good faith effort to create a responsible -- and constructive -- middle ground position on a very polarized issue.

III. **RECOMMENDATION:** I recommend that you approve the release of the attached document entitled "Protecting America's Wetlands: A Fair, Flexible, and Effective Approach" on August 24, 1993.

IV. **DECISION:**

__✓__ Approve ____ Approve as amended ____ Reject ____ No Action

THE WHITE HOUSE
WASHINGTON

DATE: 09/01/93

NOTE FOR: LAURA TYSON

The President has reviewed the attached, and it is forwarded to you for your:

Information ☐

Action ☒X

See President's note --
"What's your response to this?"

(The magazine has been returned to Chad Griffin, Mark Gearan's office, 1st Floor, West Wing, per the President's instructions.)

Thank you.

JOHN D. PODESTA
Assistant to the President and Staff Secretary
(x2702)

cc:

THE PRESIDENT HAS SEEN
9/1/93

EXECUTIVE OFFICE OF THE PRESIDENT
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TO: Chad Griffin
(1) Laura - what's your response to this? →

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VOL. 272 NO. 1

JULY 1993

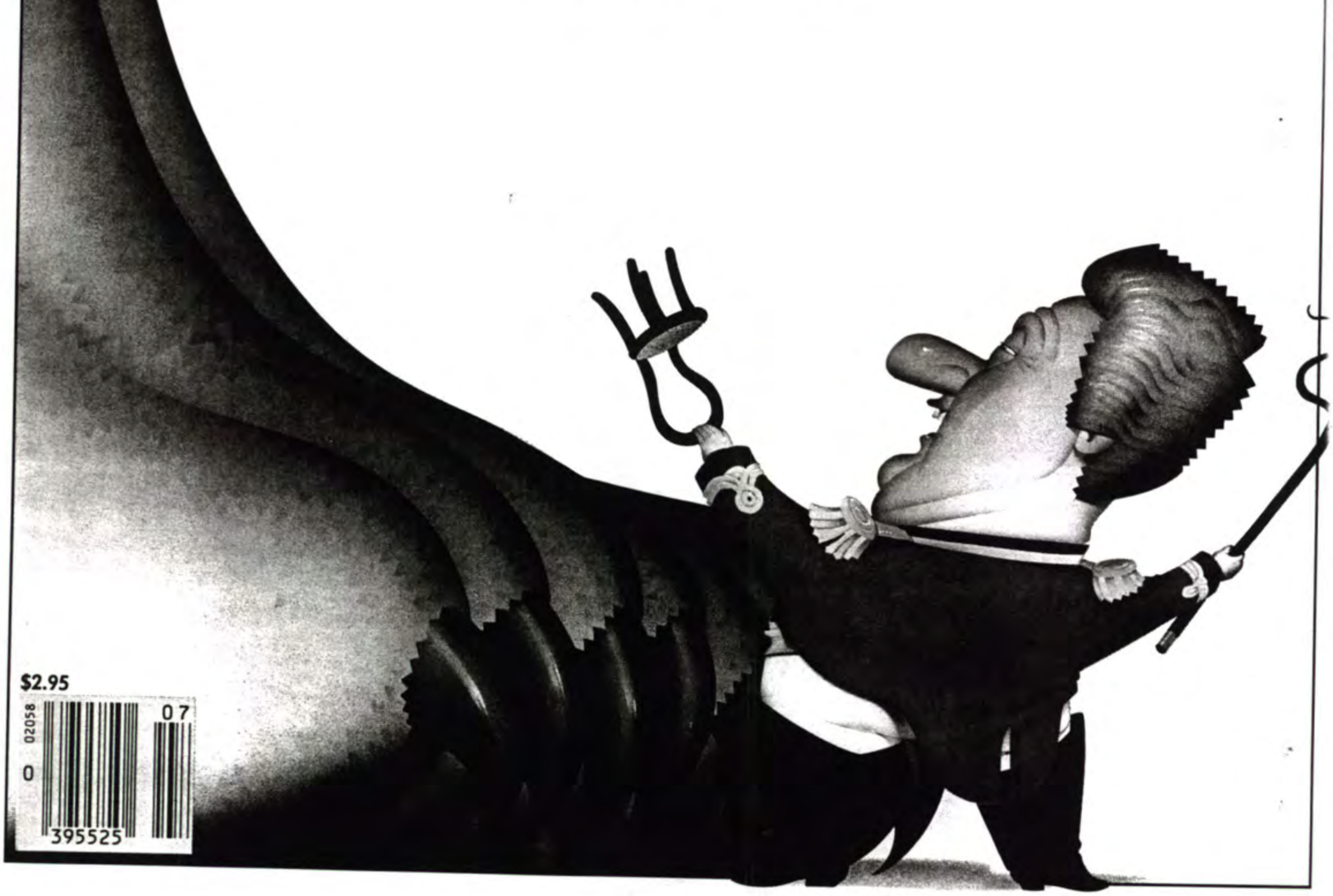
The Atlantic

"It's not the economy, stupid"

