THE PRESIDENT HAS SEEN
9/18/95

To Laura | cc Joe Stiglitz
This is very interesting and may explain a lot of US success w/o showing greater — BC

RESOLVING THE US PRODUCTIVITY PARADOX

- Innovation versus Investment in Global Competition -

Prepared for
President William J. Clinton
The White House

- September 7, 1995 -

by
Horace "Woody" Brock

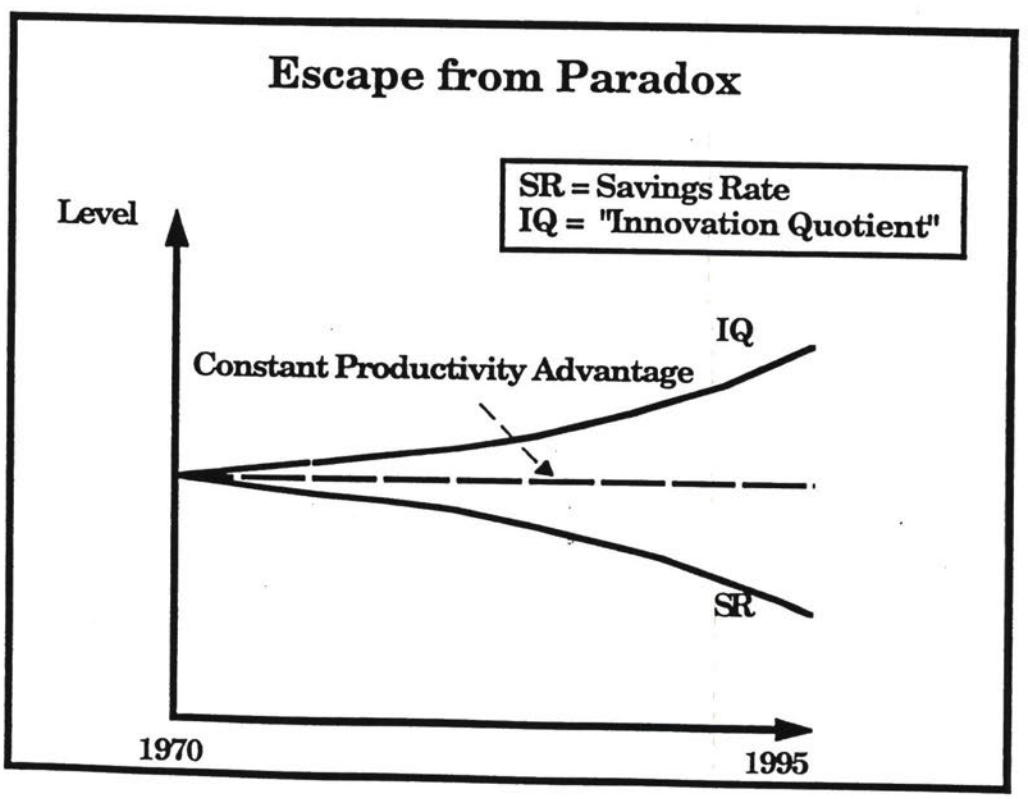
Strategic Economic Decisions, Inc.
905 Sherman Avenue
Menlo Park, California
TEL: (415) 854-2404 • FAX: (415) 854-2415

EXECUTIVE SUMMARY

It is well known that the savings rate of the United States during the past thirty years has remained consistently below that of Germany and Japan; moreover it dropped dramatically throughout most of this period. According to the prevailing wisdom, this would imply the relative competitiveness of the United States should have deteriorated in like manner given the Savings = Investment identity. Surprisingly, recent data suggest that this did not take place. Indeed, the United States has retained its output-per-person advantage over its principal economic rivals in both manufacturing and services during this long period.

What explains this ostensible paradox? According to the logic set forth below, the answer can be found in a new construct of economic theory, that of a "Multiplicative Innovation Regime". In such regimes, an economy experiences a marked *acceleration* of technological innovation due to the increasing rate at which revolutionary "core technologies" such as the microprocessor become absorbed into the economy's interstices over time. The result is an Escape from Paradox along the lines sketched below in an informal graphical manner.

While the proposed logic is consistent with advanced macro-economic theory, its implications for policy differ significantly from what usually is asserted by policy-makers and economists. Per our previous discussion, the Oval Office should focus more on strategies for innovation and less on strategies for savings and investment. This is not to say that we do not need to boost savings and investment, for all would agree that we do.



1. Introduction and Overview

Figures 1 and 2 contrast savings rates and productivity growth rates in both manufacturing and services across the three largest G-7 economies: the US, Japan, and Germany. The savings rate figures represent net national savings, which conflate personal, corporate, and government savings (dissavings in the case of fiscal deficits).

The productivity numbers are taken from pioneering studies on manufacturing and service sector productivity undertaken in the early 1990s by McKinsey & Company's Global Institute (1992, 1993) in Washington D.C., and Pilat and Van Ark (1991). Regrettably, the kinds of historical time series data on service sector productivity we would like to have on hand are not available, so we must make do with late 1980s data.

