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SPECIAL ANALYSIS

The Swedish Approach to Social Security Reform

Sweden made sweeping changes to its public pension system this summer. The most novel reform is the creation of defined-contribution individual accounts as part of a traditional pay-as-you-go (PAYGO) system.

The new program. Key aspects of the reforms include the following:

- **Notional accounts.** The lion's share of future payroll taxes will be used to finance contemporaneous benefits, as in the old PAYGO system. But these taxes will be recorded in individual "notional accounts" that will earn an imputed rate of return based on the growth of average covered earnings in the economy. Contributions will also be made to the notional accounts of some people without current market earnings (such as the disabled, the unemployed, and those caring for children). In addition, the system will maintain substantial redistribution through minimum guaranteed pensions financed by general revenue.
- **Annuitization.** Upon retirement, which can be at any age after 61, individuals' notional accounts will be automatically converted by the government into annuities. The size of the annuity will depend on the individual's account balance and the average life expectancy of men and women that age. With rising life expectancy, the monthly benefit associated with any given retirement age will decline over time. Put the other way around, successive cohorts will have to work longer in order to receive the same monthly benefit. Thus, the system may generate a naturally rising retirement age.
- **Prefunded private accounts.** A second and smaller arm of the system provides for individual accounts with claims on real assets. Taxes will be invested initially by the government in low-risk assets until precise individual pension rights can be tallied (about 18 months later, on average). At that point, individuals can direct their balances to any certified investment fund, or by default to a public fund. To reduce administrative costs, individuals will interact only with a central public agency; this agency will hold one account with each investment fund equal to the aggregate of all individuals' balances.

Analysis. The new system has several interesting implications:

- **As a defined-contribution system, it will more closely link benefits to contributions than did the old system.** This may be viewed as more fair, and the perception that payments are retirement contributions rather than taxes may reduce labor supply distortions. The unavoidable tradeoff is that redistribution will be more transparent.

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- Individuals will bear limited financial-market risk. Officially, people will bear the full risk of their investment choices in the prefunded private accounts. However, if someone's total benefit from the notional and prefunded accounts falls below a given threshold, he or she will receive additional payments. Still, this minimum guarantee is indexed over time to inflation rather than wages, so it will decline in relative importance if real wages grow unless future changes are made.
- The system is less vulnerable to demographic shifts than traditional defined-benefit PAYGO systems. The key innovation is the way that annuitizing notional accounts *automatically* adjusts benefits to changes in life expectancy. At the same time, the chosen rate of return on notional accounts will not be sustainable if the Swedish labor force declines over a long enough period. Total contributions are determined by both average earnings and the number of workers making contributions, but the rate of return is indexed only to average earnings. Thus, a shrinking labor force would drain the system, while an expanding labor force would lead to surpluses. Swedish analysts recognize that changes in the rate of return may be necessary over time, but they expect that these changes can be buffered by the public pension trust funds.

Memo

Smiley

12-12-98

To: Rahm Emanuel
From: Stephen P. Cohen
Subject: The President Speaks to Israelis and Palestinians
Date: December 9, 1998

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PART ONE: THE PRESIDENT AS MEDIATOR

1. The President's visit is surrounded by political turmoil in Israel, in Israeli-Palestinian relations, in internal Palestinian politics, and in the Arab political system. The President should seize the high ground as the protector of peace. The President should offer to have a Wye-Addendum at a secluded place in southern Israel for a full day with the two principals. If one or other rejects the idea that should eventually be leaked. Whether meeting with them for a day or an hour Clinton should brook no resistance to their fulfillment of the agreements within the timetable. He should say there is no excuse for not fulfilling obligations and that he is ready to sit with them together to (enforce the) agreement, not to change it.

2. It may be necessary to build another layer of agreement or, more realistically, build a procedure for reaching agreement about May 4, even before the permanent status talks are far advanced. This Wye-Addendum would face up to the unresolved and semi-resolved issues of Wye.

The Netanyahu view of accelerated permanent status talks and the Palestinian view of one agreement that would leave no issues unresolved are rhetorical positions for which there is neither sufficient political will nor stamina, nor a mature political conception. Actually interim agreements are just under a different rubric now. Instead of involving more territory, the next interim agreement should focus on a clearer, more well-defined status for the Palestinian political entity in its present territory.

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3. A possible combination of issues for an interim agreement could be
- a) status of Gaza as a first element in Palestinian statehood, ✓
 - b) access issues through safe passage between West Bank and Gaza and also transit of Palestinians between Jordan and the West Bank, and
 - c) fixing the status of the 1967 displaced persons, those Palestinians now living in Jordan who crossed the river in the wake of the 1967 war,
 - d) fixing the status of Palestinian political prisoners.
4. The President must be unequivocal in Israel that the issue of full compliance with agreements is and must be an Israeli commitment not only a Palestinian responsibility. The United States expects such full compliance from Israel as a responsible democracy no less than from a regime that is still in a transitional state far from full democracy. At the same time, the Palestinians must not permit every or even any political disagreement, to end up in violence.