We elect our Presidents to do the impossible: the American economy is too colossal to be "managed"

▼▼▼▼▼

BY CHARLES R. MORRIS



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“It's not the economy, stupid”

Bill Clinton was elected on an untenable premise: that it is the job of the President to manage the economy. Yes, that is what we have come to expect of Presidents; but this expectation, the author argues, is punishingly at variance with anything any President can credibly deliver

BY CHARLES R. MORRIS

As all the world knows, “the economy” was the overriding issue in the 1992 presidential election. President George Bush “mishandled” the economy. He lost. Bill Clinton promised to handle it more skillfully. He won. I will argue that he won on a false issue, and that the main criterion on which our presidential elections have come to be decided—managing the economy—is a sham.

The assumption that the President manages the economy is the core of prevailing political wisdom, dinned into the public mind by a generation of pundits, a convention of discourse endlessly repeated but rarely examined. The fact is, presidential elections have become referenda on the business cycle, whose fortuitous turnings are personified in the President—thus the “Bush recession” yields to the “Clinton recovery.” This is not economics, it is anthropology—an exercise in collective magic. Presidents are properly accountable for their executive and legislative performance, and there is no question that federal actions can affect the economy, sometimes profoundly. Eliminating the budget deficit in four years, for example, might create a nasty recession or a runaway boom—economists, as always, disagree. But the effects would almost certainly be substantial, however unpredictable. Modern political campaigns, however, are fought on the premise that Presidents can *manage* the economy, that they can take detailed actions that have a precise result—such as raising productivity, reducing unemployment, or increasing investment. In that sense, how much control do Presidents really have over the economy? The answer is, Very, very little.

Mind Over Matter

THE "ECONOMY" ITSELF IS REALLY JUST A METAphor for the enormously complex stew of daily personal and commercial transactions among some 250 million Americans. The deceptively precise numbers that purport to measure "savings" or "growth" or "income" are crude approximations compounded from a slag heap of samples, surveys, estimates, interpolations, seasonal adjustments, and plain guesses. It takes months, even years, for economists to sort through the numbers and figure out what really happened—if they ever do. There is still no consensus on what caused the Great Depression. The most recent returns on the U.S. economy show signs of respectable growth. But economists are arguing fiercely over whether it is too little or too much, the morning lark of a solid long-term recovery or just a dead-cat bounce. And, of course, they disagree even more fiercely on the policy prescriptions that flow from their prejudices: "Do something or things will get worse!" Or, "*If* you do something, things will get worse!"

Clinton's ill-fated economic-stimulus program exemplifies the confusion. Certainly it was small: at $16 billion, hardly more than the rounding error in the national accounts. And no one could argue with a straight face that a porridge of new playgrounds, vaccination programs, and Headstart dollars would visibly improve the economy. But while the Nobel laureate economists James Tobin and Robert Solow warned that the stimulus was too small, Wall Street worried that the President would spook the bond market. If bondholders decided that the economy was growing too fast, or the government was borrowing too much, and inflation was heading up, interest rates would rise and undercut the recovery—the last thing Clinton wanted.

At one point Secretary of Labor Robert Reich, a key designer of the Clinton economic strategy, argued that the "psychological impact" of the stimulus program was what really counted. The emphasis on changing people's *minds* about the economy sounded a little like official explanations of American policy in Vietnam—bombing just enough to discourage the enemy. The resemblance, in fact, is no accident, for both the image of the President as button-pusher in the economic engine room and the heavily psychologized tactics in Vietnam are squarely in a peculiarly American tradition of thinking about society and the economy.

Pulling Levers

PAN THE CAMERA BACK ALMOST A HUNDRED YEARS: there stands an aging Henry Adams, the historian and descendant of Presidents, agape before a giant electrical dynamo at the Great Paris Exposition of 1900, ready to fall on his knees, "bewildered and helpless, as in the fourth century, a priest of Isis before the Cross of Christ." Transported by this Damascene vision, Adams set out to construct a "dynamic theory of history," seeking the fundamental laws, like those of electricity or magnetism or the kinetic theory of gases, that govern the affairs of men.