It is important to note that the productivity data generated by McKinsey & Company are stated in Purchasing Power Parity terms. That McKinsey invested the effort to generate not only PPP measures, but properly-benchmarked PPP numbers is extremely important. For as we have argued in past commentaries, the ultimate purpose of productivity growth comparisons across nations is to contrast the level of real output of goods and services per employee-hour worked. If arbitrary currency market distortions are not removed from the measurement of output and hence of productivity, then the results are largely meaningless for the purpose of transnational comparisons.

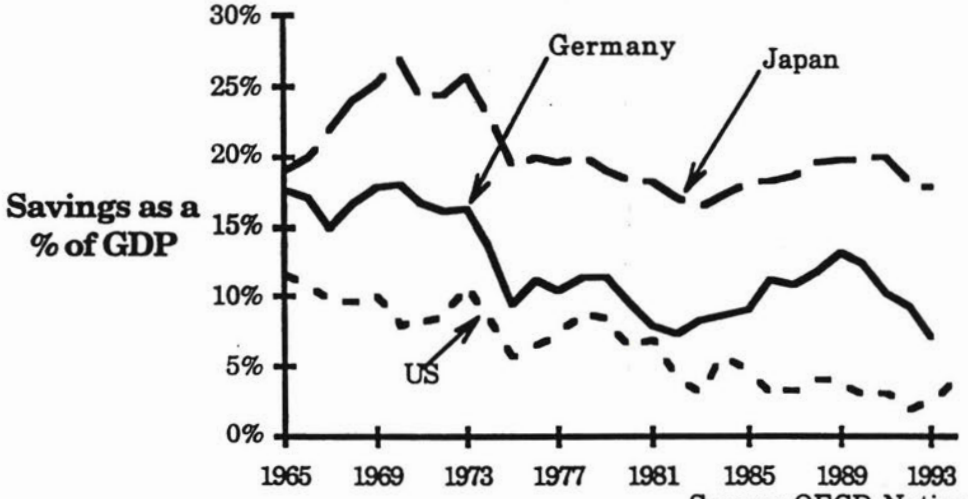
Service Sector Problems: McKinsey made another important contribution. They confronted head-on the vexing problem of defining and measuring output in the case of the service sector. To do this, they proceeded "bottoms-up" by starting at the industry level. Specifically, they measured suitably defined output-per-person-hour levels in five different industries in five different countries.

The results appear in Figure 2, where it should be understood that the US represents the base case of 100 in each industry. In only one case did an industry in another country outperform that in the US: restaurants in France! Several missing entries reveal that the requisite data could not always be obtained. The chosen industries account for 21% of the non-governmental service sector output of the nations in question.

> **The Paradox:** The paradox revealed by the data in the two figures is straightforward: the US maintained a fairly constant productivity lead over Japan and Germany despite having a savings/investment rate which was not only the lowest for three decades, but which *declined* sharply throughout most of the period as well.

