THE WHITE HOUSE
WASHINGTON

[redacted]

DATE: 8/25/95

TO: John Emerson

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

FYI

[redacted]

[redacted]

→ sign if we can get him —

THE PRESIDENT HAS SEEN
2-14-95

JACK BROWN: 56, Chairman, President, and CEO, Stater Brothers Markets
Once a student at San Bernardino Valley College, Mr. Brown began his career in the grocery industry as a box boy. He has risen to become CEO of San Bernardino's largest employer, operating 111 markets and employing nearly 10,000 people in the region. Annual sales for Stater Bros. are approximately $2 billion making it one of the largest supermarket chains in the country. Mr. Brown is a winner of many public service awards, sponsors educational scholarships, and strongly encourages all of his employees to continue their education. He was one of 10 Horatio Alger award winners -- along with Henry Kissinger, Maya Angelou, and Clarence Thomas -- in 1992. A native of San Bernardino, Mr. Brown recently donated a building at Cal State Fullerton where a plaque contains his motto, "You can't have equal opportunity without equal education."

THANH - LAN LY (known as LAN - rhymes with FAN): 22, Student at San Bernardino
Lan was born in Saigon. While her father was imprisoned for 10 years (1975-85) because of his anti-communist beliefs, Lan helped her mother sell cookies to earn a living. Lan rode her bike 7 miles each day to attend junior high school, but was not allowed to participate in school activities or attend high school because of her "dirty background." At the age of 17 (in 1989), Lan risked her life to escape Vietnam with her family on a small boat to Malaysia. An avid learner, Lan became an English interpreter after 2 years at a refugee camp. In 1992, her family immigrated to the U.S. and she applied to Valley College where she is now studying to become a nurse. She says that financial aid is her key to getting an education and proclaims, "I will not disappoint our government, I will give back because I am so grateful to be an American."

EVA (EE va) CONRAD: 49, Vice President of Instruction at San Bernardino Valley College **(Eva will act as facilitator for this discussion).** Born in Syracuse, New York, to working class parents, Ms. Conrad is a first-generation high school and college graduate. She has been a professor of psychology and health at Valley College for 18 years, and was appointed Vice President of Instruction for the college in July, 1994. She cites her childhood experiences living in Mobile, Alabama, as catalyzing a life-long interest in civil rights and education. At 13, for example, she was shoved away from drinking at a water fountain marked "colored" by a clerk in Woolworth's. While young Eva had expected to find a rainbow of blue, red, and yellow water streaming from the "colored" fountain, she instead discovered a discrimination that propelled her into civil rights activities throughout the 1960s, and a lifelong career in education.

DANIEL QUIRINO (kee REE no): 28, Student at San Bernardino Valley College
Daniel is the first person in his family to pursue a college degree, and he plans to earn his PhD. He immigrated to the U.S. at the age of 11 with his family. After one year in an English as a Second Language (ESL) class, Daniel joined the school's regular instructional program full-time and now takes pride in his strong English skills. After high school, Daniel worked for 10 years (5 as a teacher's aide), and is now studying computer science at Valley College. Daniel is currently the president of his "Puente" class. Puente, an education/business partnership for Hispanic students, focuses on upgrading writing skills, as well as providing an academic counselor and a community mentor for each student.

— Welf ref → Ed
— Americorps; lifetime L; [illegible]
— S-W; colleges; Bd/Rt

Econ: impt of Ed
Limits of govt
→ income

Bio
Min age
issue
Summ < Sam Walton

THE PRESIDENT HAS SEEN
2-14-95

ATTACHMENT #1
PARTICIPANTS IN ROUNDTABLE - SAN BERNARDINO VALLEY COLLEGE
SAN BERNARDINO, CALIFORNIA

(This list is arranged in order around the table. The first person is to your left.)

ADRIENNE HERNANDEZ: 17, Student at Rialto High School and the San Bernardino Sheriff's Academy
Adrienne is a junior in high school and would like to pursue a career in law. She has been motivated by the violence and racial tensions that she witnesses every day in school and by her father who is a police officer. She is participating in a Sheriff's Academy school-to-work program that she says has taught her "commitment, discipline, and responsibility." As part of her program, Adrienne spends 6 hours every Saturday at the Sheriff's training facilities, must take high school coursework in writing, computers, and Spanish, and must maintain a high GPA. She is also able to earn credits at both the Sheriff's Academy and at Valley College. Adrienne is so excited about law enforcement that she wants to become a lawyer and ultimately a judge. In the meantime, she is trying to be a role model for her peers.

GREG KYRITSIS (ker RITZ is): 44, Sheriff's Lieutenant, San Bernardino
Greg has spent 21 years in law enforcement, including 10 as a trainer for police recruits. Greg helped create (and is trying to expand) a school-to-work program with Rialto High School and Valley College (see Adrienne above) to improve the skills of high school graduates and encourage law enforcement as a potential career. He has become increasingly concerned about education as he sees new recruits with poor skills and writing abilities. Greg is worried that budget constraints will continue to reduce police training while demands on officers only increase. He says, "hair dressers in California must have 1600 hours of training, while the average training for a law enforcement officer is 800 hours."

CHRISTOPHER EMANUEL: 40, Student at San Bernardino Valley College & Student Member to the Board of Trustees for the San Bernardino Community College District
Christopher describes himself as "handi-capable" not handicapped. He plans to transfer to the University of Southern California and then earn a law degree. He is inspired by Thurgood Marshall and hopes to practice civil rights law in an urban area. A political activist for his fellow students, he ran for student representative on the Board of Trustees so that he could make sure that students would be fairly represented. Christopher is on a fixed income (Social Security), works hard to obtain scholarships and appreciates how important it is to have affordable education. He is very proud of the 4.0 GPA that he received last semester. On November 6, 1994 he attended a GOTV Rally and shook your hand. He carries the event ticket in his briefcase every day for inspiration.

MARY ELLEN ABILEZ (ah BEE lez): 46, Student Body President at Crafton Hills College
A single mother of 3 girls whose motto is, "Education is the only permanent way off of welfare," Mary Ellen has been on and off public assistance for most of her life. She currently receives AFDC. After struggling to find the money for her 2 older daughters to attend college, Mary Ellen decided to do the same for herself. She now receives several forms of financial aid in order to attend Crafton Hills College. Mary Ellen spent most of her life working for minimum wage in dead-end jobs, trapped in the welfare cycle. Education has opened up a whole new world to her, and she now wants to be a history teacher so she can help expand the world for others. Mary Ellen says that she has fallen in love with making a difference. As student body president, Mary Ellen serves on several college and community committees. Mary Ellen explodes with enthusiasm when she talks about education and the way it has changed her life.

RYAN S. CARRIGAN (CARE i gan): 25, Student, San Bernardino Valley College
As a salesman after high school, Ryan quickly realized that his career opportunities would be severely limited without further education. He chose Valley College because it was the only school his family could afford. On the same day that Ryan announced to his family that he intended to return to school, his father announced that he had been laid off from his job as a sprinkler fitter. Despite a severely reduced income, Ryan's family supported his decision to go to school. He has since convinced his father to enroll at Valley College as well. Ryan founded Pushing Responsible Education Positively (PREP), a group of faculty, students, administrators and parents that promotes the community college system. He is the first student from Valley College to be appointed to the Board of Governors for the California Community Colleges. Ryan plans to go on to Claremont College and get a degree in Philosophy, Politics & Economics.

MONIQUE PATTON: 23, AmeriCorps Volunteer
Monique grew up with her single mother in California. After high school she enrolled in a Junior College because it was more affordable and she could work full-time. She became an AmeriCorps volunteer to learn more about the environment, serve the public, and to earn money for college. Monique serves on the U.S. Forest Service team for AmeriCorps, spending 40 hours a week cleaning up the San Bernardino Forest. She would like to spend another year in AmeriCorps before enrolling at Humboldt State in order to earn a degree in environmental sciences.

BOB TURLEY (TUR lee): 53, Professor of Sociology, Crafton Hills College & President San Bernardino Community College District Teachers Association
Bob teaches Sociology at Crafton Hills (sister school to Valley College) and is in the first year of a 2-year term as president of the local chapter of the California Teachers' Association. He is hoping to be able to use his term as president to increase the local membership and to make his chapter more community oriented. Bob's experience as a teacher in the Peace Corps in Tanzania left a big impact on his life. He is enthusiastic about AmeriCorps and the opportunity that it provides for community service as well as educational funding. Bob realizes his job as a teacher in the community college system is much broader than just communicating the required curriculum. He is a career mentor and friend to his students, and encourages them to volunteer in the community.

DREW COLBERT: 73, Vocational Student at San Bernardino Valley College, and Former Director of a Training Center at Shell Oil

After Mr. Colbert left his native Arkansas for California in the 1940s, he began working in a shipyard and eventually became the manager of a training center for service station attendants at Shell Oil. Mr. Colbert recently returned from 18 years in Alaska with a dream of training recovering drug addicts or returning prisoners to be auto mechanics. Once trained, he hopes to place these people in jobs either at existing gas stations, or in closed-down service stations that he dreams of purchasing and transforming into "first-class," full-service gas stations. Mr. Colbert is attending classes at Valley College to learn about the latest automotive technology, and cites the need for more up-to-date equipment in community colleges to train students for today's jobs. He wants to tell those he eventually hopes to train, "If you have hope, I'll throw you a rope."

BARBARA JEAN FASENMYER (FAS sen my er): 46, Parent and Local PTA Officer

Barbara is the mother of three daughters in the Colton public schools, and has been an officer in Colton's Parent-Teacher Association (PTA) since 1985. She serves on a school site council, which determines the school budget for such activities as field trips, assemblies, and extra books and instructional materials. A volunteer on many school district committees, she cites the pressing need for more school volunteers and more mentors for students. Driven by dismal attendance at parent's night last year, Barbara is working to have parents of all 400 children attend this year's event.

SPECIAL SCHEDULING REQUESTS
HONORARY CHAIR, HONORARY PATRON, HONORARY MEMBERSHIP

Today's Date: February 23, 1995

95 FEB 23 P 4:06

Date of Request:	**10/11/1994**
Request for:	**POTUS/FLOTUS**
Type of Request:	**Honorary Chairs**
Requestor Name:	**Mrs. John C. Gore**
Title:	**Benefit Chairman**
Organization:	**Arena Stage 6th & Maine Avenue, S.W. Washington, D.C. 20024**
Contact Tel. #:	**202/554-9066**
Event Date:	**3/13/1995**
Event Description:	**1995 benefit for the Living Stage Theatre Company**
Notes:	**"Living Stage's programs serve a wide range of children and adults who are living in high-risk environments." The President and Mrs. Clinton lent their names to the 1994 benefit.**

Recommendations:

yes if HRC says

MW _______ **JP** _______ **EB** _______

yes

WJC yes if HRC says no

2/23/95

2/23/95
The original request was lost. We just got the letter today.
Jessica

SPECIAL SCHEDULING REQUESTS
HONORARY CHAIR, HONORARY PATRON, HONORARY MEMBERSHIP

Today's Date: February 23, 1995 95 FEB 23 P4:06

Date of Request:	1/27/1995
Request for:	POTUS
Type of Request:	Host Committee Member
Requestor Name:	The Honorable Sheila James Kuehl
Title:	
Organization:	Gay & Lesbian Alliance Against Defamation 1950 Sawtelle Boulevard Suite 288 Los Angeles, California 90025
Contact Tel. #:	310/996-1188
Event Date:	3/12/1995
Event Description:	6th Annual GLAAD Media Awards
Notes:	GLAAD "works for fair, accurate and inclusive representation of lesbian, gay and bisexual lives" by the media. Senators Feinstein and Boxer and Mayor Riordan have already lent their names to this event.

Recommendations:

JP ______ EB ______

2.23.95

SPECIAL SCHEDULING REQUESTS
HONORARY CHAIR, HONORARY PATRON, HONORARY MEMBERSHIP

Today's Date: February 23, 1995

95 FEB 23 P4:06

Date of Request:	1/27/1995
Request for:	POTUS
Type of Request:	Honorary Chairman
Requestor Name:	Mr. Uzi Zucker
Title:	Gala Chairman
Organization:	American Committee for the Tel Aviv Foundation 4640 Admiralty Way Suite 216 Marina del Rey, California 90292
Contact Tel. #:	310/821-3298
Event Date:	5/17/1995
Event Description:	Ambassador's Gala
Notes:	The Tel Aviv Foundation will honor Beny Alagem, CEO of Packard Bell Corporation, at the Gala by bestowing upon him the title of Honorary Ambassador. According to the letter, POTUS has met Mr. Alagem. Notable people included in the event are Ambassador Itamar Rabinovich, Paris Mayor Jacques Chirac, Senator Barbara Boxer, and some movie celebrities.

Recommendations:

NO

JP ________ EB ________

2-23-95

THE WHITE HOUSE

WASHINGTON

February 22, 1995

Steven B. Duke
Professor
Yale Law School
Post Office Box 208215
New Haven, Connecticut 06520-8215

Dear Steven:

Thanks for your letter of February 14 and for your personal recommendation of Kathy Smith to serve on the National Commission on Crime Control and Prevention.

I appreciate having your insight, and I've shared your letter with Veronica Biggins, my Director of Personnel, and asked her to give it careful consideration.

Sincerely,

Bill

Thanks for bringing this to my attention!

CC: VERONICA BIGGINS

YALE LAW SCHOOL
P.O. Box 208215
New Haven, Connecticut 06520-8215

STEVEN B. DUKE
Law of Science and Technology
Professor
203 432 4959
203 432 4177 FAX

February 14, 1995

President Bill Clinton
The White House
Washington, DC 20500-2000

Dear Mr. President:

As you know, the crime bill that you signed last year provides for the appointment of a commission to study the crime problem, including the effectiveness of the drug laws. At recent proceedings before the Senate Judiciary Committee, you were criticized for not taking a more active leadership role in the drug problem. Many of the best provisions of last year's crime act are also on the House Republican's chopping block.

I think you could effectively respond to your critics on drugs and at the same time slow the momentum that is developing to repeal the best parts of the newly-enacted crime laws by announcing your appointees on the commission called for in the law.

If and when you do appoint members of the commission, I strongly recommend that you select Kathy Smith of Anaheim, California as one of its members. Mrs. Smith is the architect of the Hoover Resolution, calling for a national commission to study the drug laws, and has spent much of the past twenty years campaigning for drug law reform. She has no fixed positions on how such a study should come out (she is not a "legalizer") and she is a conservative Republican. Basically, she is a housewife who has become a crusader for reconsidering our approach to drugs. No commission that engages in such consideration should be without her perspective.

Finally, I would like to thank you and Mrs. Clinton for a wonderful evening at the White House on December 16. I hope to see you there again in 1997.

Sincerely,

Steven Duke

Steven Duke

SD/jzt

THE PRESIDENT HAS SEEN
2.22.95

YALE LAW SCHOOL
P.O. Box 208215
New Haven, Connecticut 06520-8215

cc: Erskine
Crano
Kilberg

STEVEN B. DUKE
Law of Science and Technology
Professor
203 432 4959
203 432 4177 FAX

February 14, 1995

President Bill Clinton
The White House
Washington, DC 20500-2000

Dear Mr. President:

As you know, the crime bill that you signed last year provides for the appointment of a commission to study the crime problem, including the effectiveness of the drug laws. At recent proceedings before the Senate Judiciary Committee, you were criticized for not taking a more active leadership role in the drug problem. Many of the best provisions of last year's crime act are also on the House Republican's chopping block.

I think you could effectively respond to your critics on drugs and at the same time slow the momentum that is developing to repeal the best parts of the newly-enacted crime laws by announcing your appointees on the commission called for in the law.

If and when you do appoint members of the commission, I strongly recommend that you select Kathy Smith of Anaheim, California as one of its members. Mrs. Smith is the architect of the Hoover Resolution, calling for a national commission to study the drug laws, and has spent much of the past twenty years campaigning for drug law reform. She has no fixed positions on how such a study should come out (she is not a "legalizer") and she is a conservative Republican. Basically, she is a housewife who has become a crusader for reconsidering our approach to drugs. No commission that engages in such consideration should be without her perspective.

Finally, I would like to thank you and Mrs. Clinton for a wonderful evening at the White House on December 16. I hope to see you there again in 1997.

Sincerely,

Steven Duke

SD/jzt

THE PRESIDENT HAS SEEN
2.22.95

FAX MESSAGE

Leslie Singer
103 W. Capitol, Suite 1104
Little Rock, Arkansas 72201
Phone/Fax (501) 375-1860

To: Frontline

From: Leslie Singer

Date: 2/2/95

Number of pages: 1

Subject: "What Happened to Bill Clinton"

I guess it's not surprising that a press that thinks 81-minutes is too long for an annual State of the Union address, can't understand that the Bill Clinton they describe as "unfocused," might actually just be more complex than they can conveniently handle.

I don't see how a man-- *especially* a politician-- who aggressively takes on the NRA, the health care industry, the welfare system and the national debt can be described as "weak," or "uncommitted."

Does he acknowledge that there are at least two sides to every issue? Yes. Does he try to achieve consensus and compromise where possible? He does. But after all is said and done, have we not moved forward on many of our most critical issues for the very first time? Absolutely.

I believe that history will show Bill Clinton to be a remarkable and brave president-- and that it was the pundits of his day who followed the easy and undisciplined path of pile-on journalism and short sightedness.

Thank you,

Leslie Singer

Leslie Singer

cc Leslie's letter
to POTUS

cc: McCurry
Gearan

" I would like to invite this boy & his parents to come see me "

cc NA B.W.

I would like to invite this boy & his parents to come see me.

E HOUSE

GTON

February 16, 1995

CC: Billy Webster

Ian Hudson
1420 West Main Street
Crawfordsville, Indiana 47933

Dear Ian:

I read the Reader's Digest story on you and was very moved.

You are an inspiration to so many, and I want you to know how impressed I am by your energy and your determination.

I hope one day we will be able to meet. Until then, I will be thinking of you.

Sincerely,

Bill Clinton

Please tell your parents hello for me — Also your friend Jennifer Roberts who wrote me about you too — I hope one day you and your family can come to the White House and see me. Hang in there!

Reader's Digest

Everyone in Mrs. Z's class was gifted and talented, but none more so than Ian Hudson

PHOTOS: © MIKE FENDER/INDIANAPOLIS NEWS

The Boy Who Surprised Everyone

BY PETER MICHELMORE

AS SHE SETTLED the children for the first day of school in August 1989, Margaret Zimmerman glanced expectantly at the door. Any minute now, six-year-old Ian Hudson would be joining the 20 pupils in her class for gifted and talented children at Laura Hose Elementary School in Crawfordsville, Ind. "Mrs. Z," a 20-year teaching veteran, was worrying about how her articulate, self-assured first- and second-graders would react to Ian—and how she herself would cope.

After leading the kids in the Pledge of Allegiance, Mrs. Z began, "We're in for a special adventure this morning. A boy named Ian Hudson will be joining us." At that, the door swung open. Silently, eyes wide in astonishment, the kids watched their new classmate enter.

Blond and slight, the boy was strapped into a seat fixed inside a tubular, four-wheeled frame pushed by a smiling young woman. "Hi," said Joyce Zurkowski breezily. "This is Ian. He has cerebral palsy. He can't walk or talk, and his body doesn't work very well. But he's just as smart as you are, and he would like to be your friend."

Ian's head bobbed and his arms

waved. His blue eyes scanned the upturned faces, then swiveled away. Joyce took him out of the seat and sat with him on her lap.

Suddenly Ian's upper body stiffened and slammed back against Joyce's chest. He let out a high-pitched cry. "He's excited," Joyce told the children. "Ian does this when he's happy."

The eyes around Joyce were startled, questioning. What was such a strange little boy doing in Mrs. Z's classroom?

You're going to have to prove yourself, kid, Joyce thought, hugging him tight.

At that moment, Ian's mother, Helen, was driving away from the school teary-eyed, feeling she was on the wings of a dream. *I dropped him off at school,* she thought, *just like any other six-year-old!*

Until recently, this commonplace event had been beyond fantasy for Helen. Now, not only was Ian starting school, he was doing it with the town's best and brightest.

IAN HUDSON came into the world on July 29, 1983, weighing 5½ pounds, gray from oxygen starvation and fighting for every breath. After Helen Hudson had been in labor 12 hours, doctors at the Omak, Wash., hospital had to perform an emergency Caesarean to save the infant.

Flown by helicopter to a Spokane hospital, Ian was put on a ventilator. The parents were told that, if the baby lived, he would have cerebral palsy and might also be mentally retarded.

Grief-stricken, Marc and Helen Hudson took their son home. Many infants with severe cases of cerebral palsy exhibit some functional development, but the passing months brought little sign of progress in Ian.

There was an alertness in his striking blue eyes, however. They followed his parents' every gesture. *Something is going on there,* Helen thought.

When Ian was about a year old, Helen took a position as assistant professor of humanities at St. Norbert College in De Pere, Wis. The family moved to nearby Green Bay, where Marc became a lecturer in the English department at the University of Wisconsin. Both parents would take turns holding Ian on their lap and reading to him. They could tell his favorite books by his smiles and excited squirming.

Once when he was 2½ years old, Joyce Zurkowski, one of Helen's students, came to baby-sit. "Ian likes to pick out his own books," Marc informed her.

Joyce looked at the child incredulously, but she caught the gleam in his eyes. From that night, Joyce became part of the family. She and Ian read shelves of books and watched TV. Ian crowed over "Sesame Street," loved "Mr. Rogers' Neighborhood" and "Wheel of Fortune." Joyce sensed that Ian was following every letter named by the show's contestants.

At age three, Ian entered a preschool for severely disabled children, but became upset in the exclusive company of other kids who could not walk or talk. Switched to a regular preschool, he was much happier. At a picnic one day, he squealed with delight at the sight of a little girl whizzing down a slide. *He's identifying with that child,* his father thought. *He's sharing her joy.*

By his watchfulness and other little signs, such as the way he chuckled at the funny parts in stories, Helen was sure Ian was not mentally retarded. Marc harbored doubts, however, and medical opinion varied. Most psychological tests rated his intelligence far below average, but a couple of doctors thought he might have normal intelligence. "Believe me," one of them told the Hudsons, "your child does not miss a thing."

One day, Helen put a board on the floor and affixed magnetized letters spelling the word *cow* to the upper half of the board and *frog* to the lower half. "Which animal is green?" she asked.

Lunging forward from her lap, Ian covered the word *frog* with his whole body.

Later Helen spread out the pages of a newspaper and asked Ian if he could see the word *fire* anywhere in the headlines. She closed her eyes as Ian went forward. When she looked, his arm was resting on the target word.

Though delighted, Helen could not see how word identificationwas of any practical use to a child who could not eat or go to the toilet unaided. *It's just a trick he can do,* she thought.

In 1988 the family moved to Crawfordsville, Ind., where Marc had been hired as an assistant professor of English at Wabash College. In the spring of 1989 Helen gave birth to a healthy daughter, Alexandra. By then Ian was approaching his sixth birthday, and his education had to be considered. "Let's have him evaluated," Helen said.

School psychologist Marilyn Webb from the West Central Indiana Special Services Cooperative came to the Hudson home to test Ian's capabilities. When Helen told her that Ian was able to make a pointing motion, Webb placed four large cards—numbered one through four—on the floor in front of the boy. In her hand she had four illustrations, also numbered one through four. One of the illustrations was of a girl swinging. Webb asked Ian to point to the card on the floor corresponding to the illustration of the girl. Without hesitation, Ian picked the correct number.

Helen's heart thrilled as Ian pointed to the right answers again and again. *At last,* she thought, *he's showing us what he can do.*

Before the testing finished, Ian was answering two-stage problems in addition, subtraction and multiplication. His eyes danced at his accomplishments. Helen was amazed that he knew such words as *arid, dilapidated, replenish* and *talon.*

Webb's report, arriving in the

mail a week later, came as a shock to the Hudsons: Ian had tested in the 99th percentile for his age in the nation! Neither parent could explain their son's gift for math. Apparently he had absorbed language by being read to, watching TV and listening to conversations.

When the staff of the Special Services Cooperative met with the Hudsons, director Ronald Lewis had a startling suggestion: "With Ian's ability, why not put him in a class for the gifted and talented?" Crawfordsville's program was located in the Hose school.

Five days before the start of classes, a stunned Margaret Zimmerman met the Hudsons. "We're told that your class is the appropriate place for our son," said Marc.

I can give Ian input, Mrs. Z thought as she looked at the boy in his mother's lap. *But how can I get any output?* What she said was "I'll take him."

AFTER JOYCE introduced Ian to the class, she carried him to a chair set up with foot straps and a tray. Ian's head drooped, but his eyes raked the room. Some youngsters stared, others averted their eyes.

Desperately, Ian wanted them to understand that he was a bright, fun-loving boy. But they would have to make the first move.

"Does Ian like cars?" piped a gangling boy with curly brown hair.

"Why don't you ask him?" said Joyce.

Ian's arms flailed at the question, but Aaron Schaefer paid no heed. His eyes were on the smile spreading over Ian's face. "We're going to have fun," Aaron said. "You're going to like it here."

Never before had Ian heard such words from a kid his own age. *He's not noticing my handicap,* he thought rapturously. *He's noticing me!*

Mrs. Z felt a surge of joy. She had put popular, easygoing Aaron next to Ian by pure chance. And here they were, making friends! Aaron had seen Ian with his heart, as well as his eyes.

After school, Helen was waiting for Ian, her heart thumping. She had a thousand questions, but the most important was answered by the glow on Joyce's face. "It's going to be okay," she said.

When Joyce returned to college the following week, Ian readily adapted to his in-school aide, Ginny Froedge. Mrs. Z had carefully prepared two posters with the numbers one through ten on one and the alphabet on the other. Soon, working on the floor with Ginny, Ian made his hand fly over the letters and numbers as he solved problems and spelled out sentences. Mrs. Z was so amazed that she got down on the floor with them to make sure Ginny was not guiding Ian's arm.

When the class studied dinosaurs, each child had to write a short essay. Ian had a sly look as he spelled out the words for Ginny to transcribe. "My name is Dewey the Dinosaur. I'm going to McDonald's.

Classmate Amber Mullendore takes her turn pushing Ian's chair

I am going to order a dino-burger, caveman fries and a rock cola."

One day, Ian tried to join in singing "The Star-Spangled Banner." When only groans escaped his mouth, he broke down sobbing. It saddened everyone. Later, Mrs. Z encouraged the class to look at the positives. "Ian is bright and creative. He comes in every morning beaming. We're lucky to have him."

There was no disputing that. A special chemistry was developing between Ian and his classmates. On the basketball court, Aaron would put the ball on Ian's tray so he could flick a pass. In autumn, leaves were piled on Ian's tray, and everyone whooped as he scattered them to the winds.

One recess when the kids fled outside and Ginny prepared to follow with Ian in his chair, Aaron said, "I'll take him."

Aaron tilted back Ian's seat and set it low in the wheeled frame. As they approached the asphalt slope that led

to the playground, Aaron shouted, "We're in racing mode, Ian!" Head back, his buddy felt the rush of air on his face and heard the other kids yelling, "Here comes Ian!"

Soon the other kids began asking Ginny for a turn at pushing Ian's chair. "I'll have to make a list," she said, laughing.