Adams's search for a scientific history was tempered by self-mocking irony. But to minds less steeped in the past, America's leap into the Machine Age and the mighty transformations of American social and industrial relations opened entirely new intellectual vistas. The new "scientific" outlook was thoroughly positivist (nothing existed, or at least was worth talking about, if it could not be measured); it was atomistic (all things were condensed from identical particles); and it was statistical (the intricate but predictable dance of countless freely colliding molecules of gas was choreographed by a few simple, immutable laws). In a series of easy stages the same logic was applied to virtually the entire field of human endeavor.

Factory whistle-stops notwithstanding, Presidents can't do much to create new jobs for machinists in Topeka. Rather than admit that, Presidents and press exchange cant.

To begin with, the mapping from a mechanistic physics to the burgeoning science of economics seemed entirely natural, precise, and complete: correct prices, for instance, arose from the statistical interaction of countless atomized market participants obeying the simple canons of rational self-interest. Around the turn of the century American universities developed a defense of American liberal capitalism as the regime most consistent with a scientific outlook, and the economist's style of thinking rapidly colonized the rest of the social sciences. Franklin Giddings, at Columbia; Edward A. Ross, at the University of Wisconsin; and Charles Horton Cooley, at the University of Michigan, pushed the still-nascent study of sociology toward statistics and measurement. (Ross and Cooley started their careers as economists.) The program of the American Sociological Society, organized in 1905, was entirely "scientific," seeking the basic forces, or "sympathy," that bound society together, trying to discover a praxis of "social control" for a liberal society, teasing out the rules of the "social equilibrating-apparatus." By the 1920s all of political science was being recast into a study of the market behavior of utility-maximizing individuals. The same behaviorist faith inspired John Dewey's confidence that schools could be organized like "great factories," to turn out self-reliant citizens who would people Dewey's vision of a liberal democracy.

After a period of eclipse during the Depression, the scientific pretensions of American economics and its sister social studies were powerfully reinforced by the sweeping triumph of Keynesianism. Ignoring Keynes's own warnings about the waywardness of real markets, American academics forged a rigidly mechanistic vision of the economic apparatus: pull this lever and investment rises, turn this flywheel and consumption goes up—all the pieces clicking smoothly into place like stainless-steel tumblers. Faith in a *deus in machina* prompted John Kennedy's wildly unprescient declaration in 1962 that there were no ideological issues left to solve; the country faced only "technical problems . . . administrative problems."

The economist's vision of the rational actor was formalized in John von Neumann and Oskar Morgenstern's *Theory of Games and Economic Behavior* (1944). Game theory supplied a metaphysics for the arms race, and led Robert McNamara in his will-o'-the-wisp pursuit of a precise equilibrium of "mutual assured destruction" with the Soviets, as if nuclear arms were a problem of tariffs and quotas, like trade. Since rational actors in rational games reach mutually beneficial accommodations through signaling, it was forever a puzzlement to the civilian theorists in the Pentagon that Ho Chi Minh obdurately persisted in misinterpreting their carefully calibrated bombing campaigns.

Even American ethics has become hardly more than a branch of economics. Dewey always struggled, if not very successfully, against the economist's equation of values with mere *wants*, although it seemed an obvious implication of his pragmatist teachings. There is no such struggle in John Rawls's *A Theory of Justice*, the most discussed ethical work of the past generation. Rawls proceeds by constructing a system of goods-maximizing choices by highly rational atomized individuals who lack any history or social ties. The same economistic bias also explains much of the American obsession with personal rights and legalistic procedure: if all wants are theoretically equal, there is nothing left for moralists to do but tinker with process. Economists, after all, care only that the corn auction works; whatever price emerges will *ipso facto* be the right one.

The interventionist bias of the early Keynesians has created a leftish aura around the more "scientific" social theories. But the same empiricist, atomistic view of society, the insistence on equating choices with values, is a major theme of American conservatism, from Milton Friedman's willingness to legalize drugs to the current "school choice" movement. Thomas Sowell and Robert Nozick take issue with Rawls using exactly the same microeconomic tools that Rawls uses—they just wind up with diametrically different results. The philosophic differences between the left and the right in America, that is, most often reduce to a barren instrumentalism: Should government pull the levers, or do the levers move themselves?

The reach and power of the economic paradigm in America is impressive enough; but what makes it all the more remarkable is that there is almost no compelling reason to believe that it works any better in economics than it did in guerrilla warfare, let alone in sociology, politics, or morals.