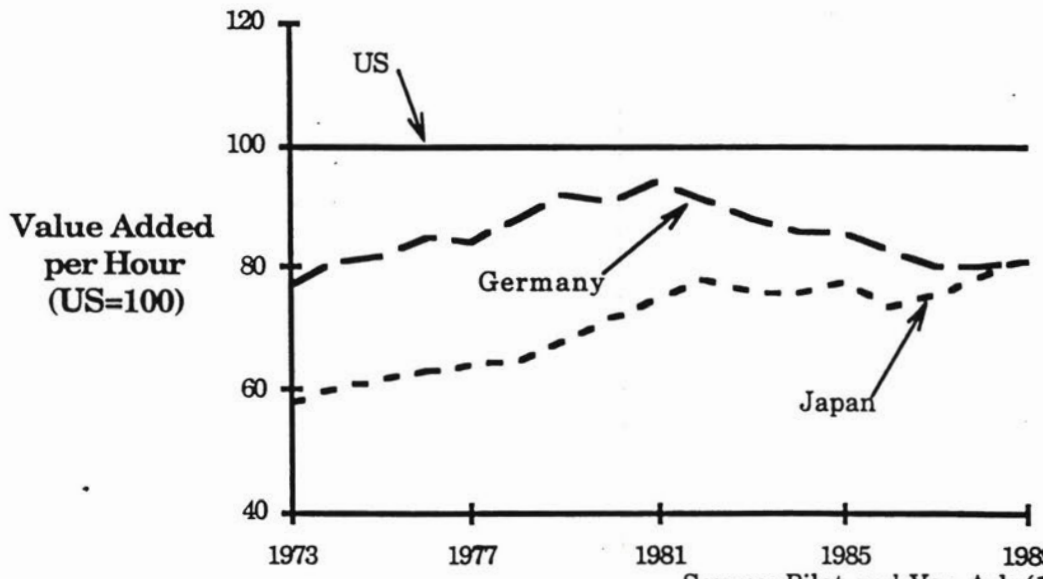
FIGURE 1: THE US PRODUCTIVITY PARADOX

Net Savings Rates



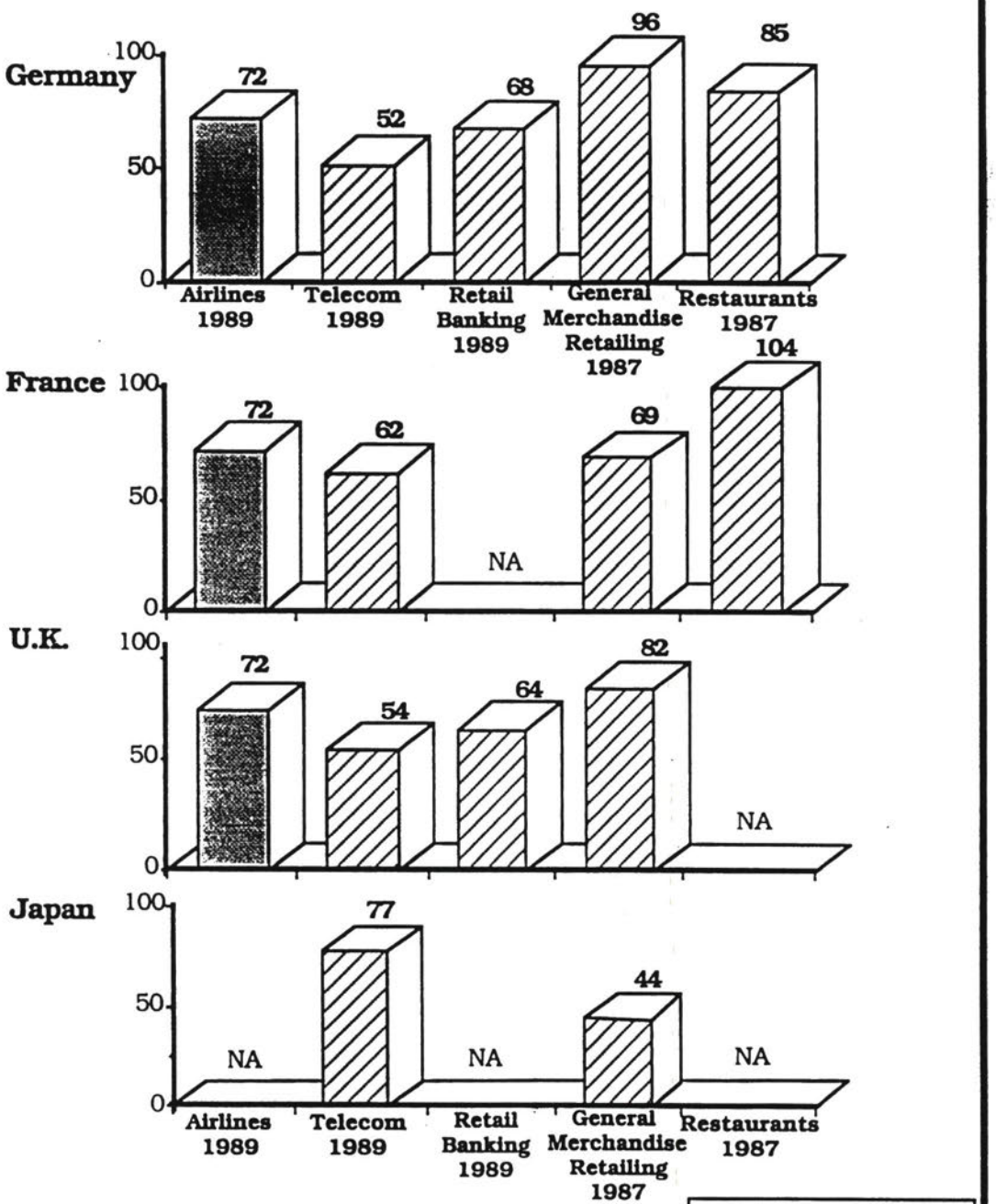
Source: OECD National Accounts

Manufacturing Productivity



Source: Pilat and Van Ark (1991)

FIGURE 2
LABOR PRODUCTIVITY COMPARISON – SERVICE SECTOR
(U.S. Equals 100 in Each Industry)



Source: McKinsey & Company (1992), p.2.

To appreciate the magnitude of this paradox, suppose that back in 1970 a clairvoyant had revealed to investors this particular savings rate data. What would they have inferred from it? Most certainly that the US would end up the *least* productive of the three nations by the mid-1990s, not the most!

The purpose of this essay is to reveal what was wrong in the way we thought then and indeed think now about productivity growth, and thus about economic growth in general.

Overview: In Section 2, we show how the paradox can be resolved at a fairly abstract level. The principal condition is that the technology regime of the economy must exhibit what we shall call multiplicative rather than additive spillover effects. This leads to a discussion in Section 3 of "Multiplicative Innovation Regimes". The concept of "General Purpose Technologies" introduced by Timothy Bresnahan of Stanford University offers real-world examples of how such regimes are propagated. These are discussed in Section 4.

Our sought-after escape from paradox arrives in Section 5. It arises from the commanding lead assumed by the US early in the history of the most important General Purpose Technology of our century: the binary logic of the modern electronic circuit. Next, in Section 6, we assess whether or not the great microprocessor revolution of the past two decades is losing steam. The answer is no, and this is explained in terms of five types of lags which cause such technology cycles to much more long-lived than one might expect.