When Ian was playing racing-car games one day at Aaron's home, Aaron's mother, Chris, whispered to her son, "Let Ian win." "No, he's got to *beat* me," Aaron insisted. And Ian did.

Watching Ian play, Chris Schaefer was filled with the wonder of his naturalness. Her heart ached for all the handicapped kids who might never sit in a classroom, never have friends. She felt Aaron was a small part of Ian's story, but it filled her with pride.

During February, Ian labored with Aaron, Aaron's twin brother Brad and a boy named John Helling on a project for a media fair. Presentations would include slides, videotapes and recordings.

Ian wrote a script called "The Big Black Hole," with Aaron as cameraman and narrator. The videotape opens with Ian, Brad and John in the playground. Suddenly the boys tumble into a big hole—represented by black construction paper—which opens up in front of them. Next, projected drawings by the boys show them as tiny figures exploring the dangerous underground, led by a fearless Ian, completely sound in body and voice.

In their adventurous journey, they encounter a swordsman and a giant mouse. At the story's end, the boys tumble back through the hole to the playground, with Ian once more in his wheelchair, struggling to keep his head held high. Aaron's voice is heard saying, "I wish we could live where everyone is the same. I didn't like being so tiny, but Ian could walk."

The fantasy video stopped the hearts of the media-fair judges, who gave it first prize in the kindergarten through second-grade category. At the awards ceremony, Aaron, Brad and John ran to the stage to get their blue ribbons. The hall rang with applause that grew like thunder, for coming down the aisle now in the arms of his father, was Ian Hudson, arms waving and face shining.

Ian completed first grade in the 99th percentile nationally. In second grade, still in Mrs. Z's classroom, his body strengthened and his left hand took surer aim at the letters on his alphabet board. Ian rarely dwells on his disabilities, and neither do his parents, who hope Ian's story will inspire others.

REPRINTED FROM THE JULY 1991 ISSUE OF READER'S DIGEST

Hudson
1420 W. Main
Crawfordsville, IN
47933
Georgetown Class of '68

LAFAYETTE IN 479
DEC
1994

AIDS AWARENESS
USA 29

President Bill Clinton
LAFAYETTE IN 47901 17:29 12/27/94
Hillary Rodham Clinton
The White House
Washington, DC.

Bill & Hillary,

You don't of course really know us, but we want you to know that 1000s of us out here wish you

Happy Holidays

well & believe deeply in what you are doing.

Marc was prize-winning poet in the Class of '68 and you will (:) have heard of our son from other sources (see enclosed)...

Our very best,
Helen & Marc Hudson

November 10, 1994

Dear Mr. President,

I would think that with your placement of being our president, you like to know what is going on with the people, and the children, of the United States. I have only wrote this to you to notify you of the great things happening in my life, but mostly to tell you about a certain boy. In the small town of Crawfordsville, a miniature Superman lives. He is remarkably cute and a little small for his age of 11. He has a smart brain and when writes his assigned projects, his fellow classmates comment of him writing a novel. His only fault, his ceberal palsy has limited him to move anything other than his hands and he can not talk. Ian Hudson is his name.

He speaks through a letter board. The board has letters and numbers. By holding his elbow, he can communicate. This procedure is not as easy as it sounds. I will admit that from personal experience! Even with this different ability (we do not use any other words such as disabled or handicapped) he is a well known and liked child at Tuttle Middle School. The sixth grader is in advanced classes with me and a certain Johnna Rogers, his best friend.

Once Ian told me and Johnna that he had two wishes. To walk and to meet President Clinton and Vice-President Gore. I know we can accomplish one of these. So, I write to you, on behalf of Johnna and myself, consider his second wish, please.

Sincerely,

Jennifer Roberts

11 years old

802 E. Chestnut
Crawfordsville, IN
47933
1-317-362-7046

THE WHITE HOUSE

WASHINGTON

December 5, 1994

Ms. Jennifer Roberts
802 East Chestnut
Crawfordsville, Indiana 47933

Dear Ms. Roberts:

Thank you for writing on behalf of your friend Ian Hudson. The President appreciates your letter of support and is sorry that he will be unable to meet with Ian at this time.

Unfortunately, the tremendous demands on the President as he works to move our country forward do not give him the opportunity to speak with as many people as he would like.

On behalf of the President, thank you again for your thoughtful letter. Please do not hesitate to contact my office if we can provide any further assistance.

Sincerely,

Billy Webster IV

William M. Webster, IV
Director of Scheduling and Advance

WMW/ing

THE WHITE HOUSE

WASHINGTON

February 22, 1995

Elmo H. Woolf
Post Office Box 218
Fordyce, Arkansas 71742

Dear Elmo:

Thanks for your note, which Jimmie Lou shared with me.

I would love the chance to see you while you're in Washington. When you know your plans in more detail, please call Nancy Hernreich at 202/ 456-6610 to set up a time to get together.

I hope to see you soon.

Sincerely,

Bill Clinton

CC: NANCY HERNREICH
CC: CAROLYN HUBER
HRC

Anne

NH -
JIMMIE LOU
GAVE TO CAROLYN

THE WHITE HOUSE
WASHINGTON

2/16 do a note a
say he hopes to see her
HC
cc:

President Bill and
First Lady Hillary -
I'll be at the WHCoA
May 2-5-95.
I'll need a hug to keep
living-!! I'm with you
all the time in heart & Prayers-
always,
Elmo H. Woolf
2/8/95.

I love Jimmie Lou, too -

THE PRESIDENT HAS SEEN
2-21-95

EXECUTIVE OFFICE OF THE PRESIDENT
COUNCIL ON ENVIRONMENTAL QUALITY
WASHINGTON, D.C. 20503

Kathleen A. McGinty
Chair

95 FEB 10 P8:07

FEBRUARY 10, 1995

MEMORANDUM TO THE PRESIDENT

FROM: KATHLEEN MCGINTY Matthew Gunter for

CC: LEON PANETTA

RE: CEQ WEEKLY REPORT

REGULATORY REFORM (H.R. 9 & H.R. 450)

Risk Legislation (H.R. 9, Title III)

We need explanation

This week the House Science and Commerce Committees passed legislation requiring elaborate risk assessments of most federal health and safety rules. Floor action is expected February 22. During committee consideration, the bill was made even worse than originally introduced by adding provisions which: (1) allows the bill to supersede existing statutory standards in current legislation; and (2) permits petitioning to reopen all currently existing regulations. However, the movement of the Republicans to the extreme right is attracting the attention of major media (NY Times, Wash. Post, Wall St, Jr.), and House Democrats have asked the Administration assistance for stiff floor resistance.

"Lawbreaker's" Bill-of-Rights (H.R. 9, Title VIII)

House Judiciary Committee held hearings on another part of the Republican regulatory reform agenda which would prevent surprise inspections of facilities that could be suspected of wrong-doing such as nursing home operators. As a result of the hearings, at which these provisions were strongly opposed by Department of Justice, Republicans have had second thoughts and may ease or drop these restrictions. If they do, they may avoid embarrassment because the Administration has not had an active communications effort on this issue to date. I fear we have missed our opportunity to really tar them with this.

We need to push

Takings Hearing (H.R. 9, Title IX)

Today, the House Judiciary Subcommittee on the Constitution held a hearing on "takings" legislation pending in this Congress. Currently over six bills have been introduced on this issue, including Title IX of H.R. 9, the "Contract" bill. Mr John R. Schmidt, Associate Attorney General, presented the Administration's views regarding these legislative proposals.

Our testimony, which was prepared by a White House/DOJ team, made it clear that your Administration believes that the right to own, use and enjoy private property is a fundamental right at the very core of our nation's heritage and our continued economic strength. We also made it clear that government must minimize the effects of its programs on landowners -- something that we are doing through our reform initiatives. And finally, we unequivocally expressed our opposition to the automatic compensation legislation proposed, including H.R. 9, because it will hurt homeowners and cost middle-class families billions of dollars. In short, we must not change what the Constitution has provided for 200 years -- fairness and justice for all Americans.

It is important that you know that we are not alone in our opposition to these bills. Other witnesses testified that these proposals are about eviscerating the ability of government to provide for the common good. The Reverend Joan Campbell notes in her testimony that we "expect every property owner to respect the covenants that we have made as a society to work for the common good." New Mexico Attorney General Tom Udall notes in a written statement that "Title IX of H.R. 9 serves neither the property values its seeks to promote nor the public interest." A broad-based coalition of religious, civil rights, labor, and environmental groups are actively opposing these compensation bills. I have attached information on a press conference held by these groups after the hearing.

The Vice President spoke to the Conference of Mayors on this issue and now we have testified on our position. We must continue to engage fully in this battle and remain unequivocal in our opposition to actions that will have such drastic effects on the middle-class and our communities.

Regulatory Moratorium (H.R. 450)

The House Government Reform Committee is expected to pass legislation imposing a moratorium on most Federal regulations extending from November 20, 1994 to December 31, 1995. Such legislation would, of course, make it nearly impossible to conduct the duties of the executive branch. The extremity of the regulatory moratorium is also beginning to attract major media attention. In fact, when all of the regulatory reform issues are taken together, they are near to reaching a critical mass in terms of their ability to burst into a very broad political message for average Americans in terms of their basic health and safety protection. I feel strongly that the time is ripe for us to draw some clear lines on these issues. I would hate to miss the opportunity here as we have on the enforcement and compensation provisions.

CLIMATE CHANGE

On Thursday, 30 CEOs from the property-casualty insurance and reinsurance industry met with the Vice President to discuss their concerns about the effect of a changing climate on United States citizens and their property. In recent years, U.S. insurers have experienced a series of extraordinary losses as a result of hurricanes, earthquakes, and floods. Following Hurricane Andrew in 1992 (a $20 billion loss to the industry), the industry has intensified its analysis of its risk exposure to these extreme natural events. In the meeting Vice President Gore asked the industry to utilize its experience with catastrophes by undertaking an analysis of the exposure to the U.S. to long term changes in the world's climate. The industry group accepted the Vice

President's request to review their loss experience and evaluate the potential effect of long term changes in climate.

STAFF NOTE

Today we said goodbye to our chief of staff, Cathy Zoi, as she embarks on a journey to the great down under. Cathy will be on a fellowship with the Australian environmental protection agency working on their reinventing government effort. With Cathy Zoi's departure, we recently welcomed Shelley Fidler as our new chief of staff. Shelley comes to us after twenty years with Congressman Phil Sharp as his staff director on the energy subcommittee.

NATIONAL LEAGUE OF CITIES
NATIONAL COUNCIL OF CHURCHES
AMERICAN COMMUNITY PROTECTION ASSOCIATION

For Immediate Release
Friday, Feb. 10

Contact:
Mike Casey
202-797-6506

Opposition Mounts to "Takings" Plank of Contract

Municipal officials, clergy, property owners warn of budget-busting costs, red tape for taxpayers, less health and safety protection

Washington— Municipal officials, clergy and property-owners announced their opposition to the "Takings" plank of the Contract With America at a noon news conference today in Room 2203 of the Rayburn House Office Building.

Participants warned that the Contract's takings language would be the "American taxpayers' worst nightmare"—by creating a new entitlement program for moneyed special interests that would require additional bureaucracy and red tape. The news conference was timed with the first congressional hearing on the takings issue, which took place this morning before the House Judiciary Committee's Subcommittee the Constitution.

The takings opponents said that passage of the takings bill would be a boon to special interests who want to use their property in ways that harm the value of surrounding properties, or would endanger public health, safety and environmental interests of neighboring communities.

Several news conference participants related personal stories of property value losses from the reckless actions of neighbors —actions against which the House proposal would leave them no recourse.

New Hampshire Republican State Senator Richard Russman explained that the takings proposal would be a budget buster, and a special burden on state and local governments.

News conference participants were:

• **Susan Thornton; Mayor Pro Tem; Littleton, Colorado**; an active National League of Cities member and opponent of takings legislation who said, "Last November, people voted for change. This billion-dollar burden for the taxpayers wouldn't be change—this is more of the same."

• **State Senator Richard Russman; New Hampshire**; a Republican and fiscal conservative who opposes takings measures because of their "budget-busting" impact. Russman said, "We just can't afford these takings bills." He is a sponsor of the line-item veto and the term limits bill in his state legislature.

• **Sally Ormsby; Homeowner; Fairfax County, Virginia;** where oil storage tanks leaked into a neighboring stream and decreased property values by as much as 50%.

• **Patrice Butterfield; Homeowner; Statesboro, Georgia;** whose home and others nearby were flooded when a real estate developer filled in a wetland.

• **The Rev. Mark Johnson; Church Camp Director; Walker County, Alabama,** where contaminated runoff from an upstream strip-mining operation flowed into the groundwater, killing aquatic life and preventing the church's children from using their swimming hole.

(MORE)

EXECUTIVE OFFICE OF THE PRESIDENT
COUNCIL ON ENVIRONMENTAL QUALITY
WASHINGTON, D.C. 20503

THE PRESIDENT HAS SEEN
2-21-95

Kathleen A. McGinty
Chair

February 10, 1995

95 FEB 10 P4:36

MEMORANDUM TO THE PRESIDENT AND VICE PRESIDENT

FROM: KATHLEEN MCGINTY

RE: OREGON FOREST PLAN UPDATE

This is in response to your concerns from your recent conversations with Governor Kitzhaber.

THE BOTTOM LINE IN OREGON

The bottom line is that you have nothing to be apologetic about with regard to the Forest Plan in Oregon. As promised in the Plan for FY95, the Forest Service and the Bureau of Land Management assures us we will deliver 60% of the 1.1 billion board feet target, or 600 million board feet. The lion's share will be in Oregon -- 235 million board feet, or 40% of the total. On the economic front, Oregon received $36 million in FY94 as a part of the economic adjustment assistance provided for in the Plan plus another $42 million from the Small Business Administration in loan guarantees for disaffected timber communities. Because of our Plan, promising new economic opportunities have been launched. Sure, we all would like to move more timber quicker. But, it is almost *physically impossible* to do that, among other things, this is because currently there is deep snow on the ground! Your opponents will, of course, try to tarnish what you have accomplished here. We can let them, or we can state more clearly and forcefully our accomplishments while, of course, we continue and strengthen our efforts.

MAKING GOOD ON PROMISES

Just this week, we made good on another one of the promises in your Plan. In the Plan, we said that if the Federal government would responsibly manage Federal lands, we could ease up on the private sector. Moving forward on this, the new rule: (a) completely exempts small woodlot owners from Endangered Species Act requirements for the spotted owl; (b) dramatically curtails requirements for big landowners; and (c) largely cedes control back to the state of California for management of owl forests in that state. For those who would say we aren't pushing Fish and Wildlife Service people hard enough, note that here we have gotten them to accept DRAMATICALLY reduced protections -- eliminating or reducing from 5,600 acres to 70 acres the protections afforded owls. (See attached *Washington Post* article)

LEGAL VALIDATION OF THE PLAN

As you know, just before Christmas Judge Dwyer ruled to uphold the Plan. Validating our efforts to provide *both* biological diversity *and* sustainable economies, Judge Dwyer noted in his opinion that "**given the current condition of the forests...any more logging sales than the plan contemplates would probably violate the laws.**"

Remember, **the only hope for any action** on timber is a consequence solely of your efforts. For years Congress (including some members who complain now) could have acted, they failed. For years, previous Administrations could have acted, they didn't even try. **You acted; you are succeeding!**

FOREST MANAGEMENT

Historically, it has taken the forest service approximately three years to prepare a single timber sale. There are two major reasons for this: 1) there were many analytical steps that must be undertaken before a sale can be prepared; and 2) weather conditions limit the times that are appropriate for timber preparation and sale. Because there typically was a 3 to 5 year supply of timber in the pipeline, the long lead time needed for a new sale was not so problematic. Now, however, because of the three and-a-half year injunction, that stockpile has been fully depleted and we are in essence starting the process from scratch. It is for this reason that we sketched-out in the Plan a schedule to climb up to 1.1 billion board feet. We said we would be there by 1997. Was this yr

True to our form, the agencies are proceeding in the preparation of timber sales, conforming to the analytic guidelines set forth in the Forest Plan. The appropriate analyses, which include watershed and NEPA analysis, biological evaluation and consultation, review by the Regional Ecosystem Office, and surveying and managing strategy and project design, are on track to deliver 600 million board feet in FY 95. Despite these processes taking a considerable amount of time, agencies assure me they are on target for offering timber sales over the next three years. For this year, we said in the Plan that we would meet 60% of the target 1.1 billion board feet. The Forest Service and the Bureau of Land Management assure me we are on track to deliver this amount -- 600 million board feet -- this year. Additionally, I am assured that we are on track to deliver 80% of the target in 1996 and 100% in 1997. **To do this, we are expending tremendous resources. Indeed we have moved resources from other parts of the country to accomplish this intense effort.** I suspect that Congressional members from other parts of the country will begin to balk at any further concentrations of resources in the Pacific Northwest.

What does deliver mean

Of the total regional harvest (including areas within the Forest Plan from all three states WA, OR, and CA) for FY 95, the lion's share, 40%, is coming from Oregon. **This will be the first significant volume of timber to move in Oregon in over three and-a-half years. As weather permits, these new contracts will yield sales amassing 235 million board feet between now and August, all from the state of Oregon.**

ECONOMIC ADJUSTMENT INITIATIVE

We have also made significant progress with regard to economic assistance. At the end of FY94, we had distributed over \$126 million to the region. Of the total, 29% or \$36 million had gone to the state of Oregon plus another \$42 million in guaranteed loans from the SBA for disaffected timber communities. Overall, as you know, in the next five years we will contribute a total of \$1.2 billion in grants (46%), loans (33%), and Jobs-in-the-Woods contracts (21%) to the region--an exceptional, unprecedented package of assistance. You should also know that our efforts here have been a model of Reinvention. We have set up completely new structures that afford states and local communities an unprecedented level of input into our decision-making process. **We should be heralding our success here.**

One example is the Roberts Creek Water District treatment plant and line expansion project in Douglas County, Oregon, an area hit hard by the decline in timber harvests. The District in 1992 placed a moratorium on sales of new water meters because of an inadequate supply of treated water. The moratorium prevented the development of a 60 acre industrial area and restricted the District's ability to provide acceptable fire protection to industrial and commercial areas. The District applied to the Economic Development Administration for a grant and received $716,000. The money, however, was not sufficient to finance the total cost of the water treatment plant expansion. The Oregon Economic Development Department completed the funding package with $957,000 in loans and grants from The Special Public Works Fund. As a result, Ingram Book Company has committed to locating in the district. That commitment will translate into 200 new jobs, according to the Oregon Economic Development Department.

Here is just a sampling of other projects in Oregon:

City of Oakridge, Lane Co.		$2,464,000	Industrial Park
Federal contribution	$1,840,000		
Siletz, Lincoln Co.		$2,910,220	Tribal Admin.
Federal contribution	$2,874,000		

Although the majority of the projects listed required multiple sources of funds, Oregon has been innovative in developing a process to coordinate funding. The concept of a "One-stop Finance Center" was developed, under the guidance of a Forest Plan Community Economic Revitalization Team in Oregon (part of the reinvention developed in the Plan), to assist communities with needed financing and to coordinate with all funding agencies.

The bottom line is that your Plan has fostered innovative, new partnerships among federal, state, local agencies and the private sector that are creating jobs and really helping communities that were left high-and-dry after the timber crisis brought on by the Reagan and Bush Administrations.

Attached for your perusal is: (1) the *Washington Post* article referenced above and several editorials/articles on the Forest Plan form Oregon papers; (2) an overall summary of Forest Plan accomplishments to date; and (3) more detailed information on our economic initiatives in Oregon.

[In the next few days I will be sending you a memo on a separate but related issue, namely timber salvage sales. Today I am speaking with Governor Kitzhaber to try to address his concerns directly and as expeditiously as possible.]

THE WHITE HOUSE
WASHINGTON

95 FEB 22 P4:59

OFFICE OF THE STAFF SECRETARY

Fax Transmittal Sheet

TO: Secretary Reich

Fax Number: 219-7659 **Phone Number:**

FROM: John Podesta

SUBJECT: Your memo

DATE: 2/22/95

NUMBER OF PAGES (including cover sheet): 8

MESSAGE:

If all pages are not received, please call 202/456-2702

February 22, 1995

Secretary Reich:

The President's note says:

Good - I think you should write a nice letter to Howard on all these points - You only dodged one, i.e., whether when Glen Gery was cited for "inadequate railings": there were railings within the 36-44 permissible range. BC

THE PRESIDENT HAS SEEN
2.21.95

(2) cc: VP

(1) good – (I think you should write a firm letter to Howard on all these points – He only disagreed on i.e. whether the Govt. was citing for "inadequate" [illegible] killing [illegible] within the permissible range
BC

95 FEB 15 P4:27

MEMORANDUM TO THE PRESIDENT

FROM: RBR

RE: Regulation, *The Death of Common Sense,* OSHA, and related thoughts

1. The general case against picayune regulation

Howard's book, *The Death of Common Sense,* is a good read. He makes a strong case for giving bureaucrats more authority to exercise their own "common sense" to achieve public goals, rather than be mired in picayune "go by the book" details that are nonsensical when applied to a particular situation.

So far so good. But, as Cass Sunstein notes in his review (which appeared last weekend in *The New York Times Books Review*, attached) Howard doesn't give us any idea of the *downside* to letting bureaucrats loose. Most of the particularity and red tape in American regulation comes as a result of public outcry about unfettered administrative discretion. The Administrative Procedure Act itself was the product of public concerns about bureaucrats with too much discretion (not surprisingly, the Act was an early product of the post-World War Two years, when the public had a fresh memory of fascism and totalitarianism).

Of course, there's another reason for the miasma of detailed regulation--found in the perverse interaction between regulators and business. I'm attaching a chapter which reveals it all, from a little-known book (*Tales of a New America)* by a little-known author.

A far better alternative to either picayune rules *or* wide grants of discretion is to create systems of prevention and resolution outside of administrative law and the courts. One example is found in the OSHA Reform legislation which you sent to Congress last year, calling for worker-management safety committees to prevent unsafe working conditions. (The legislation got nowhere, but OSHA is now establishing this on a voluntary basis. The carrot for firms that establish such committees is that they won't be inspected absent a complaint or a serious injury. I'll get into a bit more detail on this below.) The Dunlop Commission did some good work on alternative methods of dispute resolution at the workplace; I'll send it over if you're interested.

Another good alternative is to provide businesses with compliance assistance--information about how to protect the health and safety of workers and of the public, data about the best practices, even technical assistance in achieving better outcomes.

In general, I'd approach the topic this way: The regulatory process needs fixing. Everyone agrees. Republicans want to take a wrecking ball to rules that protect the safety and health of Americans (OSHA, EPA, FDA). They also want to remove from Americans a major tool for deterring bad corporate conduct, apart from regulation--tort actions based on contingency fees. Our plan, by contrast, is to reinvent regulations through emphasizing prevention, alternative methods of dispute resolution, and compliance assistance. Our plan would maintain or improve health and safety, while reducing nettlesome and unnecessary burdens on business.

2. OSHA

I've investigated Howard's specific claims about OSHA. Some are true; most are not. Of those that are true, OSHA's "reinvention" effort (one of the best in the government--Just ask Al Gore) is dealing with them. Note that worker health and safety is a key issue for one of our core constituencies. Indeed, safety at the workplace is a key issue among all workers. Note also that workers who are at greatest risk of death, injury, or illness from their jobs are lower-wage workers without four-year college degrees, whose jobs involve physical stress. These are members of the "anxious class."

Here's a blow-by-blow account of Howard's claims about OSHA, the actual facts, and what OSHA is doing about these issues.

A. "*The agency has over 4,000 detailed regulations, dictating everything from the height of railings (42 inches) to how much a plank can stick out from a temporary scaffold (no more than 12 inches). There are about 2,000 safety inspectors in the field, not many compared with 6 million workplaces, but enough to do some good if they focus on firms with bad safety records.*"

If you count every paragraph, subparagraph, item, and subitem in every OSHA regulation, OSHA might have as many as 4,000 rules. Most of the rules, however, are divided between particular industries (construction, maritime, general industry, agriculture etc.), so that in fact no individual company is subject to all of them. In fact, it's interesting to note that most of these rules actually came from industries themselves--voluntary industrial standards that were simply encoded into OSHA rules in the early years of the agency.

Still, there are too many of them, and OSHA is now in the process of weeding out the ones that make no sense, or are duplicative, or simply outdated.

More to the point, the agency has embarked on a major "reinvention" effort to focus on results--safety and health at the workplace--rather than process. A sampling:

--Incentives for employers to improve workplace safety with the help of their employees. Example: Construction employers that set up worker-management safety programs (and train their workers in safety) are inspected only for the four leading causes of on-the-job deaths (for example, falls, electrocutions). Another example: Under the "Maine 200" pilot project, the 200 employers in the state with the largest number of workers' compensation claims are given a similar choice. Implement an effective safety and health program with worker participation <u>and</u> conduct a self-inspection, or be put on a priority list for wall-to-wall inspection. Most have taken the first option. The results have been
mpressive: During the first 18 months of the program, employees and employers at these firms identified nearly 100,000 potential hazards (a rate 14 times higher than OSHA's own rate of identifying potential hazards through inspections). And more than half of these potential hazards were quickly reduced or eliminated. OSHA is now looking for ways to expand on the pilot.

--The Voluntary Protection Program, already up and running, exempts employers with excellent safety and health histories from all general inspections.

-- With the help of management consultants McKinsey and Co., OSHA is retooling field offices to focus on the most serious threats to worker health and safety; and to provide incentives for inspectors to aim for better health and safety at the workplace--rather than aim for more inspections and citations.

B. "*Safety in the American workplace is about the same as it was in 1970.*"

Howard is wrong on the facts. Here they are:

--Since 1971, the first year of OSHA, the workplace fatality rate has dropped 50 percent.

--Since 1973, the injury rate for workers has dropped by more than 25 percent.

-- Since 1975, injury and illness rates have fallen in industries in which OSHA

has concentrated its enforcement activities (construction, manufacturing, oil and gas extraction), while--interestingly--injuries and illnesses have actually increased in other industries where OSHA has not been active.

-- After the lead standard took effect in 1978, levels of lead in workers' bloodstreams dropped 66 percent.

-- After enactment of the cotton dust standard in 1978, "brown lung" cases dropped from 40,000 a year to less than 1,000.

C. "*Several years ago, there were horror stories of workers who were asphyxiated and had died in a meat-packing plant while checking on a giant vat of animal blood. Then it happened again at the same plant. OSHA had done virtually nothing, however, because it had no rule that applied to the situation. Stretched thin giving out citations all across America for infractions like improper railing height, OSHA also had not reinspected the plant that had admittedly "deplorable" conditions. Confronted with its own ineptitude, OSHA's response was to pass a universal rule requiring the installation of atmospheric testing devices in all confined spaced, without exception.*"

In fact, OSHA did investigate when it got word of two fatalities that occurred on September 13, 1983, at a meatpacking plant in Liberal, Kansas, owned by the National Beef Packing Company. Three workers had entered a processing tank containing animal blood; the combination of lack of oxygen and toxic gases killed two of them, while the third was severely injured. OSHA issued citations to the company, for not following recognized safety procedures--providing respirators to the workers before requiring them to enter the confined space.