Economics in the Real World

FINANCIAL-MARKET PROFESSIONALS OFTEN TAKE for granted the practical uselessness of economists. Recently, for example, Robert Beckwitt, a bond manager at Fidelity Investments, the big mutual-funds company, tracked the success of Wall Street's economists in forecasting interest rates. Bond values depend critically on interest rates, and bond traders basically make bets on whether interest rates will rise or fall when they buy and sell bonds. One of a Wall Street economist's most important tasks, therefore, is to forecast rate trends, and many hours of analytic energy and vast amounts of computer power are lavished on the problem. According to Beckwitt's data, however, the best bond-investment strategy over the past decade would have been to do exactly the opposite of what the consensus recommended: when the economists said "Sell," the wise investor bought—and achieved, in fact, quite outstanding returns. Charles Wolf, at the Rand Corporation, once compiled a box score for the major economic forecasters; the fit between most forecasts and actual outcomes was approximately random. A running joke at *The Wall Street Journal* is a regular feature that pits top stock pickers against a portfolio compiled by throwing darts at a wall: year after year the dart board is neck and neck with the analysts.

Forecasting in economics is not the same as plotting the path of a planet. Fundamental axioms in economics have a disturbing tendency to flip upside down with little warning, as if gravity suddenly made objects float. For many years it was received wisdom in economics textbooks that if the Federal Reserve increased the money supply (by loosening the credit reins), interest rates would fall. In theory, money is a commodity like any other, and if there is more of it, its price, or the rate of interest, should fall. For years, in the main, the theory held true. Then, at some elusive moment in the 1970s, investors decided that loose credit caused inflation, which was also arguably true. The Ford and Carter Administrations had greatly expanded credit to help cushion the 1970s oil-price shocks, and inflation was rising rapidly. If lenders expect inflation, they will insist on higher interest rates to protect the value of their money. Almost overnight the financial headlines executed an about-face: if the Federal Reserve loosened credit, it was thenceforth taken for granted that interest rates would rise, not fall. The earth, having been round, was now flat, and the economic astrolabes were adjusted accordingly.

Alan Greenspan, the chairman of the Federal Reserve, was recently lectured by a Senate committee for not pushing interest rates down faster to spur an economic expansion. (Lower interest rates presumably induce greater borrowing and therefore greater economic activity.) In fact Greenspan had been pushing interest rates down very aggressively for more than a year. But the Federal Reserve controls only short-term rates, primarily through its overnight lending to member banks. So while short-term rates fell very rapidly during 1992, longer-term rates—the ones investors mainly care about—hardly budged. Investors didn't know which law applied. Would Greenspan's aggressive loosening make money plentiful and lower rates? Or would it trigger inflation and raise rates? The result was a kind of paralysis: short-term rates went down and long-term rates stayed up. The beneficiaries were the banks, who could suddenly borrow very cheaply from the government and lend the money right back at much higher interest, by buying longer-term government bonds. The whole point of the exercise, of course, had been to increase bank lending to business; but since banks could make so much money playing the Treasury market, lending to business actually dropped.

There is no escaping the pervasive influence of the federal behemoth. About one out of every four dollars spent in the land is spent by, or put in the pocket of the spender by, the federal government. If the government lurches left or yaws right, a big chunk of the economy lurches or yaws with it. But it is hardly a surgical policy instrument; there are few obvious levers to pull. At bottom the government engages in four kinds of economic activity. Half a trillion dollars or so is passed out to citizens each year, either directly, as in Social Security payments, or in the form of medical services. Some $300 billion finances the global sprawl of the U.S. military. Another $300 billion pays for the three-million-strong army of federal civil servants and a ragout of federal programs, from Headstart ($2.7 billion) to dusty relics like the Rural Electrification Administration ($1.2 billion). Finally, the government borrows some $300 billion each year from banks, insurance companies, and pension funds and then cycles most of it back as interest on the debt—a majestically rotating wheel of money.

Any economic actor as big as the federal government can, like John Steinbeck's Lennie, clearly do some Very Important Bad Things, whether it intends to or not. In 1982, for example, Congress and the Reagan Administration chickened out on a $10 billion savings-and-loan crisis.

Instead of paying the tab and closing down the industry, they covered it up with phony accounting and looser rules, and turned it into a $150 billion problem just a few years later—managing along the way to create a vast supply of unusable commercial real estate, and to roil all the world's financial markets by unleashing a great flood of federal borrowing for the sake of unlucky depositors. By the same token, a complicated but very different series of policy decisions in Japan during the 1980s has created an almost identical American-scale S&L-style crisis there. Once in a while, on the other hand, an opportunity arises to do a Very Important Good Thing. Actually fixing the U.S. health-care system, so that costs were brought under control, the uninsured received minimal benefits, and workers could change jobs without fear of losing coverage (if all that is indeed possible), would be just such an Important Good Thing.