Finally, we discuss some loose ends in our concluding Section 7. These include Paul Krugman's controversial views that the remarkable growth of the Asian tiger economies is not what it is cracked up to be.

2. Resolution of the Paradox

As Paul Romer pointed out in Chapter III of our May 1995 report, Adam Smith and his followers rarely got things wrong. But one mistake they did make was their identification of high rates of economic growth with high levels of savings/investment. It turns out that both in theory and practice, a high savings rate is neither a necessary nor a sufficient condition for national wealth.

Romer gave us a good example of why this is true. Suppose everyone saves a lot and invests in the one and only capital good produced in the nation, namely the forklift. Then the growth rate of the economy will eventually slow to zero as the marginal productivity of each additional forklift goes to zero. "Factor accumulation" via high savings thus does not guarantee ongoing economic growth.

Role of Innovation: The problem with the classicists and their "Save More!" mantra was their failure to give proper emphasis to the role played by *technological innovation* in stimulating capital and labor productivity growth, and thus economic growth per se. This deficiency in the foundations of macroeconomics would first be redressed by Joseph Schumpeter (1942) – the great economist famous for equating capitalism with "creative destruction" – in the first half of the century. In our forklift example, wealth will come to the nation whose inventors discover a better-and-cheaper replacement for the forklift.

Several decades later, M.I.T. economist Robert Solow (1957) created one of the first and certainly the most celebrated formal models of economic growth in which innovation played an important role. However, innovation was treated as an "exogenous" phenomenon: it emerged randomly from nowhere, outside of human and governmental control. Innovation as an "endogenous" phenomenon was first satisfactorily captured by Romer (1986, 1990) who built upon a pioneering and much earlier paper by Arrow (1962).

It is thus now accepted that *two* conditions are necessary for ongoing economic growth: savings and investment on the one hand, and innovation on the other.

Conditions for Escaping the Paradox: From this elementary observation, it becomes clear how it is *logically possible* to escape the paradox presented above. What first comes to mind is the fact that a low savings nation like the US could maintain its productivity lead by *compensating* on the innovation front. Specifically, it need only maintain a high "innovation quotient" that offsets its low savings rate. (Please see accompanying Figure 3).

> *But this argument will not do the trick. For what must be explained is more difficult, namely that the US maintained a fairly constant productivity differential over time despite a rapidly declining savings rate.*
>
> *The mathematics here are simple, and dictate that the only egress from the paradox lies in a nation's ability to sustain an increasing innovation rate over the decades in question.*

Be sure to note the logical twist that arises here. It does not suffice to cite the official data which show that US productivity growth tripled over the past quarter century, rising from an average all-time low of 0.7% in the 1970s to 1.9% in the 1990s (2.9% if properly measured). For rival countries experienced much the same phenomenon, and as the above data make clear in the case of manufacturing, the productivity differential between the US and its rivals has not changed much.

Thus, to escape the paradox, we must go one level deeper. Since productivity growth is a function of both savings and innovation, and since the savings rate of the US declined precipitously relative to that of other nations, then its innovation rate proper must have risen dramatically.[1]

But what exactly does this mean? And how can we establish that the US exhibited an accelerating innovation quotient? Since there is virtually no pre-packaged data available summarizing the "evidence", we must *deduce* what happened to innovation according to the aggregate data on productivity and savings from a theory of the nature of innovation. In doing so, we shall introduce two interrelated concepts. The first is that of a Multiplicative Innovation Regime. The second is that of a General Purpose Technology. The second is a special case of the first.

Note: Henceforth, some shorthand. When referring to a nation's savings rate, we shall write **SR**. When speaking of its innovation quotient, we shall write **IQ**, a Multiplicative Innovation Regime will be written as **MIR**, and a General Purpose Technology as **GPT**. Doing so will speed things up a bit.