Ten years later, in 1993, after compiling a record of fatalities resulting from workers entering confined spaces without proper respirators, OSHA issued a rule. It applies only to confined spaces where there's potential for lack of oxygen, toxic fumes, or similar hazards. It requires that such confined spaces be tested prior to entry, to assure adequate oxygen and lack of toxins. It also provides for the use of adequate protective equipment, like respirators; worker training in safe procedures; and steps to take in event of emergency.

D. "*Glen-Gery has been cited for having railings 39 and 40 inches high, not the regulation 42 inches, in older parts of the factory. In one area already partitioned off by railings, OSHA required several thousand dollars to be spent for automatic shutoff on a one-foot-wide conveyor belt.*"

"*Glen-Gery has never had an incident, for example, related to its railings. OSHA inspectors, in the words of everyone who has to deal with them, are 'just traffic cops' looking for rule violations.*"

OSHA does have a rule requiring employers to place guardrails around dangerous equipment--stating that the guardrails should be 42 inches high. But in 1981 the agency issued a more flexible interpretation, allowing guardrails to be between 36 and 44 inches, or higher, provided that the extra height doesn't subject employees to dangers. OSHA did issue a citation to Glen-Gery in 1973, for the company's failure to put guardrails around dangerous equipment at its York, Pa. plant. Another citation was issued in 1990, for the company's failure to put adequate railings over and around conveyor equipment at its plant in Reading, Pa. In 1991, OSHA issued a third citation against the company for its failure to put adequate guardrails around dangerous equipment at its plant in Shoemaker, Pa.

E. "*An OSHA inspector noted that a worker wearing a dust mask had a beard, violating a rule that requires a close fit between face and mask... Nor did it matter that the worker was Amish and faced the choice of abrogating his religious convictions by shaving his beard or quitting.*"

There is no record of this. OSHA now permits employees to refuse to wear hardhats and respirators if such equipment violates their religious principles.

F. "*Glen-Gery was recently cited because the wrong box was accidentally checked on some internal form. About 50 percent of all violations across the nation are for not keeping the forms correctly.*"

Not true. Record-keeping violations comprise about 4 percent of total citations issued by OSHA, according to a review of the data for fiscal years 1990-1994. Record-keeping violations include failure to report workplace deaths, or to disclose to an employee when and under what circumstances he or she might have been exposed to dangerous conditions.

G. "*OSHA inspectors visit the Glen-Gery factory in Reading once or twice a year.*"

OSHA has inspected the factory 9 times in the past 18 years. Only one of these inspections was comprehensive; the others were aimed at particular hazards. One of the inspections was triggered by the death of an employee from carbon monoxide poisoning. The remainder were triggered by complaints, or followups to assure that the company fixed the unsafe working condition.

H. "*In 1991, the OSHA regional office in Chicago, after visiting a construction site, sent a citation to the brick maker for failing to supply an MSDS form with each pallet of bricks.*"

OSHA requires employers to provide employees with training and information (material safety data sheets, or MSDS) when exposed to potentially hazardous materials, such as silica dust. But if bricks are used without being cut or crushed--and thus without emitting a lot of silica dust--then OSHA doesn't require such training or data. Nor does OSHA require brick manufacturers to place a MSDS on every pallet of bricks they sell. Only one MSDS must be given to a customer, and only with the first shipment.

Chron

THE PRESIDENT HAS SEEN
2.21.95

② cc: [illegible]

① good — (I will — You should write a [illegible] letter to Howard on all these points — you only disagree on, ie, whether [illegible] "inadequate" [illegible] was citing [illegible] there were [illegible] within the permissible range BC

95 FEB 15 P4:27

MEMORANDUM TO THE PRESIDENT

FROM: RBR

RE: Regulation, *The Death of Common Sense*, OSHA, and related thoughts

1. The general case against picayune regulation

Howard's book, *The Death of Common Sense*, is a good read. He makes a strong case for giving bureaucrats more authority to exercise their own "common sense" to achieve public goals, rather than be mired in picayune "go by the book" details that are nonsensical when applied to a particular situation.

So far so good. But, as Cass Sunstein notes in his review (which appeared last weekend in *The New York Times Books Review*, attached) Howard doesn't give us any idea of the *downside* to letting bureaucrats loose. Most of the particularity and red tape in American regulation comes as a result of public outcry about unfettered administrative discretion. The Administrative Procedure Act itself was the product of public concerns about bureaucrats with too much discretion (not surprisingly, the Act was an early product of the post-World War Two years, when the public had a fresh memory of fascism and totalitarianism).

Of course, there's another reason for the miasma of detailed regulation--found in the perverse interaction between regulators and business. I'm attaching a chapter which reveals it all, from a little-known book (*Tales of a New America)* by a little-known author.

A far better alternative to either picayune rules *or* wide grants of discretion is to create systems of prevention and resolution outside of administrative law and the courts. One example is found in the OSHA Reform legislation which you sent to Congress last year, calling for worker-management safety committees to prevent unsafe working conditions. (The legislation got nowhere, but OSHA is now establishing this on a voluntary basis. The carrot for firms that establish such committees is that they won't be inspected absent a complaint or a serious injury. I'll get into a bit more detail on this below.) The Dunlop Commission did some good work on alternative methods of dispute resolution at the workplace; I'll send it over if you're interested.

Another good alternative is to provide businesses with compliance assistance--information about how to protect the health and safety of workers and of the public, data about the best practices, even technical assistance in achieving better outcomes.

In general, I'd approach the topic this way: The regulatory process needs fixing. Everyone agrees. Republicans want to take a wrecking ball to rules that protect the safety and health of Americans (OSHA, EPA, FDA). They also want to remove from Americans a major tool for deterring bad corporate conduct, apart from regulation--tort actions based on contingency fees. Our plan, by contrast, is to reinvent regulations through emphasizing prevention, alternative methods of dispute resolution, and compliance assistance. Our plan would maintain or improve health and safety, while reducing nettlesome and unnecessary burdens on business.

2. OSHA

I've investigated Howard's specific claims about OSHA. Some are true; most are not. Of those that are true, OSHA's "reinvention" effort (one of the best in the government--Just ask Al Gore) is dealing with them. Note that worker health and safety is a key issue for one of our core constituencies. Indeed, safety at the workplace is a key issue among all workers. Note also that workers who are at greatest risk of death, injury, or illness from their jobs are lower-wage workers without four-year college degrees, whose jobs involve physical stress. These are members of the "anxious class."

Here's a blow-by-blow account of Howard's claims about OSHA, the actual facts, and what OSHA is doing about these issues.

A. "*The agency has over 4,000 detailed regulations, dictating everything from the height of railings (42 inches) to how much a plank can stick out from a temporary scaffold (no more than 12 inches). There are about 2,000 safety inspectors in the field, not many compared with 6 million workplaces, but enough to do some good if they focus on firms with bad safety records.*"

If you count every paragraph, subparagraph, item, and subitem in every OSHA regulation, OSHA might have as many as 4,000 rules. Most of the rules, however, are divided between particular industries (construction, maritime, general industry, agriculture etc.), so that in fact no individual company is subject to all of them. In fact, it's interesting to note that most of these rules actually came from industries themselves--voluntary industrial standards that were simply encoded into OSHA rules in the early years of the agency.

Still, there are too many of them, and OSHA is now in the process of weeding out the ones that make no sense, or are duplicative, or simply outdated.

More to the point, the agency has embarked on a major "reinvention" effort to focus on results--safety and health at the workplace--rather than process. A sampling:

--Incentives for employers to improve workplace safety with the help of their employees. Example: Construction employers that set up worker-management safety programs (and train their workers in safety) are inspected only for the four leading causes of on-the-job deaths (for example, falls, electrocutions). Another example: Under the "Maine 200" pilot project, the 200 employers in the state with the largest number of workers' compensation claims are given a similar choice. Implement an effective safety and health program with worker participation <u>and</u> conduct a self-inspection, or be put on a priority list for wall-to-wall inspection. Most have taken the first option. The results have been
mpressive: During the first 18 months of the program, employees and employers at these firms identified nearly 100,000 potential hazards (a rate 14 times higher than OSHA's own rate of identifying potential hazards through inspections). And more than half of these potential hazards were quickly reduced or eliminated. OSHA is now looking for ways to expand on the pilot.

--The Voluntary Protection Program, already up and running, exempts employers with excellent safety and health histories from all general inspections.

-- With the help of management consultants McKinsey and Co., OSHA is retooling field offices to focus on the most serious threats to worker health and safety; and to provide incentives for inspectors to aim for better health and safety at the workplace--rather than aim for more inspections and citations.

B. "*Safety in the American workplace is about the same as it was in 1970.*"

Howard is wrong on the facts. Here they are:

--Since 1971, the first year of OSHA, the workplace fatality rate has dropped 50 percent.

--Since 1973, the injury rate for workers has dropped by more than 25 percent.

-- Since 1975, injury and illness rates have fallen in industries in which OSHA

has concentrated its enforcement activities (construction, manufacturing, oil and gas extraction), while--interestingly--injuries and illnesses have actually increased in other industries where OSHA has not been active.

-- After the lead standard took effect in 1978, levels of lead in workers' bloodstreams dropped 66 percent.

-- After enactment of the cotton dust standard in 1978, "brown lung" cases dropped from 40,000 a year to less than 1,000.

C. "*Several years ago, there were horror stories of workers who were asphyxiated and had died in a meat-packing plant while checking on a giant vat of animal blood. Then it happened again at the same plant. OSHA had done virtually nothing, however, because it had no rule that applied to the situation. Stretched thin giving out citations all across America for infractions like improper railing height, OSHA also had not reinspected the plant that had admittedly "deplorable" conditions. Confronted with its own ineptitude, OSHA's response was to pass a universal rule requiring the installation of atmospheric testing devices in all confined spaced, without exception.*"

In fact, OSHA did investigate when it got word of two fatalities that occurred on September 13, 1983, at a meatpacking plant in Liberal, Kansas, owned by the National Beef Packing Company. Three workers had entered a processing tank containing animal blood; the combination of lack of oxygen and toxic gases killed two of them, while the third was severely injured. OSHA issued citations to the company, for not following recognized safety procedures--providing respirators to the workers before requiring them to enter the confined space.

Ten years later, in 1993, after compiling a record of fatalities resulting from workers entering confined spaces without proper respirators, OSHA issued a rule. It applies only to confined spaces where there's potential for lack of oxygen, toxic fumes, or similar hazards. It requires that such confined spaces be tested prior to entry, to assure adequate oxygen and lack of toxins. It also provides for the use of adequate protective equipment, like respirators; worker training in safe procedures; and steps to take in event of emergency.

D. "*Glen-Gery has been cited for having railings 39 and 40 inches high, not the regulation 42 inches, in older parts of the factory. In one area already partitioned off by railings, OSHA required several thousand dollars to be spent for automatic shutoff on a one-foot-wide conveyor belt.*"

"*Glen-Gery has never had an incident, for example, related to its railings. OSHA inspectors, in the words of everyone who has to deal with them, are 'just traffic cops' looking for rule violations.*"

OSHA does have a rule requiring employers to place guardrails around dangerous equipment--stating that the guardrails should be 42 inches high. But in 1981 the agency issued a more flexible interpretation, allowing guardrails to be between 36 and 44 inches, or higher, provided that the extra height doesn't subject employees to dangers. OSHA did issue a citation to Glen-Gery in 1973, for the company's failure to put guardrails around dangerous equipment at its York, Pa. plant. Another citation was issued in 1990, for the company's failure to put adequate railings over and around conveyor equipment at its plant in Reading, Pa. In 1991, OSHA issued a third citation against the company for its failure to put adequate guardrails around dangerous equipment at its plant in Shoemaker, Pa.

E. "*An OSHA inspector noted that a worker wearing a dust mask had a beard, violating a rule that requires a close fit between face and mask... Nor did it matter that the worker was Amish and faced the choice of abrogating his religious convictions by shaving his beard or quitting.*"

There is no record of this. OSHA now permits employees to refuse to wear hardhats and respirators if such equipment violates their religious principles.

F. "*Glen-Gery was recently cited because the wrong box was accidentally checked on some internal form. About 50 percent of all violations across the nation are for not keeping the forms correctly.*"

Not true. Record-keeping violations comprise about 4 percent of total citations issued by OSHA, according to a review of the data for fiscal years 1990-1994. Record-keeping violations include failure to report workplace deaths, or to disclose to an employee when and under what circumstances he or she might have been exposed to dangerous conditions.

G. "*OSHA inspectors visit the Glen-Gery factory in Reading once or twice a year.*"

OSHA has inspected the factory 9 times in the past 18 years. Only one of these inspections was comprehensive; the others were aimed at particular hazards. One of the inspections was triggered by the death of an employee from carbon monoxide poisoning. The remainder were triggered by complaints, or followups to assure that the company fixed the unsafe working condition.

H. "*In 1991, the OSHA regional office in Chicago, after visiting a construction site, sent a citation to the brick maker for failing to supply an MSDS form with each pallet of bricks.*"

OSHA requires employers to provide employees with training and information (material safety data sheets, or MSDS) when exposed to potentially hazardous materials, such as silica dust. But if bricks are used without being cut or crushed--and thus without emitting a lot of silica dust--then OSHA doesn't require such training or data. Nor does OSHA require brick manufacturers to place a MSDS on every pallet of bricks they sell. Only one MSDS must be given to a customer, and only with the first shipment.

THE WHITE HOUSE
WASHINGTON

OFFICE OF THE STAFF SECRETARY

Fax Transmittal Sheet

95 FEB 22 A 2:51

TO: Secretary Rubin

Fax Number: 622-0000 **Phone Number:**

FROM: John Podesta

SUBJECT: copy from the President

DATE: 2/21/95

NUMBER OF PAGES (including cover sheet): 9

MESSAGE:

If all pages are not received, please call 202/456-2702

CAPITAL MARKETS

To Bob Rubin / L Tyson

Fyi – BC

THE PRESIDENT HAS SEEN
2-21-95

How the Clinton bond

A Fed-administration pact to shift the yield curve spurred recovery but triggered a bond rout whose effects are still being felt.

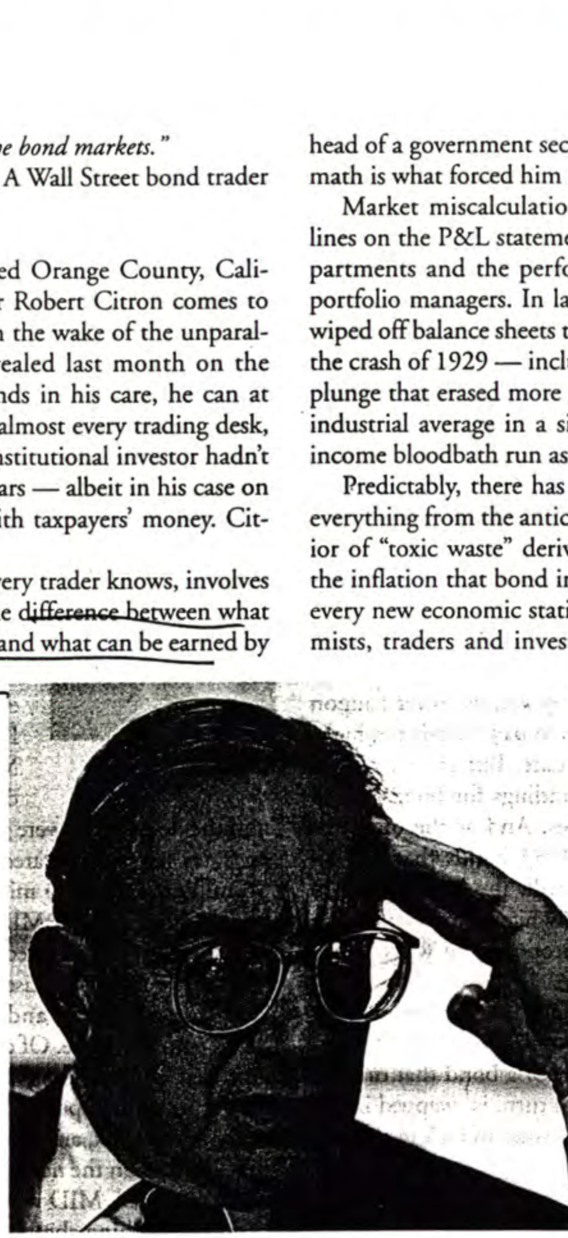
By Kevin Muehring

"The power of math is everything in the bond markets."
— A Wall Street bond trader

Whatever disgraced Orange County, California, treasurer Robert Citron comes to be accused of in the wake of the unparalleled losses revealed last month on the government funds in his care, he can at least assert that he did nothing that almost every trading desk, hedge fund, commercial bank and institutional investor hadn't also done in the past two or three years — albeit in his case on an extraordinarily large scale and with taxpayers' money. Citron got his math wrong.

The math that really counts, as every trader knows, involves a tally known as the "carry trade": the difference between what it costs to borrow money short term and what can be earned by using that money to purchase long-term securities. During 1993 the carry trade was so generous — the gap between short-term and long-term interest rates being unusually, and lucratively, large — that it amounted to a kind of government charity, especially for beleaguered banks.

But when the Federal Reserve Board began hiking short-term rates last February, the mathematics behind this oh-so-easy money began to change. As rates kept rising, ever larger chunks of bond positions that had been leveraged to the hilt to reap the maximum benefit from the carry trade became unprofitable and had to be unwound at a loss — an awful lot of loss, as it has turned out. "For Citron, like many of us," says the head of a government securities trading desk with a shrug, "the math is what forced him out."



Richard Bloom/SABA

Federal Reserve chairman Greenspan: His "carry game" saved the banks — and in the end decimated the bond market

Market miscalculations also produced blood-red bottom lines on the P&L statements of most fixed-income trading departments and the performance summaries of fixed-income portfolio managers. In last year's bond rout, more wealth was wiped off balance sheets than in any other market debacle since the crash of 1929 — including the October 1987 stock market plunge that erased more than 500 points from the Dow Jones industrial average in a single session. Estimates of the fixed-income bloodbath run as high as $1.5 trillion worldwide.

Predictably, there has been plenty of finger-pointing — at everything from the antics of hedge funds to the volatile behavior of "toxic waste" derivatives to a global capital shortage to the inflation that bond investors seemed to see lurking behind every new economic statistic. Yet a growing number of economists, traders and investors posit a more fundamental, and ultimately more troubling, explanation for the great bond rout: They point to a confluence of well-intentioned but ill-conceived monetary and macroeconomic policies that drove the bond markets to unsustainable heights in 1993, and then made last year's free fall far more severe than it might otherwise have been.

In monetary policy, the Fed fashioned an unusually steep yield curve in 1991–'92 and, as an inadvertent by-product, wound up encouraging a speculative, trading-oriented mind-set in the bond market. In macroeconomic policy, the Clinton administration further inflated the swelling speculative bubble by taking actions — notably, cutting the deficit — to bring down long-term interest

strategy backfired

President Clinton: His economic recovery plan worked — but with unforeseen consequences

rates and promote recovery. Moreover, the impact on the market of that successful effort was exacerbated by the Treasury Department's decision to cut in half its issuance of long-term bonds.

To be sure, the actions of both the Fed and the administration were well-meaning, and the policies in fact achieved their objectives: The Fed brought inflation down to a 30-year low and bailed out a teetering U.S. banking system, while the Clinton administration can legitimately claim success for fostering the recovery. But the Fed's and the administration's policies collided head-on along the yield curve with the new dynamics of the bond market, whose bias toward active trading was reflected in and amplified by an unprecedented volume of leveraged bets on the direction of interest rates. "What [the Fed and the administration] didn't see was the leverage in the bubble that was created," says Thomas Sowanick, chief fixed-income strategist for Merrill Lynch. "It wasn't just air in that bubble — it was helium."

The legacy of the fixed-income disaster — and to some extent its cause — is a profoundly changed and still changing bond market. Economists, investors and traders see a market marked by greater structural volatility and higher real interest rates — one even quicker to punish governments for wayward fiscal policies. This will make Fed monetary policy even more difficult, and painful, to carry out. And, in a true political irony, an administration strategy that spurred recovery may also help to ensure recession in 1996, just in time to further darken President Clinton's reelection prospects.

In explaining last year's bond rout, commentators usually zero in on February 4, the day the Fed raised short-term rates one quarter of a point. But that minuscule increase could hardly have triggered the sharp spike in yields that followed, let alone caused German long-term rates to jump more than 150 basis points. The Great Bond Market Crash of 1994 had deeper and wider roots.

In July 1990 the Fed, in response to an economy that was slipping into recession, reversed its tight-money policy and started to lower short-term rates. Wary of feeding the inflationary expectations that he believed were keeping long-term interest rates at unjustifiably high levels, Fed chairman Alan Greenspan steered rates downward, but gradually. He cut them 22 times over several months, bringing the federal funds rate to 4.75 percent by December 31, 1991. The Fed, as well as most economists, expected a reduction to about 5 percent in the funds rate to spur recovery, but instead the economy took a second dip.

The problem lay in the unique nature of this recession. What Greenspan came to dub the "structural headwinds" of balance-sheet distress were inhibiting recovery; banks, corporations and households, still crippled by debt, were intent on shoring up their finances rather than lending, expanding or spending.

The Fed was probably far too slow in easing rates, making it harder for the economy to rise off the floor. One former

Fed official concedes that the central bank took talk of a credit crunch with a grain of salt in 1990. But by the end of 1991, mounting debt problems and commercial banks' reluctance to lend had become a major concern for the Fed. With the inflationary threat now fading, the central bank steered short-term rates all the way down to 3 percent by September 1992. It held them at that highly accommodating level for the next 18 months.

"The nature and depth of the recession in effect forced Greenspan to overshoot in pushing rates below 5 percent, to 3 percent," says Andres Drobny, a currency strategist at CS First Boston. "But the yield curve steepened because the short rates were brought down without the long end going with them." Yields on 30-year bonds remained at about 7.5 percent. That translated into a yield spread of about 450 basis points — twice the historical average. A number of factors were keeping rates high. The Japanese, who had been big buyers of long-term Treasuries, left the market at the end of the '80s; the savings and loan bailout gave rise to an influx of long-dated paper; on top of all this, the bond market doubted that the Bush administration could hold down a deficit that was rising because of the recession.

Richard Bloom/SABA

Treasury Secretary–designate Rubin: He wanted a favorable reaction from the bond market. He got euphoria

The steepness of the yield curve — the unusually wide gap between short- and long-term interest rates contrived by the Fed — brought the bank a remarkable string of policy successes. Not only was inflation all but wrung out of the economy, but the Fed also almost single-handedly rescued the U.S. banking system. Taxpayers were spared the expense of another S&L-style bailout.

Banks enjoyed what was in essence a subsidy, but one provided by depositors, not taxpayers. The banks were able to embark on a low-risk "positive-carry trade" by using deposits to scoop up intermediate-term Treasury notes that were then yielding 100 to 200 basis points more than the banks' cost of funds. Even as banks reduced their loan books by an average of 14 percent between 1990 and 1992, they increased their holdings of Treasuries by nearly one third.

The Fed's coup came at a heavy price, however. A speculative bubble was beginning to build in the bond markets. To hold federal funds at 3 percent — effectively a zero cost of capital for banks, given the inflation rate — the New York Fed had to keep pumping high-powered monetary-base money (currency plus bank reserves) into the financial system through its open-market operations. Most of that liquidity, the Fed believed, was being soaked up by the banks, which were using it to "buy" the yield curve and repair their battered balance sheets.

The complication was that others were also able to help themselves to this low-risk, high-reward carry trade. "In a world where there are derivatives, you don't have to be a bank to play the carry game, because anyone can synthetically create a short-funded long Treasury note position using futures contracts," notes Lee Thomas, a former Goldman, Sachs & Co. trader who now heads arbitrage trading at Investcorp in London. Hedge funds, Wall Street's proprietary trading desks, institutional investors and mutual funds may have lacked the banks' deposit base, but they were able to tap low-cost short-term money just the same in the massively expanding market in repurchase agreements. That enabled them to go long, and longer still, in bonds. And they could leverage their capital with futures or other derivatives to accumulate large exposures. How much of a demand for bonds all this added up to is impossible to calculate. But in just one area — margin loans to customers to buy Treasuries — the figures are startling. Volume rose from less than $40 billion at the end of 1990 to a record $216 billion at the end of 1993.

As an additional cost of the Fed's easing, the unnaturally and persistently steep yield curve was, arguably, prolonging the recession. Low short-term rates were denying savers income that they could spend and thereby boost demand, while borrowers were being discouraged by the high long-term rates from raising new capital to finance expansion. "There could be no U.S. recovery until the long bond rallied," argues CS First Boston's Drobny. The steep yield curve confronted the new Clinton administration and quickly became the main focus of its macroeconomic policy. Clinton aides came to see it not only as the primary obstacle to economic recovery but also, paradoxically, as the main lever to pry loose a turnaround.

The administration early on shed the idea of using the Democrats' traditional economic tool: Keynesian fiscal stimulus. Presidential advisers reasoned that a burst of federal spending, rather than stimulate growth, would perversely bring on a worse recession. Mindful of the already prohibitive level of federal debt, the bond market would react adversely, driving long-term rates even higher and crushing any hope of a sustainable recovery.

Instead, Clinton's team decided on what came to be called the financial markets strategy. In essence, it was Keynesianism in reverse: *reducing* rather than increasing spending to spur recovery by breaking the steep yield curve's sway over the economy. In an interview with *Institutional Investor* in early spring 1993, then–National Economic Council chief Robert Rubin emphasized: "We needed the long-term bond market to react favorably to the plan, and we needed to have the Fed view it as credible."

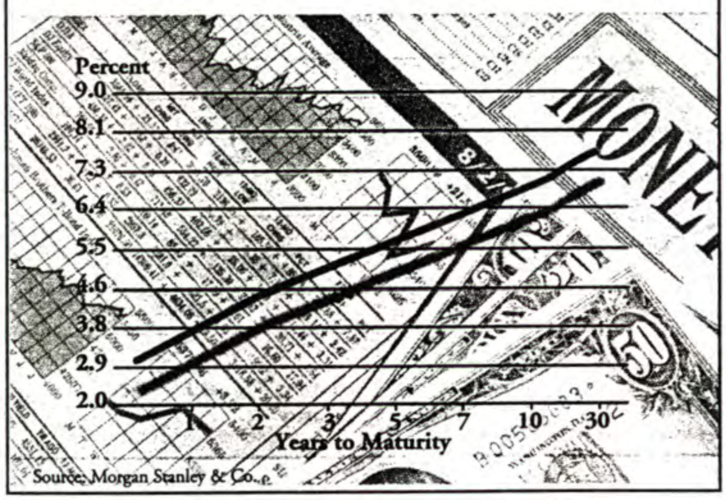
The latter task wasn't terribly difficult, for, as Bob Woodward noted in his book on the Clinton administration, *The Agenda*, the financial markets strategy was based on a scenario that Greenspan himself had outlined to the president-elect during a meeting in Little Rock in December 1992. The Fed chairman told Clinton that short-term rates were about right, but that long-term rates were 3 to 4 percentage points higher than normal because bond investors harbored lingering inflationary expectations. And those expectations, Greenspan declared, could be blamed in large part on investors' concerns over the size of the federal deficit. If the Clinton administration came out with a credible plan to begin reducing the deficit, the Fed chairman continued, market expectations would change, long-term rates would fall and demand for mortgage refinancings would rise. Lower mortgage payments, in turn, would provide a new source of consumer spending to revive the economy.