Forecasting in economics is not the same as plotting the path of a planet. Fundamental axioms in economics have a disturbing tendency to flip upside down with little warning.

But for the most part the federal apparatus trundles irresistibly ahead, a vast, splay-footed creature moving pretty much under its own power. A web of laws, regulations, long-term procurement contracts, treaties, jealously guarded congressional prerogatives, and deference to hallowed practice collectively overbear the occasional deflecting obstacle. Gentle nudges, pluckings at the coat sleeves, are of no avail against such tremendous inertial force; a minor initiative like the Clinton stimulus program is simply lost underfoot. Only very occasionally an utterly determined and utterly resourceful President, as Richard Nixon was, can bend the machinery to his will. Fearing for his re-election in 1972, with the economy slowing and inflation rising, Nixon and his Treasury Secretary, John Connally, engaged in a bravura performance of economic browbeating. They slapped on wage and price controls, broke the link between the dollar and gold, gunned up the money supply, and managed to wring out a year of strong growth with low inflation just before the election—at the price of triggering a huge recession during Nixon's short-lived second term. The economy, that is, *can* be managed over the short term, but only by relentless and violent clubbing, not by pushing buttons, and not by Presidents who are queasy about their methods or care about the consequences.

Truly important economic decisions, as often as not, zip by unnoticed by the public, probably by the President, because their consequences can take such a long time to become clear. For example, housing prices rose strongly through most of the 1980s, partly in response to severe supply problems in the early part of the decade. The housing shortage is usually attributed to the Baby Boomers' entering adulthood. The population entering retirement, however, was almost as big, and their housing behavior was something new in history. In 1973 Nixon and the Democratic Congress had sharply increased Social Security payments and indexed them to rise faster than inflation. For the first time, a retiring population had the wherewithal to keep their homes, and by and large they did so, instead of moving in with their children as previous generations had done. A substantial share of the nation's housing stock was thus withdrawn from the normal inventory-refreshment cycle, precipitating a boom in housing construction a decade later.

The new independence of the elderly, in fact, has had a long list of profound consequences: the growth of retirement villages, the boom in states like Florida and Arizona, new nursing-care patterns for the failing aged (the proverbial youngest daughter now typically lives in another city), and much more. Many of these changes, of course, represent progress. The point is merely that putting a greater share of national income in the hands of oldsters has had powerful effects far beyond the simple shifting of relative poverty indices among age cohorts.

Such examples are numerous. The country's economic structure has been profoundly affected by three decades of federal, state, and insurance-company policies aimed at expanding third-party coverage of health services. Last year the number of U.S. hospital workers increased by about as many people as are employed by all American computer makers. The Pentagon's aggressive search for miniaturized weapons technologies in the 1950s and early 1960s funded a host of unconventional electronics geniuses, helped create California's Silicon Valley and, by extension, the American venture-capital industry, and is still the source of much of the U.S. edge in advanced computer technologies. Economic models, by and large, just skate by issues like these. They're messy and unpredictable, and they involve tremendous effects from seemingly small actions—wars won or lost because of a missing horseshoe. And they are, depressingly enough for the traditional "scientific" economists, the way the real world works.

Complexity

THE BEAUTY OF MACHINES LIES IN REGULARITY and order—the predictable harmonies of the Newtonian solar system, the eternal canons of a clockmaker God. Specify the initial conditions of any system—say, a table of billiard balls. Introduce a force—the moving cue ball—into the system and calculate the angles and forces of the subsequent collisions, and you will have specified the future position of the balls. That is the fundamental premise of the modern study of economics. But billiard balls don't work like that.

The celestial machine of Newtonian physics is a simple system, a small number of bodies revolving around a single massive body. But systems with many interacting elements, "complex" systems, do not behave like simple systems. You may specify the initial position of the billiard balls to any arbitrary level of precision—the sphericity of the balls, the smoothness of the surface, the trueness of the bumpers. But there will be some level of imprecision remaining, some element of the unknown, some fleeting shadow of randomness. If you strike successive "identical" tables of balls identically, their final positions will vary widely after only a very small number of collisions. Very tiny degrees of randomness, fed through a very small number of collisions, will lead to radically varying outcomes. If God removed an electron from the end of the universe, it would change the collision pattern of the air molecules in my room. A few days later there might be a storm in a neighboring state.

The numbers that purport to measure "savings" or "growth" or "income" are crude approximations. It takes months, even years, to figure out what really happened.