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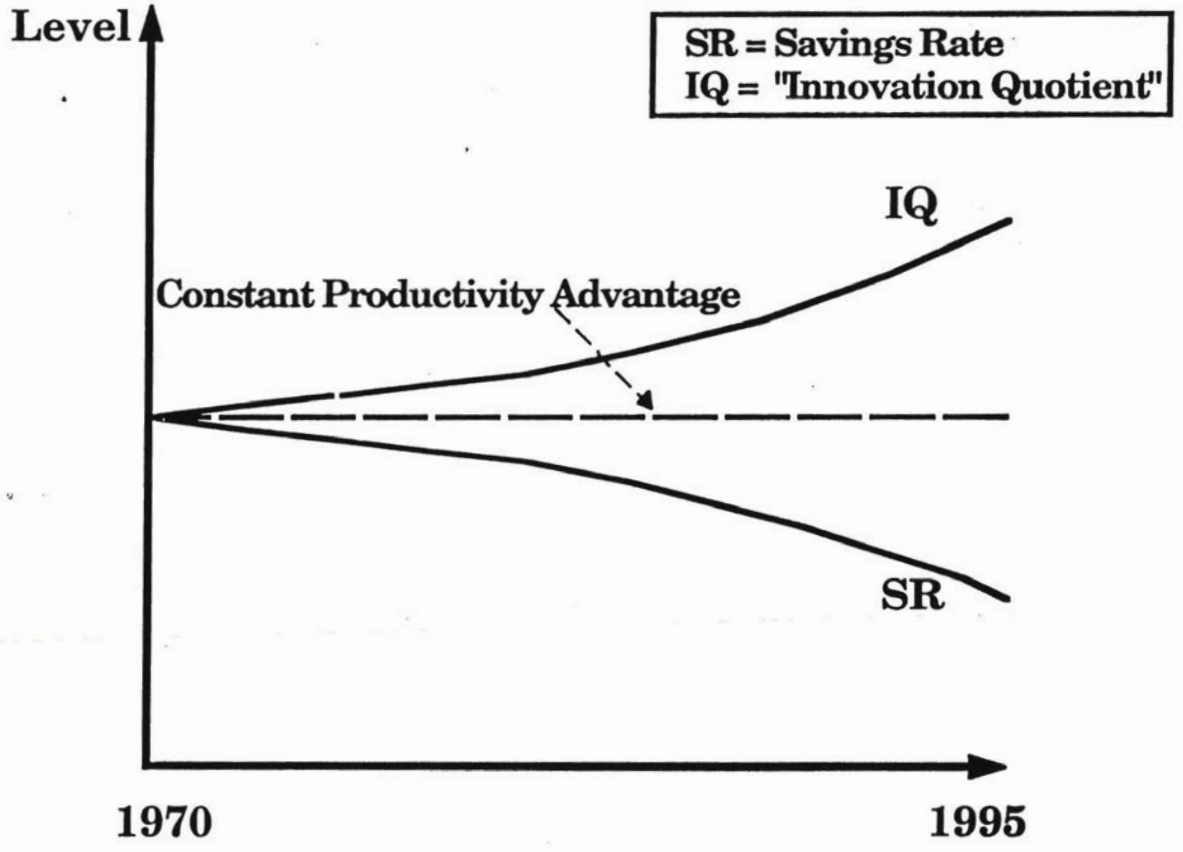
[1] Some might argue that the decline in the US savings rate is overstated in the above data since they fail to capture the inflow of foreign investment mirroring the US current account deficits which arose in the mid-1980s. But adjusting for such inflows does not materially change the above argument.

Figure 3: Escape from Paradox



3. Multiplicative Innovation Regimes (MIRs)

To make sense of the concept of an accelerating **IQ**, we must clarify the precise relationship between the individual innovations that arise within industries (sectors of an economy) on the one hand and aggregate productivity growth of the economy on the other hand. [1]

To make this linkage clear, we need to utilize the concept of a MIR. Since this is quite abstract, let's start off with an example. Consider the invention of the Gutenberg press in the 15th Century. This revolutionized the life of scribes in monasteries, and raised productivity fantastically. But automated printing did little or nothing for the blacksmith and the farmer, at least for the first hundred years or so.

> ***It can be shown that, when all technological innovations are "separable" in this sense, the aggregate productivity growth of an economy is an <u>arithmetic</u> function of the individual innovations begetting it.***

Conversely, consider the invention of the steam engine, or the electric motor, or the microprocessor. In each case, the initial innovation was seen to boost productivity growth in a host of downstream industries impacted by the original innovation. These secondary innovations would in turn feed back upon the original invention, and boost its productivity in turn.

> *When all innovations possess this spillover property, aggregate productivity growth becomes a <u>multiplicative</u> function of the individual innovations.*

A technology regime with this latter property is clearly going to be much more productivity-enhancing than one without it, and this is precisely what a MIR is. We have of course stated two polar extremes above. Most real-world cases lie between these polar extremes, with the level of productivity growth dependent upon the degree of spillover effects ("innovational complementarities") between sectors. This concept is illustrated in Figure 4, and explained in more depth in footnote 2 below [2].

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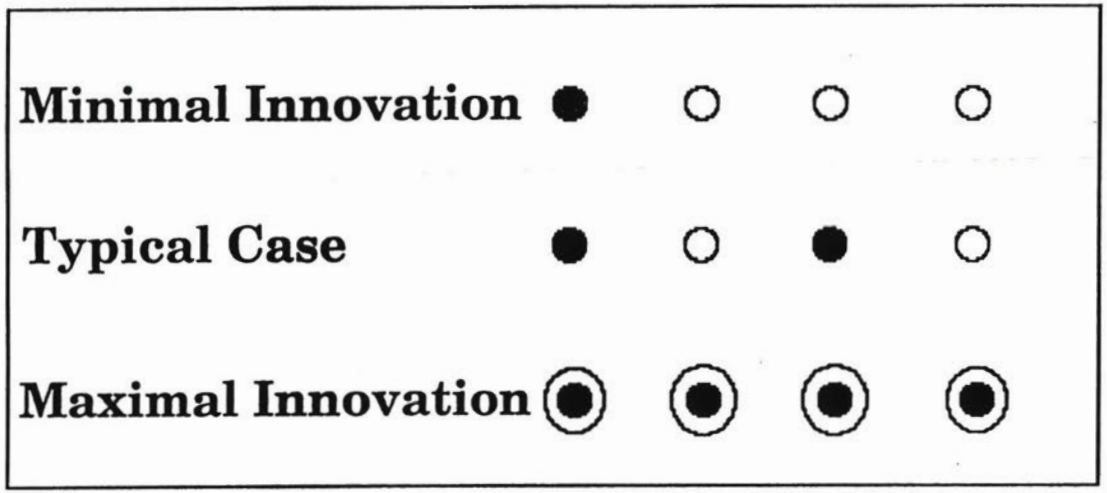
[1] Paul Romer and others rightly extol the virtues of "exponential growth", in particular how economic growth is an exponential function of the rate of growth of productivity. And indeed it is – the laws of compounding guarantee this. But what is not usually addressed is the precise way in which the (productivity growth) rate at which economic growth compounds is *itself* a function of the structure of innovation-induced productivity gains across different industries. It is this complex linkage we are focusing on here.