The plan worked, but it's no small irony that it did so for the wrong reasons and in the wrong way. "The [Clintonites] weren't expecting [the economic surge] so soon, and they didn't need as much as they got," notes Aubrey G. Lanston & Co. chief economist David Jones. The original strategy was actually based on what Rubin called a "one-two punch." A stimulus portion of the package was to come first and get the economy up and running in 1993; the spending cuts were to come in 1994; the resulting fiscal drag was to be neutralized by lower long-term interest rates. Former Fed vice chairman Manuel Johnson, who now heads the Johnson & Smick economic consulting firm in Washington, believes the administration was expecting the economic benefits of the plan to extend several years and pave the way for a middle-class tax cut in time for the '96 elections.

Of course, there was no fiscal stimulus in the final legislation. It was cut out by newly emboldened Republicans led by Kansas Senator Robert Dole. But as far as the market was concerned, the absence of the extra spending was all to the good, and it reacted to the deficit-reduction package almost immediately. A rally in the long bond began that would bring down long-term interest rates dramatically. Yields first began to fall in early February 1993, when then–Secretary of the Treasury Lloyd Bentsen floated a trial balloon about a possible energy tax. By February 21, when Greenspan gave his "endorsement" to the Clinton economic plan during testimony on Capitol Hill, the yield on the 30-year T-bond had dropped below 7 percent for the first time in 16 years. "Clinton probably knocked long-term rates down from 7.6 percent to 6.9 percent on the strength of the deficit-reduction plan," says Lanston's Jones, echoing a Wall Street consensus.

10/26/92: The steepest point

The Fed had brought short-term rates down to 3 percent, creating an unusually steep yield curve that provided the "carry trade" banks and leveraged players took advantage of on an unprecedented scale.



The bond rally spurred the desired wave of mortgage refinancing, which was almost immediately followed by a spurt of consumer spending. In the last half of 1993, household expenditures grew at three times the rate in previous years. That fueled a huge, 6.3 percent jump in fourth-quarter-'93 GDP. "There is no doubt that the mortgage-refinancing surge was a major contributing factor to the jump in economic activity at the end of 1993, which was carried into 1994," says Morgan Stanley & Co. market economist David Greenlaw.

While the Clinton administration was boasting that the long-bond rally was evidence of the credibility of its deficit-reduction plan, bond traders had a quite different perspective. "There were a number of factors that took the long-bond rally down below, say, 6.5 percent, and none of them had anything to do with the economy," contends Christopher Carroll, who trades five-year Treasury notes and heads government sales and trading at Nomura Securities.

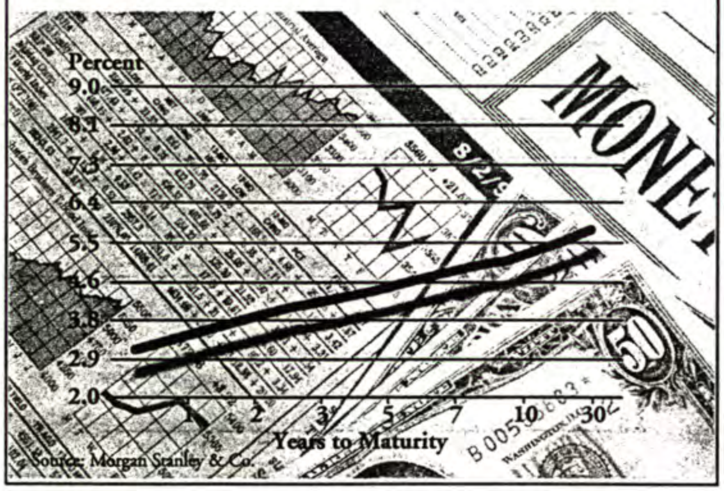
One such factor was the volume of municipal-defeasance programs prompted by the rally. In 1993 muni issuers took advantage of low interest rates to sell cheaper new debt and use the proceeds to service their more expensive old debt until it matured or could be called. But until those fresh funds could be utilized, the cash was parked in special nonnegotiable Treasuries (to which municipal and state issuers are granted access at below-market rates).

Mutual funds were also adding their considerable weight to the demand for Treasuries. As individual investors fled low-yielding bank deposits for bond funds, mutual fund companies put these ever increasing cash inflows into government securities. Mutual fund purchases of Treasuries had swelled to slightly more than $100 billion by year-end '93. Yet another factor inflating demand for Treasuries was the Brady plan to solve the LDC debt crisis. Brady bonds, of course, are backed by U.S. Treasury paper, and Argentina and Brazil bought a staggering $29 billion of long T-bonds through 1993 to participate in the plan.

But far and away the most important factor driving the bond rally, asserts Mark Werner, J.P. Morgan's head of government trading in New York, was the "mortgage-backed-securities effect." Explains Werner, "It was the honest-to-God institutional investor managing his portfolio against the index that drove the bids." At $1.35 trillion, the MBS market is easily the second largest in the U.S. after Treasuries (*Institutional Investor*, July 1994). And when the mortgage refinancing wave took off in the last half of 1993, it triggered a tremendous scramble among dealing houses to go as long as possible in ten- and 30-year Treasuries to offset the sudden loss of duration in their MBS hedges. Index fund investors also snapped up Treasuries.

10/15/93: The rally top

With the short end still held down by the Fed, the long bond rallied to its postwar low of 5.78 percent on a wave of massive market purchases driven largely by leverage and hedging.



Whoever was behind them, the bids had a self-reinforcing effect. The higher the long bond rallied, the greater the demand for it. Nomura's Carroll says that many trading desks caught on to the nature of that demand and tried trading against it as the yield fell toward 6 percent, thinking the rally would soon run out of steam. It was a vain hope.

In fact, the rally might well have ebbed soon but for yet another influence. This one came from the U.S. Treasury. In May 1993 it announced that it would begin shortening the average maturity of the government's $3.2 trillion in publicly held debt by reducing the number of long-bond auctions from four a year to two and cutting overall long-bond issuance by about 40 percent, to $22 billion annually. In addition, the agency said, it would eliminate the seven-year note altogether and increase the size of the auctions of bills and notes maturing in three years or less.

If the yield curve is positively sloped most of the time, the Treasury reasoned, it would be cheaper in the long run to fund government debt by shifting the weight of borrowing toward the market's short end. "People who issue long-term debt are paying a premium to investors essentially to avoid rollover risk," explains Darcy Bradbury, the Treasury's deputy head of federal finance. "But the U.S. government does not face the same sort of rollover risk."

Most Wall Street analysts believe the shortening was intended primarily as a ploy to help President Clinton deliver on his campaign pledge to reduce the deficit. Savings on debt service are expected to amount to $11 billion over five years. Administration officials, however, stoutly deny any such gambit. "The idea was presented to us by the Treasury in the context of debt management. And the fact that it may help us a little on the budget was a mild plus," says Bowman Cutter, deputy economic adviser at the White House.

Whatever the real motive behind the shift to shorter-term borrowing, it was interpreted by Wall Street as a supply-reducing stratagem to "seal" the overall objective of flattening the yield curve. And the move, coming amid a full-blown bond market rally, was positively electric. Talk quickly spread of an impending shortage of long bonds. Analysts advised clients to go long in the 30-year Treasury. "The cutbacks propelled the bull market into its final, overleveraged blowout phase," says Louis Crandall, chief economist for RH Wrightson & Associates.

The roaring bond market on Wall Street was quickly replicated in Europe and Japan. A current of liquidity streamed out of the U.S. into foreign bond markets. Institutional money had been flooding into European government bond markets through most of 1993 on the bet that the Bundesbank would soon push the German discount rate down sharply, producing a bond market rally of the sort Greenspan had triggered in the U.S.

U.S. investors were the major players in Europe's rally. They bought $60.8 billion of foreign (mainly European) bonds in '93, more than they'd purchased during the entire decade of the '80s. One U.S. hedge fund alone reportedly held long positions in French government bonds equal to one tenth of all new debt issued by Paris that year. In the German Bund market, Europe's most liquid, fully 70 percent, or some Dm163 billion ($95 billion), of new Bund and government agency issues in 1993 were snapped up by foreign investors. Americans did the great bulk of the buying. "Goldman Sachs and Salomon Brothers at times were scooping up a third or more of the Bund auctions," according to one bond trader.

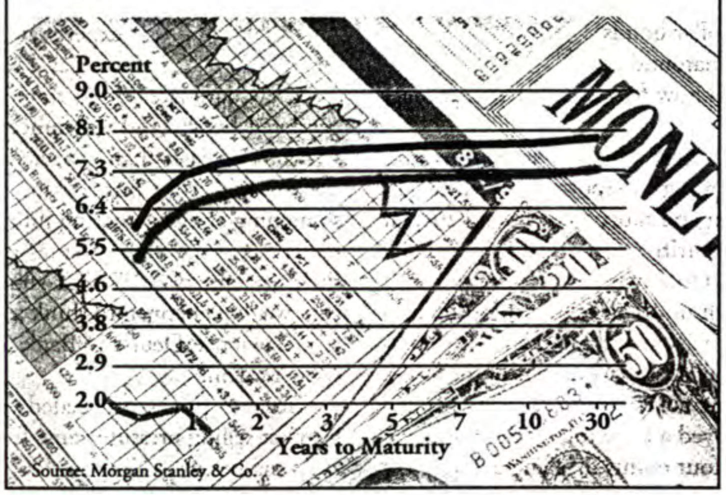
In Japan the consensus in late 1993 was that the country's deep recession would lead to a weakening of the yen against the dollar and a faltering in the Nikkei 225 index, but that the market for Japanese government bonds would do well. By the turn of the year, U.S. hedge funds, in particular, had placed big bets on short yen–long dollar and short Nikkei–long JGB strategies.

The worldwide bull market in bonds was well under way by the last quarter of '93. What's more, speculation and leverage were rapidly permeating the entire global financial structure and seeping into the credit markets. Leverage was embedded in the surging volume of structured notes sold to yield-hungry investors (or naive soap manufacturers). The exposures of the main derivatives houses pyramided skyward.

The rising influence of hedge funds, more specifically the short-term-trading-oriented hedge funds, was further eroding any distinction between trading and investing. Trading desks took on more position trades that entailed a directional view. Institutions that once invested strictly for the long term took advantage of increased liquidity and lower transaction costs to switch in and out of securities and currencies aggressively or used derivatives to execute or unwind views. And they did it in hours instead of days or weeks.

12/5/94: Flattening toward inversion?

The Fed's rate increases and heavy sales of intermediate Treasuries had flattened the yield curve by the end of 1994. Some economists forecast an inversion of the curve in the first half of this year.



Source: Morgan Stanley & Co.

The impact on the market of this short-term-trading style was heightened by a change in the way banks wielded leverage. Some leverage is essential to eking out a profit in much of fixed-income trading. "You need leverage to make a decent return on a tight relative-value trade," explains Noreen Harrington, executive director for fixed-income sales at Goldman Sachs International, "but the correlations between the two securities will be so high that the risk is relatively low." However, it was only a short step for banks to begin applying leverage to firmly held directional views on interest rates as well. Many placed what would become massive bets — this time without the safety factor of high correlations between securities. This risky business became increasingly prevalent by late '92 and was well entrenched by 1993.

It actually worked well at the short end of the Treasury market once short rates began their descent in '91, and it worked spectacularly well in the European foreign exchange and bond markets during the upheavals in the monetary union's Exchange Rate Mechanism in early fall '92. Thus emboldened, banks and other dealers pushed speculative positions to unprecedented levels in the last half of '93, underpinning tremendous worldwide demand for government securities. "There is no question that this is the first time we have seen that degree of leverage throughout the global bond markets," says Gordon Johns, managing director at Kemper Investment Management. "Five years ago it would simply not have been possible, because people didn't have the access to, or the willingness to use, such leverage. Not many had the capability to hedge and control the risks, and there wasn't the knowledge or comfort level yet in going into the international markets."

By the fourth quarter of '93, rising prices in bond markets around the world were pushing yields to postwar lows, and investment banks were firing on all cylinders and then some. Few bankers saw any signs that the good times were nearing an end. On Monday morning, October 15 — the day the long bond reached its zenith, with its yield slipping to 5.78 percent — *Barron's* ran this headline: "It Won't Get Any Better Than This." The magazine was dead right — it wouldn't.

By fall 1993 some members of the Fed's Open Market Committee had become increasingly anxious about the frenzied state of trading. In a mid-September interview with *The New York Times*, Fed vice chairman David Mullins spoke of his concern that a "bubble in asset prices" was forming. He and the other inflation hawks on the committee, Fed governors Wayne Angell and Lawrence Lindsey, as well as a handful of the regional Fed presidents, began pressing for a preemptive rate hike.

Greenspan resisted, reportedly out of fear of hammering the nascent U.S. and global recovery. But was the Fed chairman's "understanding" with the Clinton administration on financial markets strategy inhibiting him from acting to cool down the bond market? After all, as Woodward had noted in *The Agenda*, Greenspan himself had essentially "ghost-written" the strategy. And now, just as it was having an effect — albeit a more powerful one than anticipated — he could hardly scuttle the entire scheme. Nevertheless, the marriage of policy objectives between the White House and the Fed to bend the yield curve was rapidly unraveling.

Close friends of the Fed chairman insist that he shared Mullins's concern but was understandably less than eager to tell the newspapers about it. As early as late September, Greenspan was already anticipating strong fourth-quarter-'93 GDP figures, they say. By the end of the following month, yields on the long bond had begun to drift upward, signaling that the market might be expecting a spurt of inflation. By December '93 Greenspan began to enlist political backing for a rate increase.

After getting the Treasury and the NEC's Rubin on board, the Fed chairman agreed to meet with President Clinton and his advisers on January 21 to warn that the Fed was getting ready to nudge short-term rates up. On February 4 the central bank enacted its one-quarter-point increase in the federal funds and discount rates. That move has come to be called the biggest and most expensive margin call in history. One Fed official, looking back on the events of last spring, muses: "The decision on February 4 was driven in large part by the realization of the need to pop the financial speculation that was building up in the system. And when you pop a bubble, unfortunately, someone has to lose money. What we didn't know was just how much."

The runaway bond train had already started to slide off the rails. But the immediately impending accident occurred in Japan, not the U.S. In mid-January the Ministry of Finance had unveiled an antirecession fiscal-stimulus package and some supposed easing of import restrictions. Suddenly, the Japanese market developed a new trading consensus, one that turned the previous one on its head: The MoF's package was deemed bullish for Japanese stocks, bearish for bonds. Government bond yields of 2.8 percent, when set against short-term rates of 2.3 percent, looked ridiculously low and thus likely to go north instead of south, as once anticipated. Moreover, with JGBs having a rising yield differential against dollar bonds and the prospect of a faster turnaround in the Japanese economy, the yen now looked to be the stronger of the two currencies.

"Estimates put the loss on publicly traded bonds worldwide at $1.5 trillion."

Leveraged investors — George Soros' Quantum Fund prominent among them, according to reports — were caught with their short yen–long dollar and short Nikkei–long 20-year JGB positions. A Japanese securities dealer says one highly leveraged U.S. hedge fund tried to unwind what were rumored to be long JGB positions worth up to ¥3 trillion ($30 billion) and had turned to Goldman Sachs to execute the trade. Goldman reportedly undertook to lay off three quarters of the longs, but the sheer size of the trade (some estimates put the total at a still daunting ¥1.5 trillion) played a large role in driving down the JGB market a frightening four points in a single day.

Reports of yen losses by Goldman quickly spread to London, rattling an increasingly skittish market. "For a lot of the younger traders, Goldie is it," notes one head of trading at a rival firm. "So when Goldman loses a stack of money, it punctures the illusion of its invincibility. A trader is sitting in front of his screen thinking to himself, 'Shit, maybe I'm too long, too.' Let's face it, the yen wasn't the only overbought market." Fear-driven traders scrambled to get their books flat.

In Germany, meanwhile, Bund futures had peaked on December 31 and were slowly giving ground as nervous foreign investors tried to reduce their long-bond positions. They'd become painfully aware that their original logic must have been flawed: The notion of a European repeat of the U.S. long-bond rally now seemed highly dubious.

The Fed had been easing rates in the context of a lukewarm recovery and an environment of weak balance sheets, corporate, household and bank alike. "Greenspan's policies were motivated by the need to accommodate the [structural] headwinds," says Jan Loeys, J.P. Morgan's market economist in London. The Bundesbank, too, was operating in a weak economic environment, though German corporate balance sheets had not suffered the sort of asset decline that hampered American companies. Thus the German central bank was not under pressure to be as accommodating as the Fed, and it was determined not to be hurried in its easing.

Putative economic weakness was everywhere — New York, London, Tokyo, Frankfurt — as February 1993 heaved into view. The month would become "to fixed-income fund managers what October 1987 was to the equity markets," observes Robert Fouliot, a financial consultant to several private banks in Geneva.

It wasn't only the Fed's quarter-point rate rise that triggered the global bond debacle; it was also the context for it and manner in which it was unveiled to the market. Rate changes ordinarily filter out to the market through the activities of the open market desk at the New York Fed. This time the central bank called a press conference late on a Friday afternoon to announce the hike and explain that the Fed now would be fighting inflation early by raising rates to shift monetary policy from an accommodating to a "neutral" stance. But no one, perhaps not even the experts at the Fed, knew what a neutral rate level was.

A few days later, amid tremendous market uncertainty engendered by the Fed announcement, GDP figures came out showing stronger-than-expected growth in fourth quarter '93. This reinforced a hunch among traders that the Fed knew something about gathering inflationary forces that the market didn't. "It woke the vigilantes up to the fear of inflation, and their response was, 'Well, if you think inflation is on the horizon, we don't happen to think a quarter point is enough,'" says C.J. Lawrence/Deutsche Bank Securities chief economist Edward Yardeni.

Treasury prices proceeded to fall through the floor. The heaviest selling pressure came from the mortgage-backed-securities market, according to the New York Fed. Although hedging and call-risk management had helped to extend the Treasury market rally in '93, they were now propelling prices in the opposite direction. The higher interest rates extended the duration of MBS portfolios dramatically, and both MBS dealers and investors shorted Treasuries as fast as they could to hedge against the abrupt increase in duration. The Fed estimates that between October 1993 and April 1994 such hedging activities accounted for a massive surge of more than $300 billion in Treasury sales.

Things weren't much prettier elsewhere. Adding to the market's fury, renewed Japan-bashing by some members of the Clinton administration led to a sharp appreciation of the yen, causing further losses for those holding positions in Japan. (The Quantum Fund concedes that it lost $600 million in just a few hours on Valentine's Day.) Then on February 25 the Bundesbank announced that the German M3 money measure had jumped a stunning 21.4 percent in January, sending the market into another tailspin. Bunds crashed, but even louder thuds were heard in higher-yielding markets like Spain's.

Nonbank financial institutions wound up dumping nearly

$250 billion of long positions in Treasuries in the first half of last year; commercial banks unloaded $37.6 billion in the second quarter alone. And mutual funds investing in Treasuries and agency securities saw nearly $24 billion of redemptions in the first nine months of '94, which forced them to dump still more Treasuries.

The bond rout's exact toll can't be calculated, but various estimates give a sense of its enormity. The Merrill Lynch government, corporate and muni bond index fell 9.7 percent between last February and early December, translating into losses (realized or book) of approximately $500 billion. A recent Securities Industry Association study estimates that for all U.S. bonds outstanding, the loss amounted to $1 trillion of market value by the middle of November. And some estimates put the loss on the $16 trillion of publicly traded bonds worldwide at $1.5 trillion or more.

By early December the yield curve was flattening dramatically, and a growing number of traders and economists were convinced that it was not merely flattening but would invert. Merrill's Sowanick guessed that the spread between the ten- and 30-year bonds would invert some time in the first quarter and the two-to-30-year spread soon after that. The Fed is expected to provide the impetus for this inversion by raising short rates 200 basis points or more early this year. "The Fed has never been able to slow the economy without pushing real short-term interest rates to at least 450 basis points," notes one head of government bond sales and trading.

Looking beyond the near term, fixed-income analysts are adjusting their thinking and their investment scenarios for secular changes in the market:

• Sudden, potentially huge swells of cross-border capital — which can be quickly augmented by leverage — will increasingly inundate domestic bond markets, causing sharp price movements. What's more, that volatility will feed on itself by forcing fund managers to adapt to the new environment by trading more actively. "The new financial world of ours creates enormous swings in both directions," observes Henry Kaufman, a former Salomon economist who now runs his own money management firm.

"Volatility is now a permanent fixture of the trading environment," agrees Investcorp's Thomas. Everyone has access to the same information at nearly the same time, is looking for and interpreting the key data within the same intellectual framework and has the means to execute a market view instantly. But, he asks: "If everyone sees it, everyone is already there. And if everyone wants to sell, who is left to buy?"

• Additional risk premiums are being factored into bond yields because of this new structural volatility. "The markets are different from the way they were before, and that has created a different pricing structure," says Kaufman. Thomas Mayer, the highly regarded chief Germany economist at Goldman Sachs in Frankfurt, recently completed a study showing that "for every one-point increase in unexpected volatility, long-term [German] bond yields rose by 42 basis points." Of course, this pricing pattern drives up the real cost of capital, which is already under pressure because of demand from newly emerging and post-cold-war market economies.

"Bond markets are increasingly the tough cop on the global economic beat."

• The bond markets are increasingly the tough cop on the global economic beat. "Capital markets provide a number of functions, but the one that is new is as a disciplinary device," notes Morris Goldstein, who heads capital market research at the International Monetary Fund in Washington. The market "has much more clout than it did in the past because it is so much more mobile, and it can be a very blunt instrument." Thus sovereign borrowers, including the U.S., face not only the prospect of higher real interest rates but also the likelihood that their macroeconomic policies will be judged even more harshly and impatiently by the bond markets. Adding to the pressure on governments to stay on the markets' good side is the fact that capital has many alternative outlets now that the cold war is over.

• The U.S. Treasury may well come to regret its decision to shorten the maturities of federal debt. "The assumption behind it was that there would be a free lunch, in that borrowing costs would be reduced," notes Merrill's Sowanick. "But that can only happen if there is no market response to the change in supply." Despite the Treasury's denial that it used debt management to reinforce macroeconomic policy, Wall Street didn't believe it and won't next time.

• More than ever, serious questions exist about the Fed's ability to fine-tune a $6 trillion economy, particulary now that many of the bank's traditional economic indicators, notably money-supply figures, have become unreliable. Moreover, in a market undergoing such rapid structural changes, who can be sure what impact even a modest interest rate increase will have? Certainly not the Fed.

Perhaps Greenspan deftly avoided a systemic financial crisis when he decided last year to raise rates only gradually. Market watcher Kaufman, however, insists that Fed gradualism simply will not blunt credit demand and will drag out uncertainty and volatility during a monetary-tightening operation. "Gradualism doesn't arrest the demand for credit, only its cost," he says. "It is like a parent saying to his child, 'I have to punish you, so I am going to softly spank you ten times.' If you really want to influence the markets, you have to do it in big whacks."

The implication: It will take quicker and deeper rate cuts to stimulate any future economic recovery, and conversely, it will take sharper and more savage rate increases to slow a too-robust recovery. Stopping the economy dead in its tracks may become the norm of future Fed restraint policy. That can't be any consolation to the Clinton administration as the economy forges ahead and an election campaign looms. As J.P. Morgan's economic team noted late last year, "The risk that this boom will be followed by a bust — probably as early as the last half of 1996 — increases the longer the economy is allowed to overheat."

After the Republican trouncing of the Democrats in November, the Morgan report would hardly make for pleasant reading at the White House. II

To Bob Rubin / L Tyson

Fyi - Bc

THE PRESIDENT HAS SEEN
2-21-95

How the Clinton bond

A Fed-administration pact to shift the yield curve spurred recovery but triggered a bond rout whose effects are still being felt.

By Kevin Muehring

"The power of math is everything in the bond markets."
— A Wall Street bond trader

Whatever disgraced Orange County, California, treasurer Robert Citron comes to be accused of in the wake of the unparalleled losses revealed last month on the government funds in his care, he can at least assert that he did nothing that almost every trading desk, hedge fund, commercial bank and institutional investor hadn't also done in the past two or three years — albeit in his case on an extraordinarily large scale and with taxpayers' money. Citron got his math wrong.

The math that really counts, as every trader knows, involves a tally known as the "carry trade": the difference between what it costs to borrow money short term and what can be earned by using that money to purchase long-term securities. During 1993 the carry trade was so generous — the gap between short-term and long-term interest rates being unusually, and lucratively, large — that it amounted to a kind of government charity, especially for beleaguered banks.

But when the Federal Reserve Board began hiking short-term rates last February, the mathematics behind this oh-so-easy money began to change. As rates kept rising, ever larger chunks of bond positions that had been leveraged to the hilt to reap the maximum benefit from the carry trade became unprofitable and had to be unwound at a loss — an awful lot of loss, as it has turned out. "For Citron, like many of us," says the head of a government securities trading desk with a shrug, "the math is what forced him out."

Richard Bloom/SABA

Federal Reserve chairman Greenspan: His "carry game" saved the banks — and in the end decimated the bond market

Market miscalculations also produced blood-red bottom lines on the P&L statements of most fixed-income trading departments and the performance summaries of fixed-income portfolio managers. In last year's bond rout, more wealth was wiped off balance sheets than in any other market debacle since the crash of 1929 — including the October 1987 stock market plunge that erased more than 500 points from the Dow Jones industrial average in a single session. Estimates of the fixed-income bloodbath run as high as $1.5 trillion worldwide.

Predictably, there has been plenty of finger-pointing — at everything from the antics of hedge funds to the volatile behavior of "toxic waste" derivatives to a global capital shortage to the inflation that bond investors seemed to see lurking behind every new economic statistic. Yet a growing number of economists, traders and investors posit a more fundamental, and ultimately more troubling, explanation for the great bond rout: They point to a confluence of well-intentioned but ill-conceived monetary and macroeconomic policies that drove the bond markets to unsustainable heights in 1993, and then made last year's free fall far more severe than it might otherwise have been.

In monetary policy, the Fed fashioned an unusually steep yield curve in 1991–'92 and, as an inadvertent by-product, wound up encouraging a speculative, trading-oriented mind-set in the bond market. In macroeconomic policy, the Clinton administration further inflated the swelling speculative bubble by taking actions — notably, cutting the deficit — to bring down long-term interest

strategy backfired

rates and promote recovery. Moreover, the impact on the market of that successful effort was exacerbated by the Treasury Department's decision to cut in half its issuance of long-term bonds.

To be sure, the actions of both the Fed and the administration were well-meaning, and the policies in fact achieved their objectives: The Fed brought inflation down to a 30-year low and bailed out a teetering U.S. banking system, while the Clinton administration can legitimately claim success for fostering the recovery. But the Fed's and the administration's policies collided head-on along the yield curve with the new dynamics of the bond market, whose bias toward active trading was reflected in and amplified by an unprecedented volume of leveraged bets on the direction of interest rates. "What [the Fed and the administration] didn't see was the leverage in the bubble that was created," says Thomas Sowanick, chief fixed-income strategist for Merrill Lynch. "It wasn't just air in that bubble — it was helium."