PART TWO: THE PRESIDENT AS SPEECH MAKER AND LEADER OF THE MIDDLE EAST MODERATES

1. However the speech-making of this Presidential trip should not be focused on fixing Wye, nor on simply improving United States bilateral relations with each party, nor on getting Bibi back on track, and stopping the mini-intifada. I do not believe the President needs to that nor that he should do that.
4. The President's actions of the last month have revived the hopes of the sensible live-and-let-live majority in Israel, among the Palestinians and in much of the Arab world. Regimes and leaders made facile predictions that the United States would fumble the ball. The President's wise combination of tough diplomacy in Wye, and

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tough restraint on Iraq has befuddled the prophets of American decline in the Middle East. The broad majority is relieved, even grateful, though afraid that the good news will prove short-lived. **The President must speak for these majorities and to these majorities.** These are his audience, not the Governments as such. He speaks indeed for the peace majorities to the leaders of the region.

Let the leaders who seek to lead these majorities bask in his words; let the leaders who play on conflict, polarization, blaming of the other, cringe from his words. The President's constituency in the Middle East is the target of the trip. In Israel we know he is more popular than any local leader because he represents the Knesset 75 who voted for Wye, and no one else does. The broad majority in the Arab world wanted him to forge an agreement that revived the idea of peace; they wanted him to scare Saddam into backing down, but not to bomb the Iraqi people if Saddam retreated. They want to know what Clinton has in mind for the future of the region, or at least for the next steps. They want to know that President Clinton is going to persist in leading the region.

The President should not be dragged down to the level of the bickering in his public remarks. Instead he should provide the vision for the future which by implication the leaders are not providing. And he should address the whole region from Gaza and Jerusalem with a vision of a better future for the young people who need prospects of work, family and a good life, not more hatred and enmity and fear of war.

Reflections on President Clinton in Gaza (and Jerusalem)

Stephen Cohen, December 8, 1998

1. President Clinton's visit to Gaza and his address to the PNC-style gathering has assumed a larger than life proportion in the region.

Netanyahu at first must have seen the Presidential visit as a legitimization of his leadership and the end of his stigmatization. As more and more of his efforts focussed on clinging to his religious nationalist partners, he began to perceive the trip through their eyes.

These Israelis feared that Palestinian equality to Israel was being asserted by the visit of a sitting President of the United States. This was and is expressed politically as the fear of Palestinian statehood and its symbols. It extends to Israel's need to feel it has a relationship with the United States so special as to be beyond compare. If not, then America becomes just the latest in the long line of Others who threaten the special status of Israel. They see no middle ground. For their allies among American Jews this perspective expressed itself as the rejection of moral equivalency in the claims, grievances and right of restitution for suffering of the two parties. So at the core, this has become another struggle about Israeli identity and Israel's Jewish identity.

Can Israel exist as one nation next to others (as the peace movement used to say "side by side" with others) or must it be one nation not only separate and distinct, but also set off from all others? Can the distinctiveness of Israel be maintained without it veering into the zone of claims of superiority. These superior rights are seen by some as derived from Biblical interpretations, but are expressed by many also in secular terms, as a unique and inescapable essential vulnerability. The combination culminates in demands for special status. Can Israeli distinctiveness feel secure and unthreatened while the Palestinians express their independent distinctiveness and pride in their separate sovereign status?

If we examine carefully the different forms of expression of Arafat (equal statehood), Assad (equal security), and Amre Moussa (fear of Israeli claims

to be first among equals, or fear of economic domination and political centrality) they all stem from the same struggle. As Israel moves from its unique status as the dominant enemy and source of fear and anger in the Arab world, they fear it seeking to become the dominant partner in the new relationships. Peace as keeping dominance but trading military enmity for economic cooperation, is the new Arab myth of Israel. In this case the Egyptians and Syrians fear the partnership and reject the cooperation, while Arafat has started to feel confident that he can be a partner to one kind of Israeli (the brave Rabin whose bravery is in breaking from the myth) and not the other kind of Israeli who perpetuates and feeds on the myth. Not the Israeli who is fearful and rejecting of this notion of equality.

The underlying challenge of the President and of American Middle East diplomacy with Israel is to reconcile the Israeli need of special status with the Arab need for equal status. Both needs come from deep historical sources, reinforced by present leadership formulations, and realistic concerns about power balances. The United States so overwhelms local power balances and so constitutes the contemporary world arbiter of international status, that the actions and judgements of the President and the Congress are critical to this strategic balance and to "identity confidence".

Over the last years the Congress has upheld Israeli exceptionalism against Presidential (more than one President) tendencies to a balanced perspective. Can the President assert both perspectives or moderate both so that they become more compatible and permit of a more coherent, consistent and integrated American middle east policy? There need to be domains of specialness and domains of equality, rather than American Government institutions that specialize in each of these perspectives.

2. President Clinton's visit to Gaza and his addressing the Palestinian people had assumed a larger than life proportion in the history of the Palestinian people. Palestinian opposition feared that Arafat was being treated as a leader who had arrived and was no longer a pretender. Clinton's visit would be a kind of *coronation* of both Arafat and his peace process, his compromise, his sacrifice of the sacred Palestinian negation of Israel.