The real world is messily complex. Water flows in turbulent patterns; tiny variations in the flow quickly build up to big structures—eddies, riptides, vortices—that merge, expand, disappear. Molecules in a cell accrete tiny electrical variations and patterns of connections with other molecules. Suddenly a threshold is crossed and huge events are triggered—the cell divides, or pours forth viruses, or becomes cancerous, or dies. Mutations build up invisibly in the fossil record, and suddenly there is an enormous florescence of new species and life forms; the face of the earth changes. Real financial transactions are rarely structured like the rational two-person game so beloved of economic theorists: add just one more player and create a modest range of choices, and the computer simulations spin out a rich new world of shifting combinations and coalitions. Chess is a game between only two players, with only moderately complex rules, but it quickly spirals into an infinity of outcomes. Scientists are just now developing the supercomputers and the mathematical tools needed for problems like these. Even planetary orbits, it turns out, are much less stable and predictable than was once assumed.

Is the economy a complex system? Put even more radically, is the economy "computable"? That is, is it hopeless even to *try* to model it? The center of thinking about such issues is a small think tank in the foothills of the Rockies—the Santa Fe Institute, devoted to exploring the new understanding of complexity. Since the mid-1980s it has facilitated a remarkable dialogue between scholars such as the Nobel Prize–winning scientists Murray Gell-Man and Philip Anderson and the economist Kenneth Arrow, a Nobel laureate and perhaps the country's finest mathematical economist. W. Brian Arthur, a professor of economics at Stanford, and John Holland, of the University of Michigan, who was trained as a computer scientist, both Santa Fe fellows, are intensely involved in re-evaluating conventional economics in the light of complexity theory.

Both Holland and Arthur are interested in the local microformations in the economy, the vortices in the turbulent stream. Arthur points to the "QWERTY" typewriter keyboard, originally designed to slow typists down so that mechanical keys wouldn't jam. There are many more-efficient configurations, but QWERTY is now the unassailable standard, just as the Netherlands, a northern country with a short growing season, is the world's tulip center. Any economic system, that is, may have a very large number of possible equilibrium points, which flies in the face of traditional theory. Worse, raw chance may play a major role in the final equilibrium. "Economic data," Arthur says, "give an illusion of a stable, long-term trend line, but underneath that apparent stability is a constant turnover of structures. Some regions become rich, some stay poor, and often there's no obvious reason why. We need to understand those processes, how they work in the real world, from the ground up." (The idea of looking at smaller structures has immediate relevance. Recent national economic reports have been significantly influenced by recessionary conditions in a few states, such as New York and California. Politically distributed national stimulus programs are, at the very least, an inefficient response.)

Holland points out that the economy is an adaptive system, which increases its unpredictability. Unlike the molecules in a gas, economic agents learn from experience. There is indeed a kind of Heisenberg principle of economic management. If the federal government starts focusing on, say, the money supply as a tool for controlling the economy, the relationship between the money supply and the rest of the economy will surely change, vitiating the original policy assumptions. Biological systems, Holland suggests, are better than Newtonian mechanics as analogues for an economy. "The amount of biomass and its complexity seem to have been increasing at a steady, slow rate, for an extremely long period of time, although there is enormous variation in the successful life forms in any particular period. Economies may work that way. But there may also be some stable solutions; fish, porpoises, and ichthyosaurs at different times developed the same solution—hydrodynamic bodies." Arthur cautions, however, that there are nine or ten solutions to the problem of evolving an eye—pinholes, lens arrays, and the like—and that decidedly *un*hydrodynamic mollusks and crabs have been very successful colonizers of the seas.

The notion that economies are complex systems—more biological than Newtonian—has powerful intuitive appeal. But it will be a long time before complexity theory will be of much help to policy makers. One frustrating problem is a lack of data. Physicists are used to working with thousands, even tens of thousands, of observations. Industrialized countries have been collecting reasonably consistent economic statistics for only about fifty years; their quality is often poor, and their content changes subtly over the years. Financial-market data are somewhat better, and there is some tantalizing but inconclusive evidence that market behavior may mirror that of complex natural systems. Drop grains of sand, one after another, on the same spot; they will form a pile with a regular shape. Every so often a single grain will start an avalanche; most of the avalanches will be small, but once in a while, and quite unpredictably, one will be catastrophically large, wiping out whole sections of the pile. The market movements of most interest to Wall Street may be just avalanches in a sand pile. For the moment, however, the value of complexity theory in economics and finance is primarily as a cautionary metaphor, a pinprick to the pretensions of pundits, a warning that, at least occasionally, well-intended policies could, as the physicist David Ruelle put it, lead to "wild . . . fluctuations" with "possibly quite disastrous effects."