Chris Brown/SABA

President Clinton: His economic recovery plan worked — but with unforeseen consequences

The legacy of the fixed-income disaster — and to some extent its cause — is a profoundly changed and still changing bond market. Economists, investors and traders see a market marked by greater structural volatility and higher real interest rates — one even quicker to punish governments for wayward fiscal policies. This will make Fed monetary policy even more difficult, and painful, to carry out. And, in a true political irony, an administration strategy that spurred recovery may also help to ensure recession in 1996, just in time to further darken President Clinton's reelection prospects.

In explaining last year's bond rout, commentators usually zero in on February 4, the day the Fed raised short-term rates one quarter of a point. But that minuscule increase could hardly have triggered the sharp spike in yields that followed, let alone caused German long-term rates to jump more than 150 basis points. The Great Bond Market Crash of 1994 had deeper and wider roots.

In July 1990 the Fed, in response to an economy that was slipping into recession, reversed its tight-money policy and started to lower short-term rates. Wary of feeding the inflationary expectations that he believed were keeping long-term interest rates at unjustifiably high levels, Fed chairman Alan Greenspan steered rates downward, but gradually. He cut them 22 times over several months, bringing the federal funds rate to 4.75 percent by December 31, 1991. The Fed, as well as most economists, expected a reduction to about 5 percent in the funds rate to spur recovery, but instead the economy took a second dip.

The problem lay in the unique nature of this recession. What Greenspan came to dub the "structural headwinds" of balance-sheet distress were inhibiting recovery; banks, corporations and households, still crippled by debt, were intent on shoring up their finances rather than lending, expanding or spending.

The Fed was probably far too slow in easing rates, making it harder for the economy to rise off the floor. One former

Fed official concedes that the central bank took talk of a credit crunch with a grain of salt in 1990. But by the end of 1991, mounting debt problems and commercial banks' reluctance to lend had become a major concern for the Fed. With the inflationary threat now fading, the central bank steered short-term rates all the way down to 3 percent by September 1992. It held them at that highly accommodating level for the next 18 months.

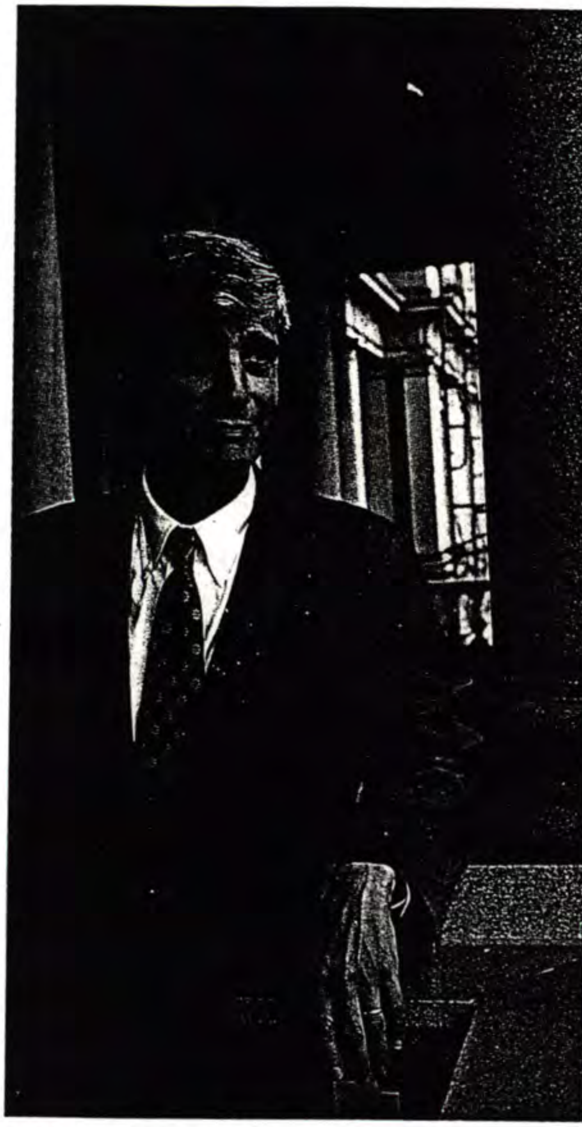
"The nature and depth of the recession in effect forced Greenspan to overshoot in pushing rates below 5 percent, to 3 percent," says Andres Drobny, a currency strategist at CS First Boston. "But the yield curve steepened because the short rates were brought down without the long end going with them." Yields on 30-year bonds remained at about 7.5 percent. That translated into a yield spread of about 450 basis points — twice the historical average. A number of factors were keeping rates high. The Japanese, who had been big buyers of long-term Treasuries, left the market at the end of the '80s; the savings and loan bailout gave rise to an influx of long-dated paper; on top of all this, the bond market doubted that the Bush administration could hold down a deficit that was rising because of the recession.

The steepness of the yield curve — the unusually wide gap between short- and long-term interest rates contrived by the Fed — brought the bank a remarkable string of policy successes. Not only was inflation all but wrung out of the economy, but the Fed also almost single-handedly rescued the U.S. banking system. Taxpayers were spared the expense of another S&L-style bailout.

Banks enjoyed what was in essence a subsidy, but one provided by depositors, not taxpayers. The banks were able to embark on a low-risk "positive-carry trade" by using deposits to scoop up intermediate-term Treasury notes that were then yielding 100 to 200 basis points more than the banks' cost of funds. Even as banks reduced their loan books by an average of 14 percent between 1990 and 1992, they increased their holdings of Treasuries by nearly one third.

The Fed's coup came at a heavy price, however. A speculative bubble was beginning to build in the bond markets. To hold federal funds at 3 percent — effectively a zero cost of capital for banks, given the inflation rate — the New York Fed had to keep pumping high-powered monetary-base money (currency plus bank reserves) into the financial system through its open-market operations. Most of that liquidity, the Fed believed, was being soaked up by the banks, which were using it to "buy" the yield curve and repair their battered balance sheets.

The complication was that others were also able to help themselves to this low-risk, high-reward carry trade. "In a world where there are derivatives, you don't have to be a bank to play the carry game, because anyone can synthetically create a short-funded long Treasury note position using futures contracts," notes Lee Thomas, a former Goldman, Sachs & Co. trader who now heads arbitrage trading at Investcorp in London. Hedge funds, Wall Street's proprietary trading desks, institutional investors and mutual funds may have lacked the banks' deposit base, but they were able to tap low-cost short-term money just the same in the massively expanding market in repurchase agreements. That enabled them to go long, and longer still, in bonds. And they could leverage their capital with futures or other derivatives to accumulate large exposures. How much of a demand for bonds all this added up to is impossible to calculate. But in just one area — margin loans to customers to buy Treasuries — the figures are startling. Volume rose from less than $40 billion at the end of 1990 to a record $216 billion at the end of 1993.


Richard Bloom/SABA

Treasury Secretary-designate Rubin: He wanted a favorable reaction from the bond market. He got euphoria

As an additional cost of the Fed's easing, the unnaturally and persistently steep yield curve was, arguably, prolonging the recession. Low short-term rates were denying savers income that they could spend and thereby boost demand, while borrowers were being discouraged by the high long-term rates from raising new capital to finance expansion. "There could be no U.S. recovery until the long bond rallied," argues CS First Boston's Drobny. The steep yield curve confronted the new Clinton administration and quickly became the main focus of its macroeconomic policy. Clinton aides came to see it not only as the primary obstacle to economic recovery but also, paradoxically, as the main lever to pry loose a turnaround.

The administration early on shed the idea of using the Democrats' traditional economic tool: Keynesian fiscal stimulus. Presidential advisers reasoned that a burst of federal spending, rather than stimulate growth, would perversely bring on a worse recession. Mindful of the already prohibitive level of federal debt, the bond market would react adversely, driving long-term rates even higher and crushing any hope of a sustainable recovery.

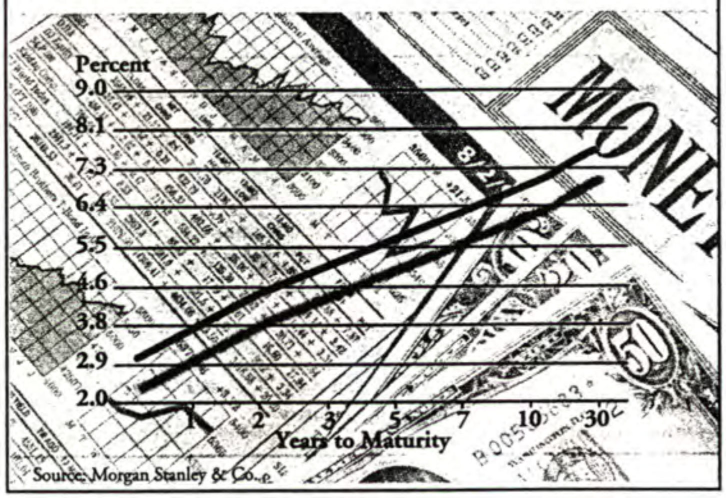
Instead, Clinton's team decided on what came to be called the financial markets strategy. In essence, it was Keynesianism in reverse: *reducing* rather than increasing spending to spur recovery by breaking the steep yield curve's sway over the economy. In an interview with *Institutional Investor* in early spring 1993, then–National Economic Council chief Robert Rubin emphasized: "We needed the long-term bond market to react favorably to the plan, and we needed to have the Fed view it as credible."

The latter task wasn't terribly difficult, for, as Bob Woodward noted in his book on the Clinton administration, *The Agenda*, the financial markets strategy was based on a scenario that Greenspan himself had outlined to the president-elect during a meeting in Little Rock in December 1992. The Fed chairman told Clinton that short-term rates were about right, but that long-term rates were 3 to 4 percentage points higher than normal because bond investors harbored lingering inflationary expectations. And those expectations, Greenspan declared, could be blamed in large part on investors' concerns over the size of the federal deficit. If the Clinton administration came out with a credible plan to begin reducing the deficit, the Fed chairman continued, market expectations would change, long-term rates would fall and demand for mortgage refinancings would rise. Lower mortgage payments, in turn, would provide a new source of consumer spending to revive the economy.

The plan worked, but it's no small irony that it did so for the wrong reasons and in the wrong way. "The [Clintonites] weren't expecting [the economic surge] so soon, and they didn't need as much as they got," notes Aubrey G. Lanston & Co. chief economist David Jones. The original strategy was actually based on what Rubin called a "one-two punch." A stimulus portion of the package was to come first and get the economy up and running in 1993; the spending cuts were to come in 1994; the resulting fiscal drag was to be neutralized by lower long-term interest rates. Former Fed vice chairman Manuel Johnson, who now heads the Johnson & Smick economic consulting firm in Washington, believes the administration was expecting the economic benefits of the plan to extend several years and pave the way for a middle-class tax cut in time for the '96 elections.

10/26/92: The steepest point

The Fed had brought short-term rates down to 3 percent, creating an unusually steep yield curve that provided the "carry trade" banks and leveraged players took advantage of on an unprecedented scale.



Source: Morgan Stanley & Co.

Of course, there was no fiscal stimulus in the final legislation. It was cut out by newly emboldened Republicans led by Kansas Senator Robert Dole. But as far as the market was concerned, the absence of the extra spending was all to the good, and it reacted to the deficit-reduction package almost immediately. A rally in the long bond began that would bring down long-term interest rates dramatically. Yields first began to fall in early February 1993, when then–Secretary of the Treasury Lloyd Bentsen floated a trial balloon about a possible energy tax. By February 21, when Greenspan gave his "endorsement" to the Clinton economic plan during testimony on Capitol Hill, the yield on the 30-year T-bond had dropped below 7 percent for the first time in 16 years. "Clinton probably knocked long-term rates down from 7.6 percent to 6.9 percent on the strength of the deficit-reduction plan," says Lanston's Jones, echoing a Wall Street consensus.

The bond rally spurred the desired wave of mortgage refinancing, which was almost immediately followed by a spurt of consumer spending. In the last half of 1993, household expenditures grew at three times the rate in previous years. That fueled a huge, 6.3 percent jump in fourth-quarter-'93 GDP. "There is no doubt that the mortgage-refinancing surge was a major contributing factor to the jump in economic activity at the end of 1993, which was carried into 1994," says Morgan Stanley & Co. market economist David Greenlaw.

While the Clinton administration was boasting that the long-bond rally was evidence of the credibility of its deficit-reduction plan, bond traders had a quite different perspective. "There were a number of factors that took the long-bond rally down below, say, 6.5 percent, and none of them had anything to do with the economy," contends Christopher Carroll, who trades five-year Treasury notes and heads government sales and trading at Nomura Securities.

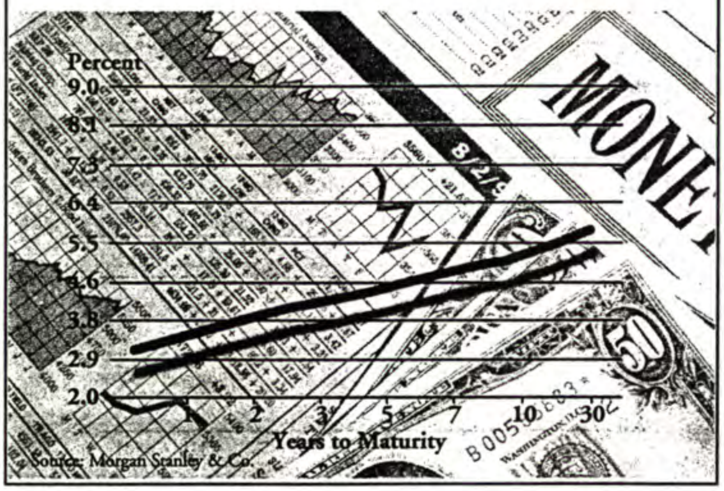
One such factor was the volume of municipal-defeasance programs prompted by the rally. In 1993 muni issuers took advantage of low interest rates to sell cheaper new debt and use the proceeds to service their more expensive old debt until it matured or could be called. But until those fresh funds could be utilized, the cash was parked in special nonnegotiable Treasuries (to which municipal and state issuers are granted access at below-market rates).

Mutual funds were also adding their considerable weight to the demand for Treasuries. As individual investors fled low-yielding bank deposits for bond funds, mutual fund companies put these ever increasing cash inflows into government securities. Mutual fund purchases of Treasuries had swelled to slightly more than $100 billion by year-end '93. Yet another factor inflating demand for Treasuries was the Brady plan to solve the LDC debt crisis. Brady bonds, of course, are backed by U.S. Treasury paper, and Argentina and Brazil bought a staggering $29 billion of long T-bonds through 1993 to participate in the plan.

But far and away the most important factor driving the bond rally, asserts Mark Werner, J.P. Morgan's head of government trading in New York, was the "mortgage-backed-securities effect." Explains Werner, "It was the honest-to-God institutional investor managing his portfolio against the index that drove the bids." At $1.35 trillion, the MBS market is easily the second largest in the U.S. after Treasuries (*Institutional Investor*, July 1994). And when the mortgage refinancing wave took off in the last half of 1993, it triggered a tremendous scramble among dealing houses to go as long as possible in ten- and 30-year Treasuries to offset the sudden loss of duration in their MBS hedges. Index fund investors also snapped up Treasuries.

10/15/93: The rally top

With the short end still held down by the Fed, the long bond rallied to its postwar low of 5.78 percent on a wave of massive market purchases driven largely by leverage and hedging.



Whoever was behind them, the bids had a self-reinforcing effect. The higher the long bond rallied, the greater the demand for it. Nomura's Carroll says that many trading desks caught on to the nature of that demand and tried trading against it as the yield fell toward 6 percent, thinking the rally would soon run out of steam. It was a vain hope.

In fact, the rally might well have ebbed soon but for yet another influence. This one came from the U.S. Treasury. In May 1993 it announced that it would begin shortening the average maturity of the government's $3.2 trillion in publicly held debt by reducing the number of long-bond auctions from four a year to two and cutting overall long-bond issuance by about 40 percent, to $22 billion annually. In addition, the agency said, it would eliminate the seven-year note altogether and increase the size of the auctions of bills and notes maturing in three years or less.

If the yield curve is positively sloped most of the time, the Treasury reasoned, it would be cheaper in the long run to fund government debt by shifting the weight of borrowing toward the market's short end. "People who issue long-term debt are paying a premium to investors essentially to avoid rollover risk," explains Darcy Bradbury, the Treasury's deputy head of federal finance. "But the U.S. government does not face the same sort of rollover risk."

Most Wall Street analysts believe the shortening was intended primarily as a ploy to help President Clinton deliver on his campaign pledge to reduce the deficit. Savings on debt service are expected to amount to $11 billion over five years. Administration officials, however, stoutly deny any such gambit. "The idea was presented to us by the Treasury in the context of debt management. And the fact that it may help us a little on the budget was a mild plus," says Bowman Cutter, deputy economic adviser at the White House.

Whatever the real motive behind the shift to shorter-term borrowing, it was interpreted by Wall Street as a supply-reducing stratagem to "seal" the overall objective of flattening the yield curve. And the move, coming amid a full-blown bond market rally, was positively electric. Talk quickly spread of an impending shortage of long bonds. Analysts advised clients to go long in the 30-year Treasury. "The cutbacks propelled the bull market into its final, over-leveraged blowout phase," says Louis Crandall, chief economist for RH Wrightson & Associates.

The roaring bond market on Wall Street was quickly replicated in Europe and Japan. A current of liquidity streamed out of the U.S. into foreign bond markets. Institutional money had been flooding into European government bond markets through most of 1993 on the bet that the Bundesbank would soon push the German discount rate down sharply, producing a bond market rally of the sort Greenspan had triggered in the U.S.

U.S. investors were the major players in Europe's rally. They bought $60.8 billion of foreign (mainly European) bonds in '93, more than they'd purchased during the entire decade of the '80s. One U.S. hedge fund alone reportedly held long positions in French government bonds equal to one tenth of all new debt issued by Paris that year. In the German Bund market, Europe's most liquid, fully 70 percent, or some Dm163 billion ($95 billion), of new Bund and government agency issues in 1993 were snapped up by foreign investors. Americans did the great bulk of the buying. "Goldman Sachs and Salomon Brothers at times were scooping up a third or more of the Bund auctions," according to one bond trader.

In Japan the consensus in late 1993 was that the country's deep recession would lead to a weakening of the yen against the dollar and a faltering in the Nikkei 225 index, but that the market for Japanese government bonds would do well. By the turn of the year, U.S. hedge funds, in particular, had placed big bets on short yen–long dollar and short Nikkei–long JGB strategies.

The worldwide bull market in bonds was well under way by the last quarter of '93. What's more, speculation and leverage were rapidly permeating the entire global financial structure and seeping into the credit markets. Leverage was embedded in the surging volume of structured notes sold to yield-hungry investors (or naive soap manufacturers). The exposures of the main derivatives houses pyramided skyward.

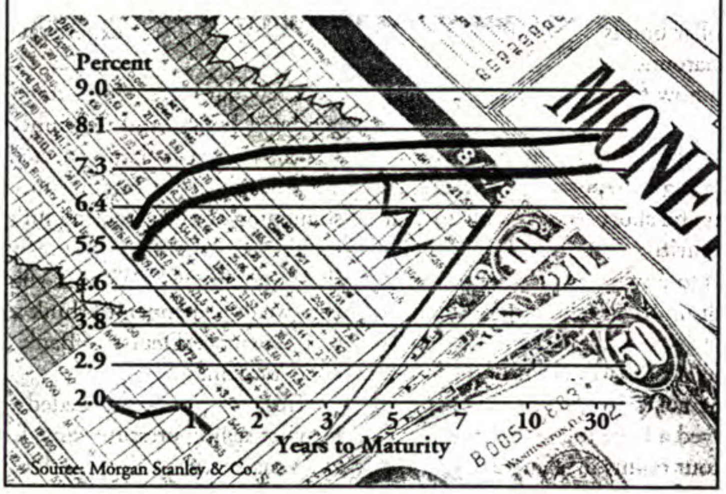
The rising influence of hedge funds, more specifically the short-term-trading-oriented hedge funds, was further eroding any distinction between trading and investing. Trading desks took on more position trades that entailed a directional view. Institutions that once invested strictly for the long term took advantage of increased liquidity and lower transaction costs to switch in and out of securities and currencies aggressively or used derivatives to execute or unwind views. And they did it in hours instead of days or weeks.

The impact on the market of this short-term-trading style was heightened by a change in the way banks wielded leverage. Some leverage is essential to eking out a profit in much of fixed-income trading. "You need leverage to make a decent return on a tight relative-value trade," explains Noreen Harrington, executive director for fixed-income sales at Goldman Sachs International, "but the correlations between the two securities will be so high that the risk is relatively low." However, it was only a short step for banks to begin applying leverage to firmly held directional views on interest rates as well. Many placed what would become massive bets — this time without the safety factor of high correlations between securities. This risky business became increasingly prevalent by late '92 and was well entrenched by 1993.

It actually worked well at the short end of the Treasury market once short rates began their descent in '91, and it worked spectacularly well in the European foreign exchange and bond markets during the upheavals in the monetary union's Exchange Rate Mechanism in early fall '92. Thus emboldened, banks and other dealers pushed speculative positions to unprecedented levels in the last half of '93, underpinning tremendous worldwide demand for government securities. "There is no question that this is the first time we have seen that degree of leverage throughout the global bond markets," says Gordon Johns, managing director at Kemper Investment Management. "Five years ago it would simply not have been possible, because people didn't have the access to, or the willingness to use, such leverage. Not many had the capability to hedge and control the risks, and there wasn't the knowledge or comfort level yet in going into the international markets."

12/5/94: Flattening toward inversion?

The Fed's rate increases and heavy sales of intermediate Treasuries had flattened the yield curve by the end of 1994. Some economists forecast an inversion of the curve in the first half of this year.



By the fourth quarter of '93, rising prices in bond markets around the world were pushing yields to postwar lows, and investment banks were firing on all cylinders and then some. Few bankers saw any signs that the good times were nearing an end. On Monday morning, October 15 — the day the long bond reached its zenith, with its yield slipping to 5.78 percent — *Barron's* ran this headline: "It Won't Get Any Better Than This." The magazine was dead right — it wouldn't.

By fall 1993 some members of the Fed's Open Market Committee had become increasingly anxious about the frenzied state of trading. In a mid-September interview with *The New York Times*, Fed vice chairman David Mullins spoke of his concern that a "bubble in asset prices" was forming. He and the other inflation hawks on the committee, Fed governors Wayne Angell and Lawrence Lindsey, as well as a handful of the regional Fed presidents, began pressing for a preemptive rate hike.

Greenspan resisted, reportedly out of fear of hammering the nascent U.S. and global recovery. But was the Fed chairman's "understanding" with the Clinton administration on financial markets strategy inhibiting him from acting to cool down the bond market? After all, as Woodward had noted in *The Agenda*, Greenspan himself had essentially "ghostwritten" the strategy. And now, just as it was having an effect — albeit a more powerful one than anticipated — he could hardly scuttle the entire scheme. Nevertheless, the marriage of policy objectives between the White House and the Fed to bend the yield curve was rapidly unraveling.

Close friends of the Fed chairman insist that he shared Mullins's concern but was understandably less than eager to tell the newspapers about it. As early as late September, Greenspan was already anticipating strong fourth-quarter-'93 GDP figures, they say. By the end of the following month, yields on the long bond had begun to drift upward, signaling that the market might be expecting a spurt of inflation. By December '93 Greenspan began to enlist political backing for a rate increase.

After getting the Treasury and the NEC's Rubin on board, the Fed chairman agreed to meet with President Clinton and his advisers on January 21 to warn that the Fed was getting ready to nudge short-term rates up. On February 4 the central bank enacted its one-quarter-point increase in the federal funds and discount rates. That move has come to be called the biggest and most expensive margin call in history. One Fed official, looking back on the events of last spring, muses: "The decision on February 4 was driven in large part by the realization of the need to pop the financial speculation that was building up in the system. And when you pop a bubble, unfortunately, someone has to lose money. What we didn't know was just how much."

The runaway bond train had already started to slide off the rails. But the immediately impending accident occurred in Japan, not the U.S. In mid-January the Ministry of Finance had unveiled an antirecession fiscal-stimulus package and some supposed easing of import restrictions. Suddenly, the Japanese market developed a new trading consensus, one that turned the previous one on its head: The MoF's package was deemed bullish for Japanese stocks, bearish for bonds. Government bond yields of 2.8 percent, when set against short-term rates of 2.3 percent, looked ridiculously low and thus likely to go north instead of south, as once anticipated. Moreover, with JGBs having a rising yield differential against dollar bonds and the prospect of a faster turnaround in the Japanese economy, the yen now looked to be the stronger of the two currencies.

"Estimates put the loss on publicly traded bonds worldwide at $1.5 trillion."

Leveraged investors — George Soros' Quantum Fund prominent among them, according to reports — were caught with their short yen–long dollar and short Nikkei–long 20-year JGB positions. A Japanese securities dealer says one highly leveraged U.S. hedge fund tried to unwind what were rumored to be long JGB positions worth up to ¥3 trillion ($30 billion) and had turned to Goldman Sachs to execute the trade. Goldman reportedly undertook to lay off three quarters of the longs, but the sheer size of the trade (some estimates put the total at a still daunting ¥1.5 trillion) played a large role in driving down the JGB market a frightening four points in a single day.

Reports of yen losses by Goldman quickly spread to London, rattling an increasingly skittish market. "For a lot of the younger traders, Goldie is it," notes one head of trading at a rival firm. "So when Goldman loses a stack of money, it punctures the illusion of its invincibility. A trader is sitting in front of his screen thinking to himself, 'Shit, maybe I'm too long, too.' Let's face it, the yen wasn't the only overbought market." Fear-driven traders scrambled to get their books flat.

In Germany, meanwhile, Bund futures had peaked on December 31 and were slowly giving ground as nervous foreign investors tried to reduce their long-bond positions. They'd become painfully aware that their original logic must have been flawed: The notion of a European repeat of the U.S. long-bond rally now seemed highly dubious.

The Fed had been easing rates in the context of a lukewarm recovery and an environment of weak balance sheets, corporate, household and bank alike. "Greenspan's policies were motivated by the need to accommodate the [structural] headwinds," says Jan Loeys, J.P. Morgan's market economist in London. The Bundesbank, too, was operating in a weak economic environment, though German corporate balance sheets had not suffered the sort of asset decline that hampered American companies. Thus the German central bank was not under pressure to be as accommodating as the Fed, and it was determined not to be hurried in its easing.

Putative economic weakness was everywhere — New York, London, Tokyo, Frankfurt — as February 1993 heaved into view. The month would become "to fixed-income fund managers what October 1987 was to the equity markets," observes Robert Fouliot, a financial consultant to several private banks in Geneva.

It wasn't only the Fed's quarter-point rate rise that triggered the global bond debacle; it was also the context for it and manner in which it was unveiled to the market. Rate changes ordinarily filter out to the market through the activities of the open market desk at the New York Fed. This time the central bank called a press conference late on a Friday afternoon to announce the hike and explain that the Fed now would be fighting inflation early by raising rates to shift monetary policy from an accommodating to a "neutral" stance. But no one, perhaps not even the experts at the Fed, knew what a neutral rate level was.