[2] To understand this in more detail, contrast the aggregate growth rate in two economies identical in all respects except the degree of "separability" between the innovations of different sectors. [Complete separability implies *no* spillover effects from an innovation in one sector to other sectors.] Our aim is to create two polar cases. Let Economy **A** have **N** equal size sectors, each of which is completely "separable". Let Economy **B** have the same **N** sectors, but this time each exhibits *maximal* innovational spillovers across sectors. That is, an innovation in any one

Figure 4

Multiplicative Innovation Regimes



● Denotes an innovation which is sector–specific

◉ Denotes an innovation with maximal spillover effects

4. General Purpose Technologies (GPTs)

In a fascinating paper, Timothy Bresnahan of Stanford and Manuel Trajtenberg of Tel-Aviv University (1992) discuss the nature and implications of what they call "General Purpose Technologies". Loosely speaking, these are the core technologies which drive downstream areas of technological innovation and economic growth over fairly long time spans ranging from 25 – 50 years. For our purposes, familiarity with GPTs is important because these technologies when they arise *cause* innovation regimes to become *multiplicative* in nature. By understanding them, we can thus better understand the conditions required for MIRs to exist and indeed flourish.

These GPTs have three properties which play an important role in shaping the nature and magnitude of productivity growth over time. The analysis of this point by Bresnahan and Trajtenberg is well worth citing:

> We think of the technologies prevalent in any given period as structured in a hierarchical pattern (i.e., as forming a sort of "technological tree"), which in the simplest case would consist just of two levels: a handful of "basic" technologies at the top (perhaps just one), and a large number of product classes or sectors that make use of the former at the bottom.
>
> Those at the top are characterized first of all by their *general purposeness,* that is, by their performing some generic function that is vital to the functioning of a large segment of existing or potential products and production systems. Such a generic function would be, for example, "continuous rotary motion," performed at first by the steam engine and later on by electrical motors. "Binary logic" would be the corresponding generic function for electronics, the obvious GPT candidate of our times.
>
> The second distinctive characteristic of GPTs is their *technological dynamism*: continuous innovational efforts, as well as learning, increase over time the efficiency with which the generic function is performed. This may show up as reductions in the price/performance ratio of the products, systems or components in which the GPT is embodied, or as multidimensional qualitative improvements in them. As a consequence, the costs of the downstream sectors that use the GPTs as inputs are lowered, they may be able to develop better products, and moreover, further sectors will find it profitable to adopt the improved GPT, thus expanding the range of applications.

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sector of Economy **B** raises productivity by every bit as much as it does on its own sector. *How then do the growth rates of the two economies compare?* The answer is that if each economy experiences the same total number of innovations, then the growth rate in economy **B** will be **N** times as great as that in Economy **A**. To state this somewhat differently, innovation *per se* is effectively **N** times more important to growth in Economy **B** than in **A**.

Third and last, GPTs are characterized by the existence of *innovational complementarities* (spillover effects) with the application sectors, in the sense that technical advances in the GPT make it more profitable for its users to innovate, *and vice versa.*

The precise route of escape from our paradox is now at hand. We shall demonstrate how the US assumed a commanding lead several decades ago in what is arguably the most important GPT of the century. In doing so, the US was able (via the algebraic logic of an MIR) to compensate for its declining **SR** with an increasing **IQ**. As a result, it could maintain the productivity differential it has enjoyed over its principal competitors for many decades.

5. The US and "Binary Logic": A Case Study of a GPT

There is little disagreement in the growth literature that the US has traditionally evinced a high level of technological innovation during the entire twentieth century.[1] This is evidenced by **(1)** the predominance of its research universities; **(2)** its number of Nobel laureates; **(3)** the number of its patents in leading-edge technologies; **(4)** its productivity dominance in manufacturing and services as evidenced in the McKinsey data; **(5)** its widely respected tradition of entrepreneurship; **(6)** its absence of those product and labor market rigidities that now burden continental Europe; **(7)** its unique venture capital industry, and **(8)** its increasing dominance in many leading-edge industries of the next century. These include telecommunications, consumer electronics, computer software, computer hardware, video-and-entertainment, and biotechnology.

Electronic Circuits – Today's GPT: It is this last strength **(8)** we wish to focus on. How can the US simultaneously be the leader in virtually *all* of these industries (consumer electronics rejoined this list in 1994)?