Economic Discourses

THERE IS NO ESCAPING ECONOMIC POLICY. THE federal government is too large a presence in the American living room to be ignored, too insistent a claimant when the pie is divided. A President who feigned not having an economic policy would be engaging in as empty, and as damaging, a pretense as the most enthusiastic economic micromanager. The element of unpredictability in economic systems counsels caution, not nihilism, humility rather than despair.

The problem is one of domains of discourse. At least since John Kennedy's 1960 campaign to get "America moving again," Presidents have been obliged to adopt the pose of day-to-day managers. Day-to-day responsibilities imply day-to-day results; the press demands them, and the voters are trained to expect them. But let's face it, all the factory whistle-stops in a campaign notwith-

standing, Presidents can't do much to create new jobs for machinists in Topeka. Rather than admit that, Presidents and press exchange cant, and voters sink into cynicism.

Discourse needs to shift toward "stewardship" and away from "management." We are a grown-up nation, with an educated, sophisticated press corps. It should be possible, although it will certainly not be easy, to set reasonable goals for political stewardship of the economy, and develop some reasonable scorecard on the important issues. Guidelines for sound stewardship might include, for instance, a list like the following.

Skepticism about one's own cleverness is usually a good policy starting point. In America, at least, markets mostly work, after their fashion. That is, although they almost never produce optimum results, and often take an uncomfortably long time to work, market outcomes are usually more nuanced, more subtly adapted to underlying complexities, than a priori designs. When Presidents Carter and Reagan decontrolled oil prices at the outset of the 1980s, supply, demand, and prices all came into a fair degree of balance with surprising speed after almost a decade of administrative floundering. Therefore a good initial bias is perpetually raised eyebrows toward complicated nonmarket solutions.

Pandering produces bad policy. There is an emerging consensus, even among quite conservative economists, that only the federal government can solve the health-care conundrum; indeed, it may be the Administration's single most important economic issue, affecting business and consumers alike. Solving the problem will be enormously difficult, requiring some measure of pain all around. The temptation to opt for politically expedient solutions with severely damaging long-term consequences may be overwhelming. The democratic principle presumes that the public will listen to arguments, consistently and persistently delivered, in favor of doing the right thing. Perhaps it is just a long time since an Administration has tried.

All important policies are long-term. The quandary facing elected officials is that anything important takes more than four years. Even successful health-care reform would not pay visible dividends sooner than the end of the decade. The benefits from careful deficit reduction will never be quantified. Even an Administration resolved to do the right thing over the long term, as the Clinton Administration seems to be, will be cruelly torn between its own decent instincts and the clamor of political advisers for short-term results.

And finally, *Presidents should trust their instincts over models.* Arguments against deficit spending are almost always cast in instrumentalist terms—its effects on interest rates, inflation, and investment. The truth is that none of these effects can be consistently demonstrated. Deficits, for example, have been rising steadily for ten years, and interest rates and inflation have been falling just as steadily: ten-year and thirty-year bonds have recently been at two-decade lows. A recent Goldman Sachs study found no relation between deficits and interest rates in most industrial countries, and only a weak, and fading, relation in England and America. There is no question that large deficits have economic consequences; it's just hard to prove what they are. It's an example of the complexity problem. The background noise—the effects of recessions, technology cycles, global capital flows, savings rates, monetary policy, commodity shortages, political disruptions—overwhelms our ability to trace the consequences of change in a single variable.

The clashes of economists on the meaning of deficits, unfortunately, obscure the truly important, if "unscientific," reason why they should be eliminated. Deficits are moral hazards. They are fundamentally antidemocratic; they allow government to increase spending without the implicit referendum of a tax increase. It has long been a settled principle of Western civil government that state borrowing leads to profligacy and irresponsibility. If revenues cannot constrain spending, government itself will be unrestrained. We need to eliminate deficit spending not because someone's computer says it will create more investment in 1996, or whenever, but to restore the integrity of our political system.

To President Clinton's great credit, his first economic speeches, stripped of the patina of economistic jargon, really do seem to have been appeals to citizens to do the right thing—to endure some pain in order to bring the appetites of government back into line with its resources, to forgo some personal benefits for a greater good. And judging from the first polls, people have reacted very positively, just as one might hope. But by so baldly appealing to principle, Clinton has assumed a heavy burden of faith-keeping. If taxes go up and the deficit does *not* go down, it will be a breach of trust not likely to be forgiven or forgotten, and the backwash of voter cynicism could poison the political system for years. Unfortunately, as the specifics of the Clinton program become clearer, the danger of precisely such a result seems very real.