A few days later, amid tremendous market uncertainty engendered by the Fed announcement, GDP figures came out showing stronger-than-expected growth in fourth quarter '93. This reinforced a hunch among traders that the Fed knew something about gathering inflationary forces that the market didn't. "It woke the vigilantes up to the fear of inflation, and their response was, 'Well, if you think inflation is on the horizon, we don't happen to think a quarter point is enough,'" says C.J. Lawrence/Deutsche Bank Securities chief economist Edward Yardeni.

Treasury prices proceeded to fall through the floor. The heaviest selling pressure came from the mortgage-backed-securities market, according to the New York Fed. Although hedging and call-risk management had helped to extend the Treasury market rally in '93, they were now propelling prices in the opposite direction. The higher interest rates extended the duration of MBS portfolios dramatically, and both MBS dealers and investors shorted Treasuries as fast as they could to hedge against the abrupt increase in duration. The Fed estimates that between October 1993 and April 1994 such hedging activities accounted for a massive surge of more than $300 billion in Treasury sales.

Things weren't much prettier elsewhere. Adding to the market's fury, renewed Japan-bashing by some members of the Clinton administration led to a sharp appreciation of the yen, causing further losses for those holding positions in Japan. (The Quantum Fund concedes that it lost $600 million in just a few hours on Valentine's Day.) Then on February 25 the Bundesbank announced that the German M3 money measure had jumped a stunning 21.4 percent in January, sending the market into another tailspin. Bunds crashed, but even louder thuds were heard in higher-yielding markets like Spain's.

Nonbank financial institutions wound up dumping nearly

$250 billion of long positions in Treasuries in the first half of last year; commercial banks unloaded $37.6 billion in the second quarter alone. And mutual funds investing in Treasuries and agency securities saw nearly $24 billion of redemptions in the first nine months of '94, which forced them to dump still more Treasuries.

The bond rout's exact toll can't be calculated, but various estimates give a sense of its enormity. The Merrill Lynch government, corporate and muni bond index fell 9.7 percent between last February and early December, translating into losses (realized or book) of approximately $500 billion. A recent Securities Industry Association study estimates that for all U.S. bonds outstanding, the loss amounted to $1 trillion of market value by the middle of November. And some estimates put the loss on the $16 trillion of publicly traded bonds worldwide at $1.5 trillion or more.

By early December the yield curve was flattening dramatically, and a growing number of traders and economists were convinced that it was not merely flattening but would invert. Merrill's Sowanick guessed that the spread between the ten- and 30-year bonds would invert some time in the first quarter and the two-to-30-year spread soon after that. The Fed is expected to provide the impetus for this inversion by raising short rates 200 basis points or more early this year. "The Fed has never been able to slow the economy without pushing real short-term interest rates to at least 450 basis points," notes one head of government bond sales and trading.

Looking beyond the near term, fixed-income analysts are adjusting their thinking and their investment scenarios for secular changes in the market:

• Sudden, potentially huge swells of cross-border capital — which can be quickly augmented by leverage — will increasingly inundate domestic bond markets, causing sharp price movements. What's more, that volatility will feed on itself by forcing fund managers to adapt to the new environment by trading more actively. "The new financial world of ours creates enormous swings in both directions," observes Henry Kaufman, a former Salomon economist who now runs his own money management firm.

"Volatility is now a permanent fixture of the trading environment," agrees Investcorp's Thomas. Everyone has access to the same information at nearly the same time, is looking for and interpreting the key data within the same intellectual framework and has the means to execute a market view instantly. But, he asks: "If everyone sees it, everyone is already there. And if everyone wants to sell, who is left to buy?"

• Additional risk premiums are being factored into bond yields because of this new structural volatility. "The markets are different from the way they were before, and that has created a different pricing structure," says Kaufman. Thomas Mayer, the highly regarded chief Germany economist at Goldman Sachs in Frankfurt, recently completed a study showing that "for every one-point increase in unexpected volatility, long-term [German] bond yields rose by 42 basis points." Of course, this pricing pattern drives up the real cost of capital, which is already under pressure because of demand from newly emerging and post-cold-war market economies.

"Bond markets are increasingly the tough cop on the global economic beat."

• The bond markets are increasingly the tough cop on the global economic beat. "Capital markets provide a number of functions, but the one that is new is as a disciplinary device," notes Morris Goldstein, who heads capital market research at the International Monetary Fund in Washington. The market "has much more clout than it did in the past because it is so much more mobile, and it can be a very blunt instrument." Thus sovereign borrowers, including the U.S., face not only the prospect of higher real interest rates but also the likelihood that their macroeconomic policies will be judged even more harshly and impatiently by the bond markets. Adding to the pressure on governments to stay on the markets' good side is the fact that capital has many alternative outlets now that the cold war is over.

• The U.S. Treasury may well come to regret its decision to shorten the maturities of federal debt. "The assumption behind it was that there would be a free lunch, in that borrowing costs would be reduced," notes Merrill's Sowanick. "But that can only happen if there is no market response to the change in supply." Despite the Treasury's denial that it used debt management to reinforce macroeconomic policy, Wall Street didn't believe it and won't next time.

• More than ever, serious questions exist about the Fed's ability to fine-tune a $6 trillion economy, particulary now that many of the bank's traditional economic indicators, notably money-supply figures, have become unreliable. Moreover, in a market undergoing such rapid structural changes, who can be sure what impact even a modest interest rate increase will have? Certainly not the Fed.

Perhaps Greenspan deftly avoided a systemic financial crisis when he decided last year to raise rates only gradually. Market watcher Kaufman, however, insists that Fed gradualism simply will not blunt credit demand and will drag out uncertainty and volatility during a monetary-tightening operation. "Gradualism doesn't arrest the demand for credit, only its cost," he says. "It is like a parent saying to his child, 'I have to punish you, so I am going to softly spank you ten times.' If you really want to influence the markets, you have to do it in big whacks."

The implication: It will take quicker and deeper rate cuts to stimulate any future economic recovery, and conversely, it will take sharper and more savage rate increases to slow a too-robust recovery. Stopping the economy dead in its tracks may become the norm of future Fed restraint policy. That can't be any consolation to the Clinton administration as the economy forges ahead and an election campaign looms. As J.P. Morgan's economic team noted late last year, "The risk that this boom will be followed by a bust — probably as early as the last half of 1996 — increases the longer the economy is allowed to overheat."

After the Republican trouncing of the Democrats in November, the Morgan report would hardly make for pleasant reading at the White House. ii

THE PRESIDENT HAS SEEN
2-21-95

THE WHITE HOUSE

WASHINGTON

THE PRESIDENT HAS SEEN
2-21-95

February 13, 1995

CHIEF OF STAFF TO THE PRESIDENT

To the President —
95 FEB 21 P12:14
FYI

INFORMATION

MEMORANDUM FOR THE PRESIDENT

CC: LEON PANETTA

FROM: KITTY HIGGINS
GENE SPERLING

SUBJECT: Communications Plan for Direct Lending

For your information, this memo summarizes the Department of Education's recent efforts to publicize your Direct Lending program.

Free Media

Radio Public Service Announcements:
The Department mailed seven radio PSAs to 10,600 radio stations in November and the ads continue to run in virtually every market in the country, with a heavy concentration on campus and college radio. The results of these PSAs have been phenomenal as the Office of Public Affairs has been inundated with calls for more information. The direct lending 800 numbers have received several thousand calls as a result of the PSAs.

Why not October!

What did they say — was (elections)

In the next few weeks, the Department will have the next generation of the ads and will send them to radio outlets across the country.

What will they say

Newspaper Public Service Announcements:
PSAs have been sent to 11,700 newspapers (ranging from weeklies to large dailies) and 1,600 campus newspapers. The ads run at the discretion of the publishers; the Department has had better success with the smaller circulation papers and the campus papers. A copy of the ad is attached. The second wave of PSAs will be mailed in conjunction with the new radio PSAs.

Television Public Service Announcements:
The Department is in the process of soliciting bids for a company to produce television PSAs.

Press Release: Today, the Department mailed to the same 11,700 newspapers and 1,600 campus papers a press release written as a news feature on the advantages of direct lending (attached). Many newspapers run a release like this as if it were their own news story. The Department has found this to be a particularly effective tool in getting out our message. This same press release will be available on the Departments's radio feed, which reaches 10,000 radio stations. A similar mailing this past November generated hundreds of calls to the Office of Public Affairs requesting additional information on the direct lending program.

Two weeks ago, the Department did a targeted mailing to the same list with a press release on a new publication, "Preparing Your Child for College." The publication discusses the direct lending program in detail. The mailing has generated hundreds of calls and numerous regional press clips.

In addition, the Department has prepared a packet for college financial aid administrators to generate local media. In the packet, there is a description of how to set up a media event showing how easy it is for a student to get a direct loan. (It literally takes a matter of minutes.) The Department also gives them direction in planning the event and inviting the media. These local events are designed to reach the grassroots in a way that coverage in The Washington Post and The New York Times can't.

Editorials: The Department routinely place op-eds by Department officials or surrogates in regional newspapers around the country. For example, in mid-January, the Department placed an op-ed by former Education Secretary Ted Bell (Republican) in more than 40 regional papers. The Department attempts to place op-eds monthly.

The Department has prepared and distributing talking points on the benefits of direct lending to editorial writers to aid them in crafting editorials. Departmental staff is contacting these writers individually to tout the benefits of direct lending and offer additional information or sources who can speak positively.

College and University Press and Radio

In addition to being part of the broader mailings, the Department routinely does targeted mailings to this audience. These mailings always generate press calls for more information. In addition, the direct lending 800 numbers usually are inundated with requests for information.

Brown Bag Lunches

The Secretary and Deputy Secretary regularly invite reporters and columnists in to talk about direct lending issues. Another is planned for late next week. Those that have written favorable so far are David Broder, Mort Kondracke, Ben Wattenberg, William Raspberry, Mary McGrory, Jack Anderson and Ed Yoder.

Events

Both Secretary Riley and Deputy Secretary Kunin have done numerous events over the past year which often generate positive local coverage. For example, the Deputy Secretary will visit Georgia State University this week to do a direct lending event. She will work with a student to show how easy it is to get a direct loan. Reporters will see how first-hand the effectiveness of direct lending. In many of the events, financial aid administrators demonstrate via computer how loans are processed and describe the ease and simplicity of the new program.

Video/Computer Demonstration

The Department is preparing a seven-minute video (with accompanying computer demonstration) on the benefits of direct lending which will be distributed to financial aid officers, University Presidents, interest groups, Department officials and others. The video can be used to make presentations and speeches to student groups and other interested parties.

Now, Uncle Sam Has a Way to Help Families and Students Afford College... *And Save Taxpayers Billions !*

Introducing New Individual Education Accounts

Finally, there's good news for families. And good news for taxpayers, too.

New Individual Education Accounts are here. Recently created by the President and the Congress, they make the American dream of an affordable college education a reality for many more young people and their families who thought it was beyond their financial reach. Here's how it works:

- *Borrowing for college is simpler.* Students get their loans directly though their colleges. No more confusion about where to go for loans. No more red tape.

- *Loans are more affordable.* The new direct loan program lowers fees and interest rates for all types of college loans.

- *Pay back as you can.* Students can tailor their repayment plan to match their ability to pay. That means they can start a business, do community service, or take other jobs without being burdened with a big, fixed debt early in their careers.

- *Refinancing is available.* If students have more than one loan, an IEA can help consolidate them and offer a refinancing plan that makes more sense.

- *Taxpayers come out winners, too.* With streamlined procedures, IEA's will save American taxpayers billions of dollars in unnecessary costs.

That *is* good news!

For more information, call your college financial aid officer or 1-800-4FEDAID.

DEPARTMENT OF EDUCATION · UNITED STATES OF AMERICA

THE NEW INDIVIDUAL EDUCATION ACCOUNT
The better way to finance a college education.

William D. Ford Federal Direct Loan Program
U.S. Department of Education

Getting Money for College Just Got Simpler... and More Affordable, Too.

Introducing the New Individual Education Account

You know the problems with college loans. They're a hassle to get. And you worry about how you're going to pay them back.

Pres proposed - Cong adopted -

Well, there's something new that can help. It's the Individual Education Account, recently created by the President and the Congress. It's great for undergraduates and graduates, too. Here's how it works:

- *Borrowing for college is simpler.* You can get your loan directly through your college. No more confusion about where to go for a loan. No more red tape.

- *Loans are more affordable.* The new direct loan program lowers fees and interest rates for all types of college loans.

- *You pay back as you can.* You can tailor your repayment plan to match your ability to pay. That means you can start a business, do community service, or take other jobs you want without being burdened with a big, fixed debt early in your career.

- *Refinancing is available.* If you have more than one loan, an IEA can help you consolidate them and refinance in a way that makes more sense.

Sound good?
Then call your financial aid officer or 1-800-4FEDAID to get all the facts.

THE NEW INDIVIDUAL EDUCATION ACCOUNT
The better way to finance a college education.

William D. Ford Federal Direct Loan Program
U.S. Department of Education

DRAFT

FOR RELEASE
k:\shared\nddrafts\yeadl.tl
Add Univ. of Calif. example

Contact: Jane Glickman (202) 401-1307
Stephanie Babyak (202) 401-2311

DIRECT LOANS WORK FOR STUDENTS, SCHOOLS AND TAXPAYERS

"Getting a student loan was easier than I ever imagined," says Marjorie Collins, a graduate student at Washington, D.C.'s American University (AU). She's a single mom, working full-time and attending a weekend master's program in public affairs.

"I made a last-minute decision to go back to school and was afraid I wouldn't be able to secure a loan in time to pay my tuition. And with my busy schedule, I also worried about the time it would take to find a lender and do the paperwork. But with direct lending, I only had to make one visit to the school's financial aid office and AU was able to process my loan and credit my account in a few days. It was a tremendous relief."

Students like Collins -- and financial aid administrators across the country -- are praising the new William D. Ford Federal Direct Loan Program, which allows students to borrow directly from the federal government through their schools instead of through banks and other third-party lenders.

Schools cite a number of benefits to direct lending: it's simple, with less paperwork, less money spent on staff overtime and phone calls to lenders, and much quicker turn-around time for loan processing; improved cash flow; and flexibility to structure the loan program to fit their particular needs and capabilities.

"The program is so much simpler than the FFEL (Federal Family Education Loan) program that we've completed awarding aid to 800 more students this year than we did at the same time last year," said a financial aid administrator at SUNY-Brockport just a few weeks into the program.

And at the University of Idaho, the financial aid director said, "The biggest joy of direct lending is having the money ready for the students when they expect to receive it. Our students have definitely been the beneficiaries of better service."

The University of Florida pointed to other administrative benefits: "...a happier, more in-control financial aid staff who are better able to meet their customers' needs and an overall cash flow improvement for the school."

These are just some of the comments from the 104 colleges, universities and trade schools participating in the first year of the direct loan program. Beginning July 1, the total number of schools in the program will climb to about 1,400, or 40 percent of total loan volume, as set by law. More than 2 million students are expected to receive direct loans next year.

Benefits for students were summed up by University of Michigan President James J. Duderstadt, "With one-stop shopping, students have been able to obtain their loans in precord time. By the end of the first month of school this year, there was a 43 percent increase over 1993 in loans originated and funds disbursed to students." In addition to having loan money earlier in the school term to pay for books and other up-front expenses, flexible repayment options give student borrowers more control over their finances and career choices.

Students also report that they borrow less because it is now so easy and simple to obtain additional funds if needed compared to the hassle under the FFEL program.

Borrowers with direct loans can open an Individual Education Account (IEA), giving them the option to repay their loan in one of four ways -- and to switch repayment plans as their financial situations change.

The four repayment options are:

- o **Pay-as-you-can or income contingent plan** -- monthly payments are based on a percentage of annual income, family size and loan amount, with payments rising and falling as income fluctuates.

- o **Extended plan** -- monthly payments are a fixed amount over a period of 12 to 30 years, depending on loan amount.

-MORE-

- o **Graduated plan** -- payments are lower initially and then increase every two years over a period of 12 to 30 years.

- o **Standard plan** -- monthly payments are a fixed amount for up to 10 years.

Taxpayers also gain from direct lending. From the Student Loan Reform Act that created direct loans, the government expects to save an estimated $6.8 billion from FY 1995 to FY 2000 by eliminating unnecessary payments to lenders and taking advantage of the federal government's ability to borrow at a lower interest rate. The Administration's FY 1996 budget proposes speeding-up the phase-in of direct loans to 100 percent of loan volume by academic year 1998, for an additional $5.2 billion savings ($12 billion total savings).

"We are determined to take the expense and confusion out of how students finance and pay for higher education," said U.S. Secretary of Education Richard W. Riley. "We're determined to make the loan process simple, easy and efficient, and it's working. Both schools and students recognize that direct lending accomplishes these goals -- and saves billions of dollars at the same time."

Last month, the Education Department held a meeting in New Orleans to provide schools who will begin direct lending in the 1995-96 school year with training and technical assistance to get the program up and running smoothly. Campus officials from the 104 schools that began direct lending this year also attended, sharing their start-up experiences and describing its advantages. One benefit cited by many financial aid directors was the importance of being in control of their own programs and funds -- an impossibility in the guaranteed student loan program, which involves over 7,000 lenders, 42 guaranty agencies and more than 50 secondary markets. Assuming control of the loans, they said, means corrections and adjustments are easy to do and the whole process flows more smoothly.

The financial aid director at Ohio University in Athens put it this way: "Direct loans put the students back where they belong -- at the center of this business. Our purpose is to provide the best service possible and to deliver financial aid in a timely manner. Go direct loans!"

###

THE PRESIDENT HAS SEEN
2/21/95

Memorandum to the President

From: George Stephanopoulos

February 17, 1995

Affirmative Action

Past statements a problem in moving forward
Really a question of what's right, what works → need to discuss

As you may know, we have established a working group from the White House and Justice Department to respond to the affirmative action challenge posed by the California initiative and legislative efforts on the Hill. (See attached memo to Leon)

All involved believe that it's important for you to make a major statement in the near future emphasizing your lifelong commitment to civil rights and racial equality, and outlining your response to the new debate on affirmative action. All share your belief that we need a "national conversation" on this issue, that the conversation must be based -- first of all -- on real facts, and that you should be the voice of healing, progress and common sense in this debate. We are meeting on an accelerated basis to prepare recommendations for you.

As we do this work, we thought it might be helpful to you to review your own Presidential statements on civil rights, race and affirmative action. Attached is a packet prepared by the White House Office on Research.

I know you have been giving this subject a lot of thought. We will report back to you after our next meeting. In the meantime, please let me know if you need any further information or would like to give more direction to the strategy group.

cc. Leon Panetta
    Harold Ickes

Memorandum to the Chief of Staff

From: George Stephanopoulos

February 15, 1995

Affirmative Action Strategy

Yesterday we had our first meeting to discuss affirmative action strategy here in the Roosevelt Room. The list of attendees is attached.

Recognizing the sensitivity of the issue and the acceleration of political activity on the Hill and in California, the group consensus is that the President must make a major statement on the broad issue of race in America sometime in the next 2-6 weeks. Any policy decisions the President reaches on affirmative action must be embedded in this larger context.

This group will meet at least weekly to formulate strategy and policy recommendations. Our next meeting is Tuesday, February 21st. The following assignments were made pursuant to that meeting:

-- The President will receive a package of his previous statements on affirmative action and civil rights before he goes to Camp David.

-- Chris Edley will prepare talking points both on our current stance on affirmative action and the process we are engaged in. They will be reviewed and circulated today.

-- Deval Patrick will prepare an outline for a draft Presidential statement and policy paper. Bill Galston and Joel Klein will respond and critique the draft, and we will discuss it further at Tuesday's meeting.

-- Lorraine Miller will monitor and report on Congressional activities for group.

-- Kitty Higgins will monitor and report on Administration-wide activities for group.

-- Alexis Herman will coordinate and report on outreach efforts for group.

Participants: Affirmative Action Meetings

Sec. Cisneros
Sec. Ron Brown
Maggie Williams
Jack Quinn
George Stephanopoulos
Harold Ickes
Abner Mikva
Joel Klein
Alexis Herman
Pat Griffin
Carol Rasco
Kitty Higgins
Bill Galston
Lorraine Miller
Chris Edley
Gene Sperling
Goody Marshall
John Angell
Nancy McFadden
Deval Patrick
John Schmidt

THE WHITE HOUSE

Office of the Press Secretary

Internal Transcript February 16, 1995

INTERVIEW OF THE PRESIDENT
BY BOB ELLISON, AMERICAN URBAN RADIO NETWORK

The Oval Office

6:30 P.M. EST

Q When you mention wedge issues, there are attempts to make affirmative action a wedge issue. Do you see the need to repeal it, retain it as it is, or modify affirmative action?

THE PRESIDENT: Well, I think we ought to look at all the things that people call affirmative action; particularly where there's evidence of discrimination, I think that affirmative remedies should lie. And in general, I think we ought to try to have a national conversation about this, looking at the facts and asking ourselves, what is the best policy to bring the American people together and guarantee everybody has a real opportunity to fulfill his or her potential? That's really what this issue ought to be.

So far, it's been a highly-charged and rather political debate. I've read or heard almost no serious discussion about the programs in question and what their impacts are and what the alternatives are if they're to be discarded. So I'm hoping that we're going to see the beginning of an honest debate that will bring the American people together, not the onset of another political campaign designed to divide us.

CIVIL RIGHTS/SOCIAL RIGHTS

President Clinton's Address to Members of the Church of God in Christ, Mason Temple
Memphis, Tennessee
November 13, 1993, Saturday

"Over 20 years ago I first came in contact with -- (inaudible) -- and a movement and the commitment and I have watched them over these years help people all across the country with the practical problems of life, to give real meaning to the idea of civil rights, when you can actually live in a decent house and have a decent job and know your kids are going to get a decent education and know that you're going to be treated fairly no matter what your race is."

"This administration is committed to the enforcement of the civil rights laws. This administration is also committed to programs like national service that give everybody the possibility of being part of a new era of civic responsibilities. This administration is committed to guaranteeing that every American is entitled to a fair chance at the brass ring, but even more important, to empowering people to seize those opportunities, to moving beyond the incredible gridlock in the mind of this town, that you either have to give somebody something for nothing or take it all off the table.

Why don't we behave in Washington the way people behave in their normal lives? We need opportunity and responsibility. Why don't we stop making these nutty arguments that imply that everything in life is an either/or proposition? We're either going to write somebody a check and bust the government budget or we're just going to stick it to them and walk away. That's not the way life works.

You know, civil rights should embody a country that works. We don't want to guarantee everybody equal employment opportunities when there are no jobs. Does that mean that we have to sacrifice one and not the other? No, it means you should have a president who will pursue both -- walking and chewing gum at the same time. That's what this is about. Is that -- we want to guarantee everybody an equal opportunity to get an education, but wouldn't it be nice if the education you're getting is also better? It's not either/or."

"I tell you, folks. I refuse to believe that we cannot go forward together, that we cannot set an example, that we cannot make progress. I refuse to believe that you can't be committed to civil rights and to civic responsibility. I refuse to believe that we can't create economic opportunity by empowering people to seize control of their destiny and changing the government's policies. And I think that if this Leadership Council should have any mission today, it should be to break through those barriers that push us all into one extreme camp or the other and make us mute in the face of reality and common sense. Surely we can bring the experience of our own lives and the lives our fellow Americans beyond the borders of this city to the policy-making process that will dominate Washington for the next year. That is what we ought to do if we want civil rights to come alive in this country.

You know, when I ran for this job, I spent a lot of time in African-American churches cause I always had and because I felt at home. When I got this job, and I sought to protect the religious and civil liberties of every American, it was because I wanted mine protected and because I have a sharp memory of what it was like to live in a society where half the people I knew because of their color were treated as second-class citizens. I also have a sharp memory of those who had the courage to try to change that position. Now that I am president, I want you to know that I'll make my mistakes from time to time, but I'm going to keep trying to move the ball forward. I believe we can make advances. I don't believe that our fights are over. I know that there are still civil rights battles to be fought, but I know that they need to be fought today in the context of making a real difference in real peoples' lives. And we should not be intimidated those of us who believe in the cause of civil rights for all Americans into thinking that somehow that can be separated from the fight for economic justice and economic progress and making our free enterprise system work better.

And we should not let people who basically don't care whether we make progress in civil rights think that you can separate civil rights from the fight for substantive improvements in education and for meaningful advances in health care or any other areas of our national life. Let us resolve tonight that we're going to spend the next four years breaking down the gridlock by starting -- tearing down the artificial barriers in peoples' minds to bringing us together saying we don't have a person to waste and lifting up everybody's God-given potential and doing what we can to see that they achieve it."

CIVIL RIGHTS/EQUAL OPPORTUNITY

Memorandum on the Civil Rights Working Group
August 4, 1994

" I am writing to you about our responsibility to promote equal opportunity for all Americans. We have accomplished much in our pursuit of a society in which all our people can achieve their God-given potential. But we still have a long way to go.

Americans believe that in spite of our differences, there is in all of us a common core of humanity that obliges us to respect one another and to live in harmony and peace. We must build on this belief and give real meaning to civil rights by tearing down all remaining barriers to equal opportunity -- in education, employment, housing, and every area of American life.

Throughout the Nation, each of us must bring new energy to our efforts to promote an open and inclusive society. Those of us who are public servants have a special obligation. At the Federal level, we will do this by re-evaluating the civil rights missions, policies, and resources of every agency, so that they carry out their missions in a manner consistent with the Administration's commitment to equal opportunity. In reviewing our activities, we must seek not only to eliminate barriers to equal access and opportunity, but also to identify opportunities for innovation. No Federal office should be exempt from the obligation to further the struggle for civil rights. And every State and local government should be encouraged to do the same.

On January 17, 1994, I issued an Executive order establishing a President's Fair Housing Council to be chaired by the Secretary of Housing and Urban Development. Working across agencies and programs, this Council will bring new focus and leadership to the administration of the Federal Government's fair housing programs. On February 11, 1994, I issued an Executive order directing agencies to develop strategies to identify, analyze, and address environmental inequities that are the result of Federal policies. That order will increase public participation in the environmental decision-making process.

In addition to these efforts, I believe more can be done to exercise leadership for civil rights enforcement. That is why I hereby establish a Civil Rights Working Group, under the auspices of the Domestic Policy Council, to evaluate and improve the effectiveness of Federal civil rights enforcement missions and policies. The Civil Rights Working Group will identify barriers to equal access, impediments to effective enforcement of the law, and effective strategies to promote tolerance and understanding in our communities and workplaces. More important, I expect the Working Group to develop new approaches to address these issues.

The principal focus of the Working Group will be our civil rights enforcement efforts. We must recognize, however, that public and private enforcement resources will never be fully adequate to the task, and all of the remaining obstacles to opportunity cannot be removed through litigation alone. Therefore, I direct the Working Group to identify innovative strategies that can leverage our limited resources to provide new avenues for equal opportunity and equal rights. Among those potential strategies are new measures relying on civic education and voluntary efforts to engage citizens in overcoming the effects of past discrimination. These new strategies should be designed to complement our improved and reinvigorated enforcement efforts.