The reason is that the US took a commanding lead early in the game in what is arguably the single most important GPT of all time: the logic of binary numbers (formally, Boolean lattices) physically embodied in the (digital) electronic circuit.

This technology gave rise to and interconnected more downstream innovations, faster, than any other GPT in recorded history. But why is this so? What exactly is it that makes (binary) electronic circuits the great driver of progress that they have become? By taking the microprocessor for granted, we lose sight of this all-important issue.

[1] The criticism launched in the early 1980s that the US had lost its ability to *commercialize* its innovations was true, at least until the 1990s. But this view is irrelevant to our point here.

Happily, Bresnahan and Trajtenberg address precisely this question at one point in their paper, and they answer it better than anyone else we know of. The reader is advised to read twice the following rather challenging passage:

> What accounts then for the 'general purposeness' of electronic circuits? The workings of virtually any system and, in particular, of any electro-mechanical system, can be thought of as (and actually be broken down into) a series of steps that transform a given input into a desired outcome. Thus, a traditional watch transforms the power of the spring into an analog signal, depicting time; a washing machine transforms electrically-induced continuous mechanical traction into a series of actions involving movement of parts, the opening and closing of valves, etc.
>
> **Despite their variety, a vast majority of these intervening steps can in principle be done (or be replicated) by the application of binary logic, that is, by activating a circuit consisting of a series of binary elements (e.g., gates, flip-flops, etc.). This is a striking *technological* fact that has reaching *economic* implications. What it says is that the enormous variety of seemingly disparate products, materials, methods of production, etc. conceal the *uniformity* of a few underlying technological principles; these principles, in turn, give rise to potent economic forces that would shape the (endogenous) process of technical change.**
>
> Contrary to popular perceptions, substituting binary logic for mechanical parts is in many cases extremely *inefficient*, if measured by the number of steps required by the former, and hence by the number of circuit components and operations involved.
>
> However, as the price and size of circuit components decrease dramatically, and as their reliability improves, it becomes eventually cost–effective to use *them* rather than the old electro-mechanical parts. And, in turn, these dramatic advances in costs, size and reliability are due to a large extent to the tremendous increases in the volume of production of *standardized* circuits, where 'learning' plays a key role.

The authors then demonstrate that the electronic circuit is the dominant technology of our time, and that it exhibits very clearly the key features of a GPT reviewed above. *First,* it has proven to have the inherent potential for persistent and manifold technical advances along its main performances dimensions. *Second,* these advances impinge upon a wide range of applications which, when coupled with complementary innovations by the user sectors, have brought about a reshaping of the universe of goods and services at our disposal.

Resulting Prediction for the US: When these aspects of the digital revolution are factored into our earlier arguments about the nature of MIRs and their implications for aggregate productivity growth, the following theoretical prediction emerges:

As the leader exploiting these new technologies, the US should have been experiencing an increasing rate of growth in its IQ during the 1970 – 1995 period.

Note that this was the period when the electronic circuit GPT was domesticated via the ever-more-powerful "chip", with the result that new applications and downstream innovations proliferated profusely. A significant sector of the US economy became a MIR.

Happily, this prediction seems to fit the empirical facts. It also explains away the paradox with which we began in Section 1.

6. The Future – Is the Revolution Over?

Is the revolution launched by the GPT of binary logic nearing its completion? No. Moreover, the greatest risk to investors is that they will think "Yes", and jump ship. But why will the revolution continue? The answer is subtle, and can best be understood by citing four obstacles which explain why it took so long for productivity gains from the digital revolution to show up in the official numbers in the first place. [Keep in mind here that the digital computer has been around since the late 1940s.] The nature of these lags also clarifies why GPT-based technology waves are particularly long waves – a phenomenon with which most investors are both uncomfortable and unfamiliar.

1. Lags in the Innovation Process Itself: The great economic virtue of the chip is that it raises the benefits and/or lowers the costs of innovation in so many related fields. But precisely because this is true, the *total* impact of the microprocessor on productivity and growth will not be realized until its spillover effects (complementarities) are recognized and in turn acted upon by other entrepreneurs throughout the economy.

2. Lags in Business Applications: Suppose that entrepreneurs do comprehend the possibilities inherent in a GPT, and attempt to create the downstream innovations stipulated by (1) above. Suppose, moreover, that these innovations become economically viable once the microprocessor arrives on the scene. For example, some farsighted entrepreneur perceives that the "fax machine" will become a commercial success, because businesses will eventually deem the technology to be "indispensable". He creates the blueprint and prototype. What next? Who has benefited?

The truth is that there will be no increase in *aggregate* productivity until the fax machine is *widely* used years later. But this will only happen once people take "faxing" for granted. But for these downstream users to take the new technology for granted, a host of related innovations must first be in place: offices with complementary equipment (e.g. computer programs which manage faxes), speedy and reliable links to transmit messages throughout the economy, etc. It takes a lot of time for these related goods and services to accumulate to the extent

required before the fax machine is fully accepted and makes its ultimate contribution to productivity growth.