The public and its elected politicians need to reinforce each others' best instincts, not their worst ones. Presidents will perform up to the standard the public sets for them. Dropping our insistence that our Presidents spout cant and pretend to be daily miracle workers, shifting the focus to the long term, and helping to search out the right principles of action are the least we owe our Presidents, and ourselves. □

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"It's not the economy, stupid"

We elect our Presidents to do the impossible: the American economy is too colossal to be "managed"

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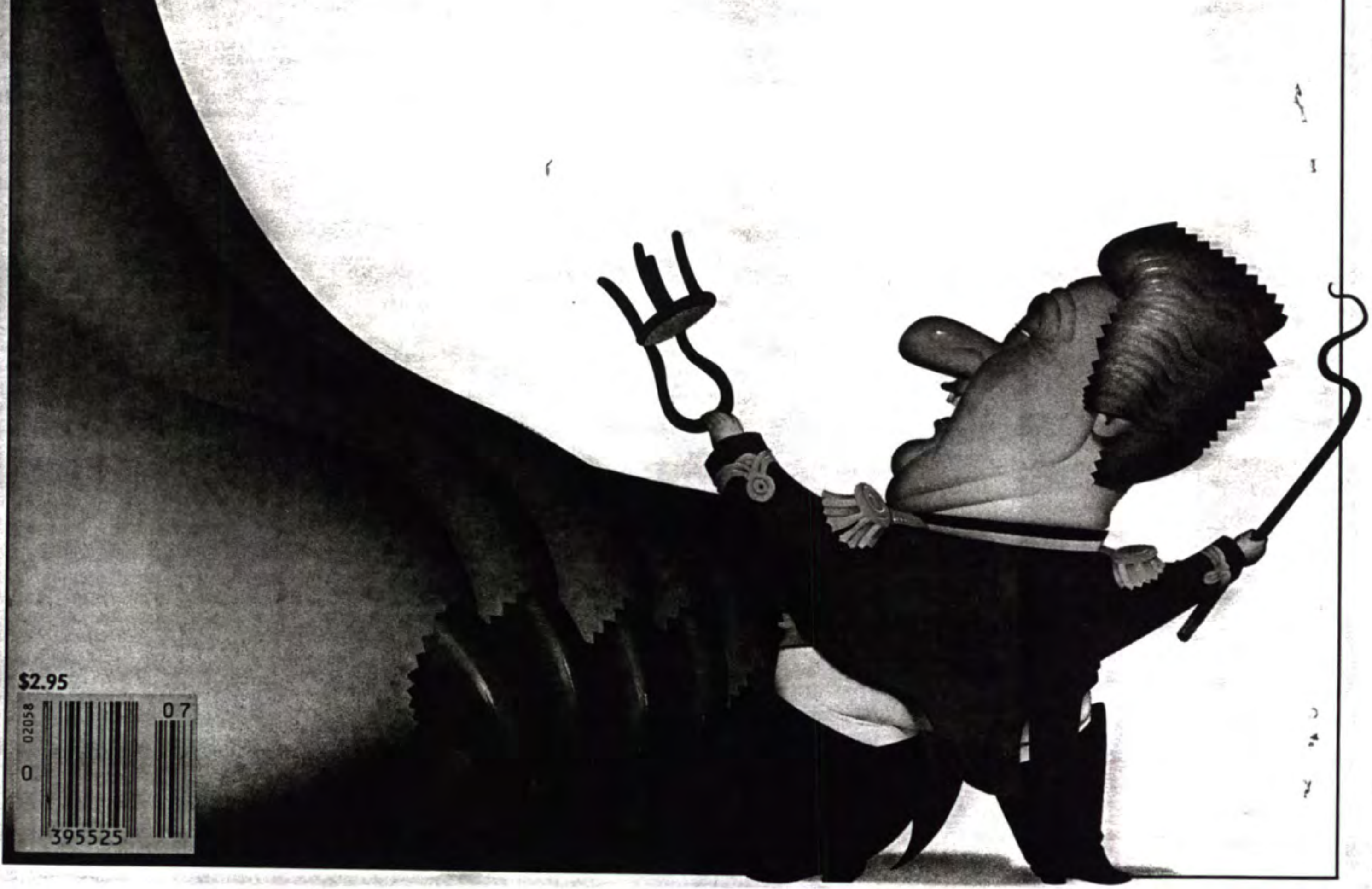
BY CHARLES R. MORRIS



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