The Attorney General and the Director of the Office of Management and Budget will co-chair the Working Group. The following Administration officials will serve as members: the Secretary of the Treasury, the Secretary of Commerce, the Secretary of Agriculture, the Secretary of the Interior, the Secretary of Education, the Secretary of Health and Human Services, the Secretary of Housing and Urban Development, the Secretary of Labor, the Secretary of Transportation, the Secretary of Veterans Affairs, the Administrator of the Environmental Protection Agency, the Chair of the Equal Employment Opportunity Commission, the Assistant to the President for Economic Policy, the Assistant to the President for Domestic Policy, and the Assistant to the President and Director of Public Liaison. I also have invited the Chairperson of the Commission on Civil Rights to participate in this crucial endeavor on an informal basis, respecting the independent and critical voice we expect of that Commission. Finally, this membership list is not exclusive. I invite and encourage all Cabinet officers and agency heads to participate in the Working Group.

The Working Group will advise appropriate Administration officials and me on how we might modify Federal laws and policies to strengthen protection under the laws and on how to improve coordination of the vast array of Federal programs that directly or indirectly affect civil rights. I direct the Working Group to provide the Cabinet and me with a brief progress report no less than every 6 months, and specifically to:

(a) examine each Federal agency with a significant civil rights mission and provide me with an evaluation of how well that mission is being implemented. These analyses should examine whether each agency uses the experience gained form enforcement activities of other agencies and other levels of government. Counterproductive and inconsistent practices should be identified and proposals for change recommended;

(b) examine cross-cutting civil rights law enforcement challenges such as voting rights and equal access to government benefit programs and identify innovative means of coordinating and leveraging resources;

(c) develop better measures of performance for Federal civil rights enforcement programs, taking into account the real impact of programs on the daily lives of all Americans; and

(d) support and advise all agencies as we reinvent our strategies for the promotion of an open and inclusive society.

With this interagency effort, I underscore the commitment of this Administration to bring new energy and imagination to the opportunity agenda. In departments and agencies throughout the Federal Government, this work is already well underway. The Working Group will provide a mechanism to expand and accelerate that vital work. Its work will be among our greatest contributions to the people we serve."

Remarks in a Town Meeting in Cranston, Rhode Island
May 9, 1994

[A commissioner with the New England Hispanic civil rights commission asked about civil rights policy.]

The President: "Well, if you look at -- first of all let me say, we don't have time to go into the specifics, so if you will write me a specific letter, I will give you a specific answer. But I want to mention one thing in particular. Last year, the Civil Rights Division of the Justice Department was much, much more active in many areas than it had been in the past. The civil fights activities of the Department of Housing and Urban Development under Henry Cisneros dramatically increased last year over what they had done for years in the past. And then I appointed Deval Patrick, who's a very distinguished civil rights lawyer, to be head of the Civil Rights Division. And most people who had been following it believe that we have dramatically increased the activism of the division.

But I can't respond to any specific concerns you have, sir, but if you will write them to me, I will get back to you on the specifics, because I intend to be very vigorous in this area. And my impression, just looking from the statistics, and I've gotten reports from the Civil Rights Division of the Justice Department and on the Housing and Urban Development, is that we have dramatically increased our civil rights activities, which is what I had intended to do. And so if there are problems, I'll fix them if you will get them to me."

Remarks Announcing the Nomination of Deval L. Patrick To Be Assistant Attorney General for Civil Rights and an Exchange With Reporters
February 1, 1994

The President: "For tens of millions of Americans the Civil Rights Division of the Department of Justice has historically embodied what is best about our country. It's helped us to keep the promise of our Constitution, to provide to every American equal opportunity and equal protection under the law, regardless of race or gender or disability. Because of our pursuit of equal treatment under the law, we've made a lot of progress in this country in the workplace, in the schools, in the voting booths, and in the courts. But there is still much more to be done. We need a strong and aggressive Civil Rights Division and a strong and compassionate advocate for freedom and fairness at the helm of that Division.

Today I am proud to nominate Deval Patrick to be Assistant Attorney General for Civil Rights. I believe he is uniquely qualified to lead this Division in this decade. He's been chosen because he has distinguished himself as a lawyer whose wise counsel, keen negotiating skills, and mastery at litigation are held in the highest esteem.

He's fought successfully against discrimination and for civil rights for his entire life, both professionally and personally. He understands that the law is a tool to help real people with real problems. He's here with his family today, having come a long way from his childhood on the south side of Chicago through a distinguished academic and professional career of which any American could be proud.

The quest for civil rights gives life to our highest ideals and our deepest hopes. For his entire career Deval Patrick has played a role in that struggle, and he has made a real difference. Therefore, I know he will perform in a very outstanding manner in his new role as Assistant Attorney General for Civil Rights."

The President's News Conference
October 21, 1994

Q: "Mr. President, several years ago a Piscataway, New Jersey school board had to lay off teachers. And it came to a white female teacher and a black female teacher. And rather than flipping a coin -- as it turns out, both had been hired on the same day so they had equal experience -- the school board fired the white teacher because of the color of her skin. Now, your Justice Department originally opposed the school board in court, but has flipped recently. And I was wondering if you agree with that decision, if you think that we need more affirmative action acts like this or whether that's a case of reverse discrimination.."

The President: "I support the position as finally articulated, but I'd like to says it's a very narrow case. That is, if you have a school district where the children are overwhelmingly of one race or another and the faculty is as well and you have two equally qualified people and you stipulate that -- in this case, both sides in the lawsuit stipulated they were absolutely equally qualified -- then can trying to preserve some racial diversity on your faculty be a ground for making the decision, as opposed to flipping a coin? As long as it runs both ways, or all ways, I support that decision, that is, there are other conditions in which if there were only one white teacher on the faculty in a certain area and there were two teachers, they were equally qualified, and the school board or the school administrator decided to keep the white teacher also to preserve racial diversity. That is the position the Justice Department has taken. And on those very narrow grounds, I support it because both sides stipulated, both teachers and their lawyers stipulated that there was absolutely no difference in their qualifications for the job."

CIVIL RIGHTS/LEGISLATION

Governor Bill Clinton
Remarks on MTV
June 16, 1992

"Why have you not gotten a civil rights act
through your legislature?"

Governor Clinton: "Because I want to pass one that's tough to pass. Let me explain what I mean. Most state civil rights law allow you to bring an action in a state court, under the federal law. That is, most state civil rights law say we're going to give you the state courts as well as the federal courts to enforce your rights under the federal law. I want a law which covers things which the national law doesn't cover; which provides more protection to women; which provides more protection to small business; which sets up some things which are quite controversial. And the sponsors of the last civil rights bill and I decided that rather than pass a bill which didn't mean anything, just to say we had one on the books, we'd set up a special task force and try again in 1993 to pass a really tough civil rights law."

"The New Covenant:
Responsibility and Rebuilding the American Community"
Remarks of Gov. Bill Clinton
Georgetown University
October 23, 1991

"Nothing exemplifies this more clearly than the battle over the Civil Rights Act of 1991. You know from what I've already said today that I can't be for quotas. I'm for responsibility at every turn. That bill is not a quota bill. When the Civil Rights Act was in place from 1964 to 1987, I never had a single employer in my state say "it's a quota bill." We need rules of workplace fairness for the 70% of new entrants in our workforce who will be women and minorities in the decade of the '90s. That's what that bill is for."

"Why does the President refuse to let a civil rights bill pass? Because he knows that the people he is dependent on for his electoral majority--white, working-class men and women, mostly men--have had their incomes decline in the 1980s, and they may return to their natural home, to someone who offers them real opportunity. And so he is dredging up the same old tactic that the hard Right has employed in my part of the country, in the South, since I was a child. When everything gets tight, and you think you're going to lose those people, you find the most economically insecure white people, and you scare the living daylights out of them."

CIVIL RIGHTS/PERSONAL HISTORY

Remarks by Governor Bill Clinton
NAACP Convention
Nashville, TN
7/11/92

"I want to say one personal word in closing. The feelings I have about Civil Rights are rooted very much in my background. When my mother was widowed shortly before I was born she moved in, as so many people do, with her parents. And I lived with my grandparents till I was four.

My granddaddy had a grade school education, ran a country store in a little town called Hope, across the street from the cemetery. Most of his customers were black. That's back in the late '40s and early '50s. I first got to know just about all I know about human nature sitting in that store trying to steal cookies out of the Jackson's cookie jar, watching people come in and out who worked hard and did the best they could and sometimes needed credit. I watched my grandfather relate to people as people.

In 1957, '56 and '55 when all this tension was building up, my grandparents told me when I was a kid, they said, this is wrong, we ought to integrate these schools because all these kids need a good education. I never knew why they were different from so many other people in my part of the country, but I've always been grateful that they were. I was raised to believe that if I didn't respect everybody and want everybody to live up to their God-given potential, some day somebody might not want me to either."

CIVIL RIGHTS/DISABILITY

Proclamation 6605 -- National Disability Employment Awareness Month, 1993
October 6, 1993

"The United States has long been a champion of the civil rights of individuals, and it is only natural that we now serve in the forefront of efforts to ensure equal opportunity for persons with disabilities. Inspired by the enactment of the Americans with Disabilities Act (ADA) on July 26, 1990, other nations have begun to reexamine the challenges faced by their citizens with disabilities. The ADA, which prohibits discrimination in employment, public accommodations, government services, transportation, and communications, provides a practical model for people everywhere to ensure that individuals with disabilities will not be excluded from the social, cultural, and economic mainstream."

Remarks by President Clinton
at a Ceremony Celebrating the Anniversary
of the Americans With Disabilities Act
July 27, 1994

"Like every civil rights law in our history, the Americans with Disabilities Act is just that; it's about potential. It is not a handout. It stands for what's best in our heritage -- empowering Americans to build better lives for themselves. In that tradition, I pledge as your president to see that this act is fully implemented and aggressively enforced in our schools, our workplaces, in government and in public places, for the benefit of all persons with
disabilities -- the blind and visually impaired, the deaf and hard of hearing, persons with mental retardation, persons with mental illness, persons who are mobility impaired, all people who have problems that can be overcome. That's what this act is about."

Remarks by President Bill Clinton
Conference on the Future of the American Workplace
Chicago, Illinois
July 26, 1993

"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, this law is clearing the barriers to full participation in American life, making real the whole pledge that we often say that we don't have a person to waste."

AFFIRMATIVE ACTION

Michigan Citizen
President Clinton responds to reparations demand
February 5, 1994

"I support affirmative action, but I am opposed to quotas..."
"As President, I want to lead a nation that is coming together, not coming apart....Let us heal the divisions..."

Remarks by Governor Bill Clinton
ABC's Good Morning America Interview
October 30, 1992

Audience Member: "Yes, thank you. Will your administration revitalize affirmative action in America?"

Governor Clinton: "Yes. I believe in affirmative action. I oppose quotas, but I believe in affirmative action. The import of the civil rights bill that was signed last year was to draw a clear line in the sand between mandated results and the obligation on the government to make sure people got a chance to participate.

But let me follow that up. I think one real problem, even with affirmative action laws, is that in the minority communities in America there's not enough opportunity to get into business, to get the capital to get into business, and to succeed or fail, and one of the most interesting things I have proposed--again a private sector initiative--is to have the federal government take the lead in organizing a national network of banks devoted exclusively to taking deposits and making loans in the communities they're located in.

There's a bank in Chicago called the South Shore Development Bank that has helped to revolutionize the south side of Chicago without government involvement by making loans to people in the private sector. Loans to really poor people. We put one of those banks in Arkansas, and we found that even in rural areas it would work. I want that for all of America, and the banking community that I've talked to, very enthusiastic about the prospect of helping to finance that sort of thing."

Democratic Presidential Candidate Bill Clinton Today Show
Interview and Viewer Question-and-Answer Session
June 30, 1992

"With that in mind, what is your position on the Civil Rights Bill, which in my opinion is a quota bill designed against certain segments of the population?"

Governor Clinton: "I strongly supported that bill and it says right on the first page of the bill that it is not a quota bill. There is a difference in requiring people to make an extra effort to appoint people that are representative of the population in which they live and requiring people to achieve certain specific results.

I also said on this program that I would make an extra effort to find people of genuine excellence and ability of all races and both genders to serve in the president's Cabinet, in the White House staff, in the judiciary of the country, not with any set quota in mind but with the clear obligation to try to give every American a fair shot without regard to race or ethnic group or gender. And I think I should still do that, and I think that's what the Civil Rights Bill of 1991 requires of the American people."

Gumbel: "How do you ensure that fair shot without dictating some numbers from the federal level?"

Governor Clinton: "You have to demonstrate that you've made an effort. You can require people to demonstrate that they've made an effort and that they haven't discriminated and that if their workforce is dramatically different from the racial make-up of the workforce of the people that they serve and where they live, that there is some reason for it."

Doug Sosnik

HMcCurry / DSosnik

fr. J Hilley

B.

THE PRESIDENT HAS SEEN
2 21 95

Jan. 23, 1995

Dear Mrs. Clinton,

I greatly enjoyed meeting with you on Thursday. Enclosed is my outline of the three-legged stool argument, and the need for a new paradigm. In this outline, I have tried to present the conceptual case while leaving to later the strategies and tactics necessary for implementation.

While the task may seem imposing, we should find hope in the fundamental unreality of the premise underlying the Republican manifesto. Through discipline, a smart communications and grass-roots effort, our mistakes and lack of unity, the Republicans have accomplished a feat of political prestidigitation that I would have thought impossible: **they have converted their core belief in the protection of economic privilege into a populist revolution.** Getting government "out of people's lives, out of their wallets, and off their land" has become the accepted battlecry. But the underlying reality is a prescription for the privileged to increase their privileges while the rest (around 80 percent these days) fall behind. I refuse to believe we can't compete and win against such a lie. But the debate must be cast in our terms, thus the need for a new paradigm.

We did not have a chance to talk about many other issues which will be critical in 1996, such as: legislative strategy; the efforts needed to unify and mobilize current and potential Democrats; managing domestic and foreign operations to benefit the President; positioning relative to the economy and the Fed.; anticipating Republican and Democratic attacks and countermeasures; putting Republicans and their Presidential aspirants on the defensive; filtering all actions through the prism of the election, being disciplined and systematic, and others.

In the next twenty-two months, you and the President will be greatly challenged to preserve and enhance what is best about our country. I hope some of my ideas and efforts can provide help along the way.

The Republican Three-Legged Stool

Republican political success is built on a three-legged stool -- the economy and taxes, defense and foreign affairs, and the manipulation of people's insecurities and animosities. To be successful politically, Democrats must have a strategy to counter each leg, and must break through on two.

There are clear strategies to deal with the first two legs. However, Democrats are at a natural disadvantage on the third since Republicans have no hesitancy to pander to people's worst instincts. As important, we have acceded to a paradigm that makes it nearly impossible under current circumstances for Democrats to break through on the third leg. We must alter that paradigm or face electoral defeat.

Economy and Taxes

On the first leg of the economy and taxes, the Republicans are very close to hitting a home run. Their goal is to pass the constitutional balanced budget amendment, then move a reconciliation bill that pays for a tax cut with spending cuts while making a down payment on deficit reduction. Republicans can easily assemble such a package using the entitlement cap as the cornerstone. They will get credit for cutting taxes and government spending while the negative consequences of the entitlement cap will not be fully felt for years. And the public will perceive passage of the constitutional amendment as dealing decisively with the deficit problem -- even while Republicans avoid the heavy lifting and negative consequences of actually balancing the budget as called for in the constitutional amendment. They will not revisit the issue until after 1996.

The President was correct to associate himself with the tax cut. But this must be complemented by a strategy that makes passage of the balanced budget amendment contingent on actually balancing the budget by 2002. That is the purpose of the "right to know" approach we have launched. Our efforts have been to get supporters of the balanced budget amendment to oppose taking it up until a real budget resolution passes. If we can hold firm, the Republicans must either come up with $1.2 trillion of deficit reduction or be revealed as being unwilling to accomplish what they demand through the balanced budget amendment.

Defense and Foreign Affairs

On the second leg of defense and foreign affairs, I would urge the President to pursue initiatives that can deliver a decisive edge, and not merely try to break even. It was smart to add money to the defense budget in the outyears. Democrats must avoid the label of wanting to cut defense. Ultimately, however, the President can't beat the Republicans at the game of throwing dollars at defense. Therefore, he should pursue initiatives that can be consummated largely in isolation from Republican interference. Sensing the impending loss of the Senate in 1986, Reagan attempted an "October surprise" through the meeting with the Soviets at Reykjavik. Lack of time and uncareful analysis doomed his initiative. But the concept is sound. The President can show leadership in foreign affairs on issues that matter to Americans. For example, an agreement on verification and proliferation (not further arms reductions) with Russia, other CIS nations, China, or other parties would be widely supported as in American security interests and could pay significant political dividends.

Insecurities and Frustrations

The third leg is the most difficult. We have acceded to a paradigm that puts Democrats at a huge political disadvantage. It assigns responsibility for dealing with people's insecurities and frustrations to the government and the President. When these problems aren't fully dealt with, the President becomes the villain rather than those responsible for the plight of these people.. However, there is an alternative paradigm which could allow Democrats to recapture the allegiance of the working classes. It would enable the anger and frustrations of the people to be channeled toward the Republicans and those they defend.

The Republicans understand a fundamental truth about political reality. Americans are looking for more than feel-good politics, especially during times that are uncertain and anxiety-producing. The electorate needs both heroes and villains. Democrats err greatly to believe the electorate only responds to sweetness and light -- education, health care, job training. Unless we can unburden their lives of uncertainty and anxiety (which we can't), voters will seek a villain. The reigning paradigm places the government and the President right in the villain's seat.

In what follows, I first discuss these issues from the broad perspective of paradigms. The political dividends can't be reaped until a new paradigm is established which gives context and credence to the lines that will be drawn with Republicans. Otherwise, actions taken will appear as partisan finger pointing rather than a high-minded and principled defense of working Americans.

The reigning paradigm is the competitive/economic one. Business enterprise is the source and creator of jobs and wealth. To maximize national well-being, businesses need free reign to make business decisions, including the treatment of workers. Government has a role to play in two respects. First, it should positively assist the competitiveness of enterprises through measures such as tax breaks, trade agreements to open markets, deficit reduction to free up capital for private purposes, and provide the financial and physical infrastructure which supports business operations. The second role of government is to assist people whose lives are disrupted as a natural result of the march of competition. Examples include unemployment insurance, retraining and education programs, job search assistance, and provision of subsistence support for those who are really down. In essence, business is the good actor and individuals and government are left to deal with the problems.

American workers and families are insecure and frustrated. Their wages haven't risen in two decades, parents are working harder just to stay even, people feel that their years of loyalty to their firms count for little, and that their futures and livelihoods could be altered dramatically by an impersonal financier here or abroad with no concern for their welfare. Workers and families know their problems are real , they want their lives to improve, and are ready to assign blame. Under the reigning paradigm, the businesses who make these decisions escape the blame. That is largely reserved for the entity who is supposed to deal with their problems -- the government led by Democrats. Politically, it's the worst of all worlds. The top echelons of society who truly benefit from the economic/competitive structure vote Republican anyway, and the working stiffs who feel frustrated and at risk abandon Democrats because the government neither stands up for them nor deals adequately with their problems.

The Republicans understand how well the reigning paradigm works for them and deftly reinforce people's perceptions with their antigovernment rhetoric. The government the Democrats defend has failed to help people (notice it's the government responsible for doing the helping). Nothing is said about the actions of those who caused people to need the help. Politically, the President can't position himself as the champion of working people when the reigning paradigm tags him as the one responsible for the mess. This wouldn't be such a huge problem for 1996 if people's views of government weren't so poisoned, if there were more time for the administration to constructively solve people's problems, and the Republican legislature would deal in good faith to enact real solutions. None of these conditions obtains at this time.

The President's "change" speeches embrace the reigning paradigm, contributing to his political problems. In these speeches he casts government and himself as agents of change who step into the breach and provide the skills and sense of personal security so that people can embrace change rather than resist it. But when people in their daily lives lack a sense of security, feel they are getting a raw deal, and are frightened about their futures, they blame the self-described agent of change for their problems. Government and the President become the scapegoat, rather than the forces and actors who are the direct cause of their anxiety.

A New Paradigm

The alternative paradigm shifts the focus of responsibility in a fundamental way. It supplants the competitive/economic paradigm with one based on economic community. It rests on the linkage between opportunity and responsibility, but extends the linkage beyond the realm of individual behavior and action to the behavior of collective entities such as business and government.

This paradigm of economic community posits opportunity and freedom as the birthright of Americans. But the birthright of opportunity is paralleled by the obligation and responsibility to act in ways conducive to the interests of the entire economic community. In contrast to the reigning paradigm in which government shoulders the responsibility for the negative consequences of business and other decisions, business organizations and other collective entities are held responsible for the consequences of their decisions and actions.

The new paradigm gets the President out of the clean-up and repair business and into the role of championing the rights of American workers in the economic community. If the shift in paradigm can be achieved, and that will take several months of carefully planned and executed activity, the real anxieties and frustrations of workers can be channeled away from Democrats onto Republicans and those they represent. The needed contrast between Republicans and Democrats will emerge in many ways as Republicans can't resist promoting and defending the interests of the elites.

This paradigm also offers our best opening on "values" issues. The nexus between opportunity and responsibility is tough-minded, and rings true with Americans. The President can articulate it extremely well. This paradigm creates a path to family values: positive values are nurtured in secure and loving family settings, whereas economic hardship and dislocation undermine the family and the transmission of these values.

The language and imagery of this paradigm differ markedly from the economic/competitive one. Economic competition is replaced by economic community; opportunity is linked to responsibility at every turn; the nature of our shared interests is stressed; the foundation of prosperity is a common heritage and inheritance; economic potential and growth rest on shared enterprise and are more than the sum of individual actions; each success is in part due to the effort, investment, insight of others; the perseverance of community is the foundation of opportunity for our children, etc.

This is not a legislative or programmatic strategy but a positioning one. At this time, it is impossible to execute a coherent legislative strategy based on this approach for many reasons. In addition, this positioning must be initially broached from a positive values perspective and not be seen as an antibusiness strategy. Only when the paradigm is assimilated will there be discrete opportunities to champion the causes of the working classes and shift the bogeyman off the government, Democrats, and the President.

We can bank on the Republicans passing legislation, and proposing regulations and policies that will create the needed opportunities. And chances for action will emerge from the private sector as a business uses a tax break to move offshore, or another Bridgestone-like confrontation comes along. The President is fortunate that the Republicans control both Houses and the press gives them the lion's share of attention. If the paradigm can be established and the President exploits the correct targets of opportunity, the press will be the instrument through which the election is won. The first signs of success should not be anticipated for several months. But within a period we should see: the elite interests tagged as the cause of specific problems, the alliance between Republicans and elite interests made evident, the removal of the Republican self-proclaimed mantle of populist reformers, and the emergence of the President as the one who's mad and isn't going to take it -- in the name of economic community.

Finally, a word of caution. In standing up for workers, it must be clear that the responsibility for the solution lies with private parties, not the government (even while the government routinely continues its programs that assist these and other people). The President must position himself on the side of insecure and frustrated workers, the community, and our common interests. He must resist the temptation to fully take on their problems as his own, thereby returning to the reigning paradigm.

THE PRESIDENT H
THE PRESIDENT HAS SEEN
2.21.95

To Elaine K
Reply - BC

MEMORANDUM TO THE PRESIDENT

FROM: RBR

RE: Regulation, *The Death of Common Sense,* OSHA, and related thoughts

1. The general case against picayune regulation

Howard's book, *The Death of Common Sense,* is a good read. He makes a strong case for giving bureaucrats more authority to exercise their own "common sense" to achieve public goals, rather than be mired in picayune "go by the book" details that are nonsensical when applied to a particular situation.

So far so good. But, as Cass Sunstein notes in his review (which appeared last weekend in *The New York Times Books Review*, attached) Howard doesn't give us any idea of the *downside* to letting bureaucrats loose. Most of the particularity and red tape in American regulation comes as a result of public outcry about unfettered administrative discretion. The Administrative Procedure Act itself was the product of public concerns about bureaucrats with too much discretion (not surprisingly, the Act was an early product of the post-World War Two years, when the public had a fresh memory of fascism and totalitarianism).

Of course, there's another reason for the miasma of detailed regulation--found in the perverse interaction between regulators and business. I'm attaching a chapter which reveals it all, from a little-known book (*Tales of a New America)* by a little-known author.

A far better alternative to either picayune rules *or* wide grants of discretion is to create systems of prevention and resolution outside of administrative law and the courts. One example is found in the OSHA Reform legislation which you sent to Congress last year, calling for worker-management safety committees to prevent unsafe working conditions. (The legislation got nowhere, but OSHA is now establishing this on a voluntary basis. The carrot for firms that establish such committees is that they won't be inspected absent a complaint or a serious injury. I'll get into a bit more detail on this below.) The Dunlop Commission did some good work on alternative methods of dispute resolution at the workplace; I'll send it over if you're interested.

Another good alternative is to provide businesses with compliance assistance--information about how to protect the health and safety of workers and of the public, data about the best practices, even technical assistance in achieving better outcomes.

In general, I'd approach the topic this way: The regulatory process needs fixing. Everyone agrees. Republicans want to take a wrecking ball to rules that protect the safety and health of Americans (OSHA, EPA, FDA). They also want to remove from Americans a major tool for deterring bad corporate conduct, apart from regulation--tort actions based on contingency fees. Our plan, by contrast, is to reinvent regulations through emphasizing prevention, alternative methods of dispute resolution, and compliance assistance. Our plan would maintain or improve health and safety, while reducing nettlesome and unnecessary burdens on business.

2. OSHA

I've investigated Howard's specific claims about OSHA. Some are true; most are not. Of those that are true, OSHA's "reinvention" effort (one of the best in the government--Just ask Al Gore) is dealing with them. Note that worker health and safety is a key issue for one of our core constituencies. Indeed, safety at the workplace is a key issue among all workers. Note also that workers who are at greatest risk of death, injury, or illness from their jobs are lower-wage workers without four-year college degrees, whose jobs involve physical stress. These are members of the "anxious class."

Here's a blow-by-blow account of Howard's claims about OSHA, the actual facts, and what OSHA is doing about these issues.

A. "*The agency has over 4,000 detailed regulations, dictating everything from the height of railings (42 inches) to how much a plank can stick out from a temporary scaffold (no more than 12 inches). There are about 2,000 safety inspectors in the field, not many compared with 6 million workplaces, but enough to do some good if they focus on firms with bad safety records.*"

If you count every paragraph, subparagraph, item, and subitem in every OSHA regulation, OSHA might have as many as 4,000 rules. Most of the rules, however, are divided between particular industries (construction, maritime, general industry, agriculture etc.), so that in fact no individual company is subject to all of them. In fact, it's interesting to note that most of these rules actually came from industries themselves--voluntary industrial standards that were simply encoded into OSHA rules in the early years of the agency.

Still, there are too many of them, and OSHA is now in the process of weeding out the ones that make no sense, or are duplicative, or simply outdated.

More to the point, the agency has embarked on a major "reinvention" effort to focus on results--safety and health at the workplace--rather than process. A sampling:

--Incentives for employers to improve workplace safety with the help of their employees. Example: Construction employers that set up worker-management safety programs (and train their workers in safety) are inspected only for the four leading causes of on-the-job deaths (for example, falls, electrocutions). Another example: Under the "Maine 200" pilot project, the 200 employers in the state with the largest number of workers' compensation claims are given a similar choice. Implement an effective safety and health program with worker participation <u>and</u> conduct a self-inspection, or be put on a priority list for wall-to-wall inspection. Most have taken the first option. The results have been
mpressive: During the first 18 months of the program, employees and employers at these firms identified nearly 100,000 potential hazards (a rate 14 times higher than OSHA's own rate of identifying potential hazards through inspections). And more than half of these potential hazards were quickly reduced or eliminated. OSHA is now looking for ways to expand on the pilot.