The opposition needed to cut Arafat down to size, show him as a challenged

leader, with a dwindling constituency. The Palestinians in diaspora organized their counter-PNC, hoping to claim the mantle of the Palestinian idea even if Arafat could claim the leadership of the Palestinian people. First they tried to do it in the Gulf, under the umbrella of the pretentious, and creative, and polymorphous perverse Qatari regime. When that was nipped in the bud, the Opposition reverted to Damascus, the retirement home of washed up Arab revolutionaries.

Fatah and other 'organizations' of the Palestinian mid-60's to mid-90's inside the land itself could also see the writing on the wall. The new Palestine was not to be a revolutionary state led by its foremost revolutionary movement, Fatah. It was going to be just a defanged normal state in which the movements would be replaced by western-style political parties led by the middle class and the businessmen, not by the fighters and street warriors. Arafat had uncovered the secret of the Palestinians on the land which the fight with the Jews had so long covered up: the people wanted a good life, a good economy; fair governance which meant largely to be not bothered too much; to have their sons at home not underground and not in prison; and a measure of freedom. Butter not guns.

So Fatah and more so the opposition pounced on the Palestinian weakness of Wye. The popular issue was prisoners and they set out to embarrass Arafat, but Arafat passed the cost down the line to Abu Mazen and Abu Alla, and Abu Mazen became a political prisoner in his own home. Yes, the Palestinians may have flubbed this negotiation item, but there was going to be one issue around which the internal Palestinian struggle would swirl. Just as the Israeli struggle swirled around May 4, an issue which was beyond the Wye guidelines of Bibi who focussed instead on the Charter, the prisoner issued was explained well by Abu Mazen but the much criticised detail men, Asfour and Erakat, were kept away.

So the Palestinian Authority prepared to trade in the Palestinian credentials as a core of the Third World grievance against the west, to seize a little dignity and a little decent living. The Palestinian idea remains an untarnished revolutionary idea separate from the evolution of Palestinian daily life under the post-Oslo reality. Under the rule of the Palestinian idea all Arab regimes had legitimacy only if they contributed to a defeat of Zionism and its imperial sponsors, only if they negated Zionism. Not for the Palestinian idea any search for equal status, rather an assertion that their

enemies had only the illegitimate status of usurpers. Equality with the usurper is an affront, an unethical compromise. Arafat had sacrificed the Palestinian idea for the hope of a mini-state for the Palestinian people in the West Bank and Gaza and for his PLO. Arafat seeks equality instead of revenge, only to find that the idea of equality is suspect to some hard core Israelis.

Worst of all, Arafat had sacrificed the sacred idea of armed struggle. This idea that encapsulated a proud form of Arab anger at a century of perceived humiliation at the hands of the west. Arafat had accepted Israel and the permanence of the Zionist entity, that mark of shame that the Arabs could not protect their homeland from incursion even when decolonization was accomplished throughout the Third World. Why without apartheid and Zionism, and absent Soviet-American rivalry, there was no more Third World. Apartheid, at least, had ended with the humiliation of the white settler regime, but the Palestinian idea was ending with the consolidation of Zionism and of American hegemony in the Middle East. ***Arafat was to be anointed by the new Imperial power itself, by the United States, turning the Palestinian idea on its head.***

3. President Clinton's visit to Gaza and to Arafat was assuming a larger than life proportion in the eyes of Arab leaders. President Assad was seeing American energy flow more and more to the Palestinian issue and the revival of Arafat. His own Syrian strategy of insisting on getting clear Israeli commitments in advance instead getting down in the negotiation pit with the Israelis was looking more timid than dignified after Wye. Turkey had certainly taken the full measure of his post-Cold War weakness. The Wye agreement of Arafat may look meagre compared to Assad's notion of a grand deal worked out completely in advance, but when compared with the Diktat of Turkey force fed by Mubarak, Wye looked awfully good served up so elegantly by Clinton. So Assad is doing his best to make Arafat fall in his bid for meeting his PNC commitments to President Clinton.

Mubarak saw how King Hussein emerged from a little assist in Wye and sent Amre Moussa whistling a different tune to Secretary Albright. And all the Arabs were more than impressed with the American realistic threat followed by remarkable restraint in not bombing Iraq. Could Clinton after all be the second term Democratic President Arabs have dreamed about since the assassination of Kennedy? (Yes there is an Arab branch of Kennedy

conspiracy theories as well, which was dusted off for that Zionist plot of Monica.)

Suddenly Arabs were acknowledging that Saddam was their problem, and could not have a free ride on America militancy camouflaged by America bashing.

So what will be the wages of Arafat for supporting an American scheme with Israel, and, more so, while America was confronting Saddam? Will Clinton seek to solve other problems in the Middle East? How can I get him to focus on my problem.....

4. The Clinton visit was built up in the Middle East mind. Now there are those trying to tear it down. *The last attempts to build it up and to tear it down may still be ahead of us.*