--The Voluntary Protection Program, already up and running, exempts employers with excellent safety and health histories from all general inspections.

-- With the help of management consultants McKinsey and Co., OSHA is retooling field offices to focus on the most serious threats to worker health and safety; and to provide incentives for inspectors to aim for better health and safety at the workplace--rather than aim for more inspections and citations.

B. "*Safety in the American workplace is about the same as it was in 1970.*"

Howard is wrong on the facts. Here they are:

--Since 1971, the first year of OSHA, the workplace fatality rate has dropped 50 percent.

--Since 1973, the injury rate for workers has dropped by more than 25 percent.

-- Since 1975, injury and illness rates have fallen in industries in which OSHA

has concentrated its enforcement activities (construction, manufacturing, oil and gas extraction), while--interestingly--injuries and illnesses have actually increased in other industries where OSHA has not been active.

-- After the lead standard took effect in 1978, levels of lead in workers' bloodstreams dropped 66 percent.

-- After enactment of the cotton dust standard in 1978, "brown lung" cases dropped from 40,000 a year to less than 1,000.

C. "*Several years ago, there were horror stories of workers who were asphyxiated and had died in a meat-packing plant while checking on a giant vat of animal blood. Then it happened again at the same plant. OSHA had done virtually nothing, however, because it had no rule that applied to the situation. Stretched thin giving out citations all across America for infractions like improper railing height, OSHA also had not reinspected the plant that had admittedly "deplorable" conditions. Confronted with its own ineptitude, OSHA's response was to pass a universal rule requiring the installation of atmospheric testing devices in all confined spaced, without exception.*"

In fact, OSHA did investigate when it got word of two fatalities that occurred on September 13, 1983, at a meatpacking plant in Liberal, Kansas, owned by the National Beef Packing Company. Three workers had entered a processing tank containing animal blood; the combination of lack of oxygen and toxic gases killed two of them, while the third was severely injured. OSHA issued citations to the company, for not following recognized safety procedures--providing respirators to the workers before requiring them to enter the confined space.

Ten years later, in 1993, after compiling a record of fatalities resulting from workers entering confined spaces without proper respirators, OSHA issued a rule. It applies only to confined spaces where there's potential for lack of oxygen, toxic fumes, or similar hazards. It requires that such confined spaces be tested prior to entry, to assure adequate oxygen and lack of toxins. It also provides for the use of adequate protective equipment, like respirators; worker training in safe procedures; and steps to take in event of emergency.

D. "*Glen-Gery has been cited for having railings 39 and 40 inches high, not the regulation 42 inches, in older parts of the factory. In one area already partitioned off by railings, OSHA required several thousand dollars to be spent for automatic shutoff on a one-foot-wide conveyor belt.*"

"*Glen-Gery has never had an incident, for example, related to its railings. OSHA inspectors, in the words of everyone who has to deal with them, are 'just traffic cops' looking for rule violations.*"

OSHA does have a rule requiring employers to place guardrails around dangerous equipment--stating that the guardrails should be 42 inches high. But in 1981 the agency issued a more flexible interpretation, allowing guardrails to be between 36 and 44 inches, or higher, provided that the extra height doesn't subject employees to dangers. OSHA did issue a citation to Glen-Gery in 1973, for the company's failure to put guardrails around dangerous equipment at its York, Pa. plant. Another citation was issued in 1990, for the company's failure to put adequate railings over and around conveyor equipment at its plant in Reading, Pa. In 1991, OSHA issued a third citation against the company for its failure to put adequate guardrails around dangerous equipment at its plant in Shoemaker, Pa.

E. "*An OSHA inspector noted that a worker wearing a dust mask had a beard, violating a rule that requires a close fit between face and mask... Nor did it matter that the worker was Amish and faced the choice of abrogating his religious convictions by shaving his beard or quitting.*"

There is no record of this. OSHA now permits employees to refuse to wear hardhats and respirators if such equipment violates their religious principles.

F. "*Glen-Gery was recently cited because the wrong box was accidentally checked on some internal form. About 50 percent of all violations across the nation are for not keeping the forms correctly.*"

Not true. Record-keeping violations comprise about 4 percent of total citations issued by OSHA, according to a review of the data for fiscal years 1990-1994. Record-keeping violations include failure to report workplace deaths, or to disclose to an employee when and under what circumstances he or she might have been exposed to dangerous conditions.

G. "*OSHA inspectors visit the Glen-Gery factory in Reading once or twice a year.*"

OSHA has inspected the factory 9 times in the past 18 years. Only one of these inspections was comprehensive; the others were aimed at particular hazards. One of the inspections was triggered by the death of an employee from carbon monoxide poisoning. The remainder were triggered by complaints, or followups to assure that the company fixed the unsafe working condition.

H. "*In 1991, the OSHA regional office in Chicago, after visiting a construction site, sent a citation to the brick maker for failing to supply an MSDS form with each pallet of bricks.*"

OSHA requires employers to provide employees with training and information (material safety data sheets, or MSDS) when exposed to potentially hazardous materials, such as silica dust. But if bricks are used without being cut or crushed--and thus without emitting a lot of silica dust--then OSHA doesn't require such training or data. Nor does OSHA require brick manufacturers to place a MSDS on every pallet of bricks they sell. Only one MSDS must be given to a customer, and only with the first shipment.

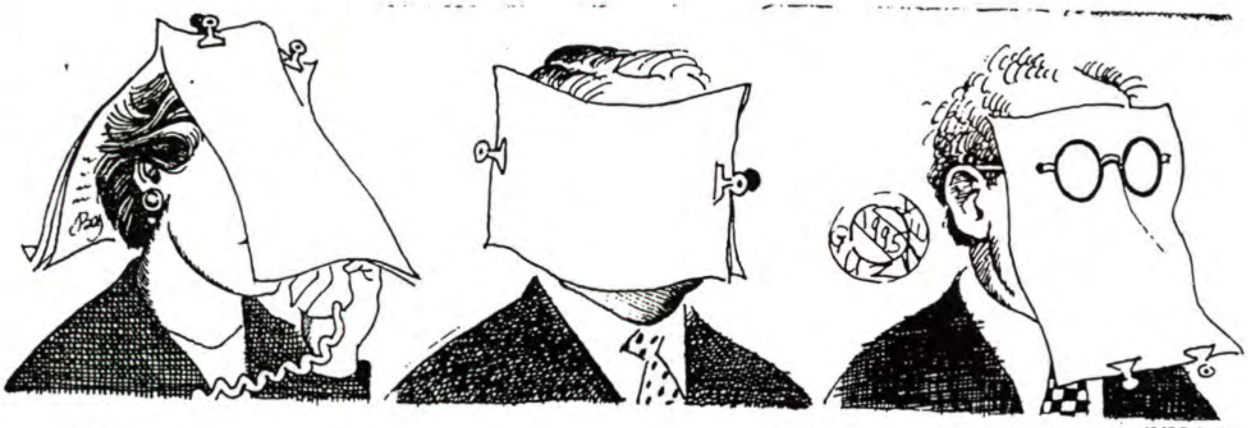
and will not hold or
esent-day conflict of
st as she is, in many
ok, and Miss West's
pathetic portrayal of
tanding the novel as

only the first in a
ical forays into the
of both the maternal
Clark and Corinne.
esent fades, as the
oth content and ca-
nd their situations.
copper-haired and
egat on an innocent
wife, "the butternut
d his mistress, "the
ransplanted and ca-
ined New England
ly mansion in Oak
's fair-skinned wife,
the schoolteacher, a
n as a Lady Bounti-
tion.
se accounts are, all
ion thread — racial
n voluntary, many
ove than by conven-
after another tum-
we come to see that
dding involving one

seems
intain its
universe
e one from
barred.

ind one dark, but of
s. Thus "The Wed-
a journey forward
oward "real" black,
he seeds planted so
red a family tree of
butternut, golden,
iore.
olor are important,
complex are the
ning the outcome,
id imagery as well
is reminded not so
issance colleagues
and Nella Larsen
igenerational race
ambition, William

t to separate Doro-
id from the author
ited book, you have
that you are in the
At the end, it's as
ich to a wedding as
t one great artist is
down the house. □



VLAD GUZNER

Land of 4,000 Unreadable Rules

A lawyer argues that this would be a better country if we had less law.

THE DEATH OF COMMON SENSE

How Law Is Suffocating America.
By Philip K. Howard.
202 pp. New York: Random House. $18.

By Cass R. Sunstein

AMERICANS pride themselves on the "rule of law" — the idea that government officials must act according to clear and specific rules laid down in public and in advance. The catch phrase that ours is "a government of laws and not of men" captures the aspiration to rule-bound justice. But Philip K. Howard thinks that we need less law, fewer rules and more common sense. He thinks that American law is now endangering both freedom and prosperity precisely because it is so excruciatingly rule-bound.

Mr. Howard, a New York lawyer, builds his case nicely, with many impressive stories of mindless bureaucratic rigidity. Consider the sad case of Mother Teresa and the Missionaries of Charity, who had agreed to convert two abandoned buildings into a homeless shelter in 1988. New York City's building code requires an elevator in every renovated multiple-story building. The Missionaries were told, after two years of protracted discussions and red tape, that their promising project could not go forward because it did not comply with the regulations — even after they explained their order's religious beliefs, which prohibit the use of modern conveniences, including elevators. Mother Teresa ultimately gave up; no shelter was built.

Consider as well the Federal Occupational Safety and Health Administration's book of more than 4,000 unreadable regulations, prohibiting inspectors from asking whether the workplace is really safe and instead dictating such things as the acceptable lengths that planks can stick out from a temporary scaffold (maximum, one foot). Ponder the senseless regulatory obstacles to much-needed public toilets in New York, in the form of rules requiring every such toilet to be accessible to handicapped people; or the endless requirements for day-care centers, which have driven child care underground, where there are no regulatory protections at all; or environmental regulations that ignore cost and waste resources on trivial problems.

Mr. Howard is especially troubled by laws that impose expensive procedural requirements. Fixing a $50 lock in a New York public school, he says, takes 10 bureaucratic steps consuming six months. He also says the Federal Government has estimated that "annually, 289 million hours are spent complying with its procurement procedures." With so many procedural requirements, Mr. Howard thinks it is no wonder that our officials cannot do what they are supposed to do.

Mr. Howard has a final complaint. The post-1960's transformation of so many diverse interests into "rights" — for the handicapped, for welfare recipients, for endangered species — has imposed unnecessary costs and prevented people from working together. He believes that instead of a legally fueled "rights revolution," carrying the language of absolutes, we need a sense of mutual obligations, a willingness to compromise and a sense of proportion.

What should be done? Mr. Howard doesn't offer many details, but he wants a lot less law. He thinks that we should release ourselves from rules, process and rights, and try to harness private initiative through laws that allow officials and ordinary citizens alike to exercise their own judgment and common sense.

Some of this is pretty familiar, but Mr. Howard's argument is fresh, reflecting an impressive combination of wisdom, wry humor and quiet passion. Its weak point is that it is too impressionistic and anecdotal, collecting lots of stories without giving anything like a systematic sense of the costs and benefits of rules or the costs and benefits of what he calls common sense. Once freed from rules, public officials and private citizens may exercise their discretion invidiously. They may be confused, biased or corrupt. Without rules, it may be very hard to monitor whether people are doing what they should do. And without fair process, officials may make damaging mistakes. To know whether law is really suffocating America, and whether rule-free common-sense judgments would be better, we need to have a more systematic investigation of our current approach and of possible alternatives. In some contexts rules and rights are indispensable; the alternatives would be much worse.

Nonetheless, I think that a more systematic investigation would show that Philip Howard points in most of the right directions — toward much less governmental focus on how people do things, much more attention on real-world results; less in the way of governmentally specified technologies and outcomes, more in the way of public use of private initiative; fewer Soviet-style governmental mandates and commands, more reliance on flexible programs creating proper incentives. "The Death of Common Sense" is a reflection of a mood rather than a sustained argument, but it sets the right mood. When we think about "reinventing government," it's a good place to start. □

Cass R. Sunstein, who teaches at the University of Chicago Law School, is the author of "Democracy and the Problem of Free Speech."

CHAPTER 18

THE MIASMA OF REGULATION

1

Ask any business executive about government regulation, and he will tell you a horror story of bureaucratic excess. This is his version of the Rot at the Top. But the executive will not, most likely, object to the goal of regulation. Most executives agree that the public deserves protection from toxic wastes, nuclear accidents, air and water pollutants, unsafe products, fraudulent claims, and monopoly. Even in eras like the present, when business is ascendant and government suspect, the public supports these broad objectives. The complaints of American business center not on the purposes of regulation, but on the ways they are designed and implemented: Statutes are overly complicated; the rules devised to fulfill them are excruciatingly detailed, comprising voluminous rulings and interpretations, interpretations of interpretations, opinions and dissenting opinions of interpretations of interpretations. Even the simplest public goal spawns an imposing herd of rules requiring exhaustive filings, reports, nitpicking inspections, and picayune compliance with every jot and tittle of the law. And they are subject to constant alteration, elaboration, and ever more detailed explication. Under the spell of congressional committees, regulatory agency officials, hearing examiners, administrative law judges, appellate judges, and scores of zealous government lawyers, inspectors, and bureaucrats, regulations grow more complicated by the hour. They multiply in the *Federal Register*; they engorge the *Code of Federal Regulations*; they inundate companies with their petty requirements.

Tales of bureaucratic atrocities abound. The chairman of one large pharmaceutical firm complains that his company spends more hours filling out government forms and reports than it does on research for cancer and heart disease combined.[1] Others tell of trivial, often silly requirements, like giving loan applicants pages of detailed information that nobody ever reads, or putting a toilet within one hundred yards of each employee. The laws are impenetrable: The Employee Retirement Income Security Act, which regulates private pension plans, runs to more than two hundred pages. It has been estimated that federal agencies each year require American businesses to fill out 4,400 different forms, together consuming 143 million hours of executive and clerical time, and costing $25 billion.[2]

Nitpicking regulation has been blamed for slowing America's productivity and impairing the nation's competitiveness.[3] Yet other advanced industrial nations require that their companies achieve similar regulatory goals. Environmental, health, and safety requirements in Japan and most of Western Europe are no less stringent than in the United States.

There is one significant difference, however. Although the *results* of regulation are about the same among all advanced nations, the *means* of regulating are quite distinct. In these other nations, regulations are far less detailed than they are in the United States. Their regulations involve fewer rules and interpretations, impose less paperwork, entail only informal inspections and reports, and generate significantly lower compliance costs. If American business is conspicuously burdened by government regulation, it is not due to the ends that regulation seeks, but to the means employed. Among advanced industrial nations, the regulation of American business is uniquely picayune.[4] Why should this be so?

2

Many who speak from or for American business attribute the trouble to the attitudes and values of the people who inhabit government regulatory agencies: These people *want* to be nettlesome. In this story, the Rot at the Top is traceable to a "new class" of college-educated social planners and public policy professionals who disdain economic growth and abhor private enterprise. In the words of Irving Kristol, a principal exponent of such views, regulators and their fellow travelers "find it convenient to believe the worst about business because they have certain adverse intentions toward the business community to begin with." They seek "the power to shape our civilization—a power which, in the capitalist system, is supposed to reside in the free market." Their ambition is "to see much of this power redistributed to government, where *they* will have a major say in how it is exercised [emphasis in the original]."[5]

In this story, many denizens of the new class populate the staffs of regulatory agencies—surviving administration after administration. These individuals relish any chance to harass American business with endless, trivial commands, to clog the channels of commerce with their piddling requirements and endless forms. They take delight in transforming commonsensical regulatory goals into reams of irritating detail. According to Kristol and others who share his views, the new class is waging a war of attrition against capitalism.

> The New Regulation [to protect the environment, safety, and health] is the social policy of the new class. . . . They have merely transferred power from those who produce material goods to those who produce ideological ones—to the intellectuals, policy professionals, journalists, and "reformers," who are arguably much less representative of the American people as a whole than those whose influence has been curtailed. . . . With each passing year it becomes clearer that the real animus of the new class is not so much against business or technology as against the liberal values served by corporate capitalism and the benefits these institutions provide to the broad mass of the American people.[6]

This conspiracy has proven to be an oddly comforting phantom for American businessmen. First, it provides a ready explanation for why business has felt so besieged. It is not any serious failings or erosion of legitimacy on the part of industry, but rather the machinations of a group bent on undermining free enterprise. It is an enemy within, an ally of the Mob at the Gates that seeks to substitute centralized planning for free markets. Second, the story suggests a plan of action. All we need do is to expel from government these ideological traitors and put in their place teams of levelheaded and unbiased civil servants. (Hunting out the miscreants should be no problem; they leave a trail of red tape wherever they wander.) Finally, the story promises a happy ending. Once these saboteurs have been ejected, the present regulatory miasma will be transformed into simple, sensible rules. The public will continue to be protected—as it should be—from the irresponsible acts of a few misguided managers. The rest of American business will be freed of the nitpicks, technicalities, and meticulous excesses of the present system.

Unfortunately for those who find the story satisfying, it wilts in the face of the facts. To begin with, the "new class" of interventionist zealots who are supposedly responsible for the picayune character of so much modern regulation have been far harder to track down than expected. Both the Carter and Reagan administrations were committed to reducing the burden of government regulation. The latter, indeed, installed its own counterzealots at the controlling levels of government agencies to track down the guilty parties. The Reagan administration did succeed in abandoning some regulatory efforts. But—and here is the important point—it did nothing to change the *way* in which the remaining regulations were administered. Notwithstanding its concerted efforts, the *Code of Federal Regulations* continued to swell with detail, the *Federal Register* bulged with new interpretations and elaborations, and American business continued to writhe under the burden of pettifogging directives from Washington. The underlying problem had nothing to do with nefarious forces hidden within regulatory agencies; it was inherent in the American regulatory process itself. A probusiness administration might succeed in rescinding particular regulations, but not in reducing the amount of niggling minutiae surrounding any regulatory goal that survived.

In addition, it turns out that the vast majority of regulatory agency lawyers and middle-level managers aspire not to undermine American capitalism but to live off it. After gaining experience in government, they move on to the private sector. They gain jobs in law firms, representing companies before regulatory agencies. They join consulting firms, accounting firms, research institutes, and public relations firms. They move into government affairs offices of large corporations, and into trade associations. Some have even been known to join university faculties, from where they sell extracurricular insights to corporations. Their experience in government makes them valuable to the private sector, and they are not reluctant to trade upon that value. Far from comprising a "new class" of intellectuals animated by an antibusiness bias, these former civil servants prove themselves adept at making money off what they have to sell—their inside knowledge of how regulations are made. They bring as much zealousness to their newfound corporate jobs as they did to their former ones.

If America's regulatory miasma is not due to a covert war against capitalism waged within government agencies, then what is the real cause?

3

Let us return to our inventor friend, Henry, and his turbo-charged automatic vacuum cleaner. (You remember: Just leave the vacuum on a shelf for five minutes and—presto!—the room is spanking clean.) Imagine, as before, that the product proves enormously popular. But this time imagine that it suffers from a small flaw: It emits a roar something like a jet engine at full throttle, but louder. Every time the machine is switched on, the noise loosens tooth fillings and induces deep neurosis in dogs within a radius of two hundred yards. This flaw does not deter consumers from using the vacuum; following operating instructions, they simply set the timer, sedate the dog, and go off to the movies while the machine cuts loose. Soon in neighborhoods all over America the vacuum's roar issues from empty houses, causing flocks of passing birds to fall stunned from the sky and neighbors at table to drop plates and fling drinks into the air. Henry would like to make a quieter version of the product, but so far has had no luck; adding an adequate muffler would triple the cost of the vacuum.

Now suppose that several years before all this Congress had instructed the Environmental Protection Agency to take steps to "ensure no household appliance emits excessive noise." That was all the legislation said. Congress decided to leave it to the EPA to devise and enforce regulations concerning neighborhood noise pollution. Since then, the agency has issued only one broad rule: "No consumer product shall generate noise in excess of 110 decibels." That's it—nothing more specific than this, no reporting requirements, no interpretations, no elaborations. The EPA publishes the rule and considers the problem settled.

Henry has hired a Washington lawyer named Seymour, who informs him of the EPA's regulation. Worried about the threat to his company, Henry asks Seymour if he can think of some legal way to continue selling the turbo-charged vacuum cleaner. Seymour is a smart lawyer who specializes in federal regulations. "Not to worry," Seymour assures Henry. "I can think of two hundred ways to dodge this regulation." Henry rests easier.

Two months later, the EPA inquires about the vacuum. It seems they have been getting complaints about its noise. Seymour meets with the EPA's attorney. "The regulation doesn't apply to the turbo-charged automatic vacuum," says Seymour, matter-of-factly. "It says no *consumer product* should emit a sound in excess of 110 decibels, but this isn't a consumer product. It's designed for industrial applications, although consumers happen to use it. And it's not even a *product*, but a service, since under our unique payment plan it is leased rather than purchased outright." The EPA attorneys silently take off their hats to Seymour and go back to their law books and word processors.

Two months after that, the EPA announces a more detailed set of rulings, which define "consumer product" as "any product or service sold or leased to industrial or consumer users." They then return to Seymour's office. "Still doesn't apply," says Seymour calmly. "The regulation prohibits sounds in excess of 110 decibels. But our automatic vacuum records only 95 decibels when we've tested it outside in the middle of a field during a hailstorm. Here's the proof." He hands the EPA attorneys computerized results of the experiment. They take off their hats again, solemnly shake his hand, and drag back to the office.

Two months later, the EPA announces precise specifications for how such products are to be tested to determine decibel levels—the kind of sound chamber in which testing is to occur, the type of testing equipment, scientific definitions for "decibel," and detailed requirements for when the testing must be done and under whose auspices. The agency also announces that hereafter all manufacturers of a new product "designed for or adaptable to household use" must file a report with the agency indicating its decibel level according to the prescribed test. All over America, developers of new cat beds, corn poppers, and sock matchers fume as they pay for the premarketing decibel tests Washington demands.

Over the next several years Seymour meets with the EPA attorneys innumerable times. Each time, he claims that the burgeoning regulations, rules, and interpretations still do not apply. Each time thereafter, they become more detailed. Seymour also disputes their applicability before administrative law judges and he appeals their rulings to the federal courts. He argues, as the occasion warrants and the spirit moves him, that the EPA has exceeded its mandate from Congress, or that the agency has acted arbitrarily in singling out the turbo-charged automatic vacuum, or that the company's constitutional rights have been violated. The administrative judges and appellate courts issue opinions that further elaborate upon the EPA's regulations and interpretations, and its authority to regulate in this area. Meanwhile, the original statute has been amended by Congress to avoid the loopholes and ambiguities that Seymour (and others like him) have discovered. The new law is far more detailed and complex, spelling out in excruciating specificity what is required.

Five years later, Henry meets with Seymour. "I'm afraid," says Seymour, "we've reached the end of the line." Seymour points to a bookshelf sagging under the weight of statutes, EPA regulations, rulings, advisory opinions, interpretations, court opinions, and appellate decisions, all concerning noise pollution. "But at least I got you more than five years of delay." Henry is downcast nonetheless. "Does this mean we have to stop selling the turbo-charged automatic vacuum, or else install the muffler?" he asks. "Either that," Seymour warns, "or you'll have to pay the fine every year you violate the regulation." "How much?" Henry asks, trembling. "A full twenty-five hundred American dollars," Seymour says as he grins and takes off his hat to himself. Henry jubilantly goes back to his company, where he asks his secretary to organize a bake sale to cover the fine.

This example exaggerates, but not much, the typical fate of a regulatory effort. It describes a familiar dynamic between American business and government. American corporations are not reluctant to test the limits of the law. They pay lawyers handsome sums to discover loopholes, technicalities, and elegant circumventions. In many instances the investment is worth it to the corporation. It buys the firm at least temporary relief from a regulation, enabling the company to profitably continue doing what it was doing before. Nor do American lawyers recoil from the challenge. They relish it. They cultivate reputations for their elegant pirouettes around statutes. The art of Washington practice is to stake out an area of government regulation and then become expert at outwitting those who administer it. Talented people have been known to spend entire careers circumventing a single, arcane area of regulation for the benefit of a few corporations.

This ploy may be rational from the standpoint of the lawyer and his client, but it is often irrational for American business as a whole. Each such maneuver generates a countermaneuver from within the regulatory bureaucracy and Congress; every feint and dodge, a more complicated prophylactic for the next encounter. The result, over time, is a profusion of legislative and regulatory detail that confounds American business. The underlying dynamic is analogous to the commercial gridlock examined earlier, and the crippling dilemma of irresponsibility in social programs, which was also explored. American business finds itself strangled by the red tape that government uses to seal the loopholes through which American business repeatedly tries to sneak.

The profession of discovering and exploiting loopholes is both intellectually and financially rewarding. It is also eminently respectable. Some of the nation's most erudite and honorable people do it. Those who play the game on the other side—the lawyers and middle-level bureaucrats within regulatory agencies and pertinent congressional committees—are simply trying to realize a simple and often sensible congressional mandate. Honor and financial reward will come to them later on, moreover, if they have gained a reputation for expertise and adroitness. The best law firms and largest corporations will hire them out of government, paying them many times their government salaries, to outwit their successors.

Washington lawyers who advise American business have a certain stake in the profusion of regulatory detail. When an area of regulation, like noise pollution, is compounded by such maneuver and countermaneuver into volumes of detailed statutory language, rules, interpretations, and opinions, it becomes accessible only to those, like Seymour and his tenacious opponents inside the agency, who have spent long hours refining it. The very complexity of the area generates new business and further elaboration. Soon every major corporation whose activities touch upon the area of law must have tactical advice about it. Seymour and his younger partners (who had once enforced EPA regulations on noise pollution) are sought out. Their practice mushrooms.

Unlike the story of the "new class," there are no plotting villains to this tale, which makes it far less satisfying. Seymour and other lawyers like him have no intention of confounding American capitalism. Seymour does his job as he understands it, and is good at what he does. Henry and other chief executives are no revolutionaries either. Henry also is trying to do his job, protecting his company's interests. Indeed, Henry has a responsibility to his shareholders to do whatever he can, within the limits of the law, to maximize the firm's profits. If he did not hire good lawyers to maneuver around statutes and regulations that were open to such circumnavigation, Henry might be found liable for breach of fiduciary duty to his shareholders, or he might be taken over by someone with fewer scruples about exploiting every possible route to higher profits. Every actor in this sad and silly tale is simply carrying out the responsibilities assigned him within a set of rules that we all have accepted.

The story, exasperatingly, suggests no obvious plan of action. For any fundamental improvement to occur would require a broader definition of responsibility by which businesses would not simply yield to the letter of the law but endorse its spirit, or else openly challenge the goals underlying the laws. And the story promises no happy ending, because such a change in attitude and practice will be difficult to achieve. Business executives like Henry, lawyers like Seymour, shareholders and regulatory officials alike, act on the expectation that American business will try to outmaneuver government. As thrust meets parry, the miasma of regulation thickens.