3. Lags due to Psychology: Resistance to change is pandemic. "We don't really need a xerox machine or a personal computer". [Recall that IBM turned down opportunities to buy both Xerox and DOS for a pittance in earlier days]. The Internet was deemed a hacker's toy for over a decade. Virtual reality was for video arcades, not Boeing. Desktop publishing was a luxury we thought we could never afford. And so on.

4. Lags due to Standardization Problems: The full advantages of new technologies stemming from a GPT such as the electronic circuit cannot be reaped until complex sets of uniform standards are in place. Even today, brand name PCs don't communicate with one another. Recall Betamax versus VHS? Digital TV? Putting Lotus Notes up on the Net?

7. Conclusion

In concluding, there are a number of issues we would have liked to address, but could not. For example, Paul Krugman of Stanford University (1994) has re-examined the nature of the success of the Asian Tiger economies from an interesting standpoint. As we have done, he distinguishes the relative contribution to Asian growth due to "factor stuffing" (high SR and capital accumulation) on the one hand, and IQ on the other. He concludes that the tigers' success has largely been "bought" by high levels of savings and investment that are forced, and that will decline. Such growth is expensive (in terms of foregone current consumption), whereas IQ-based growth is cheaper, and thus preferable.

Because of such arguments, Krugman does not believe that the Asian economies will perform in the future as well as they have in the past. Factor stuffing strategies run into laws of diminishing returns, whether of the kind experienced in the USSR, or in Asia. However, we believe that he overstates his case because a good part of the capital accumulation in these Asian economies *does* embody new innovations. These economies are not simply accumulating more and more of the same capital goods (i.e., more "forklifts") as Krugman seems to imply. But this and related issues will have to be postponed to some future date.

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Horace W. Brock, Ph.D.
President
Strategic Economic Decisions, Inc.
905 Sherman Avenue
Menlo Park, CA 94025

THE PRESIDENT

9-26-95

Dear Woody

I got your memo and have circulated it widely. It makes sense and explains our recent experience better than any other theory I've heard — We should spread and cut taxes in accord with it — Best, Bill Clinton

COPY
from ORM

STRATEGIC ECONOMIC DECISIONS, INC.
905 SHERMAN AVENUE
MENLO PARK, CALIFORNIA 94025

TEL: (415) 854-2404
FAX: (415) 854-2415

Sent Ltr to Lee Johnson for review

Lost ltr sent for Pres

September 11, 1995

Ms. Nancy Hernreich
Assistant to The President
The White House
1600 Pennsylvania Avenue
Washington, D.C. 20500

Dear Nancy:

I have enclosed the memo that Tommy Caplan asked me to give The President. An earlier and incorrect version was given to him at the Orioles game last Wednesday.

Thanks to both you and Cathy for your help – as always!

With Best Wishes,

Horace W. Brock, Ph.D.
President

NH

Lee Johnson -

Checking

No record of letter since February.

Mr. President,

I found this chapter from Woody's recent report utterly fascinating and asked him to excerpt it for you. It is cutting edge work, leading to

With the Compliments of

Thomas Caplan

profound, often counter-intuitive conclusions, e.g. (one among many) that education which develops/fosters innovation(eventually) may be more effective in creating growth than savings.

6th September 1995

THE PRESIDENT

9-18-95

(9-18-95)

Dear Bob -

Thanks for your article on the Stabilization Conversation - It was good -

It was great to be with you and your wife in Wyoming - and we'll be back in touch on the things you wrote me about -

Bill Clinton

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Robert E. Nelson
Chairman

18401 Von Karman Ave., Suite 120
Irvine, CA 92715
(714) 957-1010 FAX (714) 474-7738

Irvine, CA
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Washington, D.C.

Robert E. Nelson
Chairman
Nelson Communications Group
18401 VonKarman Avenue,
Suite 120
Irvine, CA 92715

The Stagnation Generation

by Robert Nelson

95 SEP 15 P1:40

Finally, an appropriate name for "generation X': let's call it the *Stagnation Generation.*

In real terms, average family income has not increased during the lifetime of most post-Boom Americans. And while a few at the top watch mom and dad's income grow, the lower income segment sees things getting worse.

This is a new, important and unhappy change for America. Throughout our history we have seen steady increases in our standard of living. From 1950 to 1973 -- while Baby Boomers were moving from Gerbers strained peas to avocado and bean sprout sandwiches -- real income grew an average of 1.5 percent annually.

But since 1974, real hourly earnings have actually *fallen* by one percent per year. American workers, on average, now earn almost $50 *less* each week than they did 20 years ago.

At the same time, overall economic growth has followed similar patterns. From 1950 to 1973, real gross domestic product (GDP) grew an average of 3.8% annually. Since 1974, however, the rate of growth has dropped to about 2.5% per year.

If there is malaise among the Stagnation Generation, it probably reflects the moribund reality of post-granola America. And it's not just the kids who feel things have gone astray. All national surveys show that about two thirds of Americans think we are seriously off track, opinion data whose trend closely mirrors the decline in real wages and real family income.

Since its inception in 1991, the U.S. Competitiveness Policy Council (CPC) has studied the causes of and some solutions to economic stagnation. To achieve a substantial improvement in the standard of living for most Americans, the CPC figures we must sustain productivity growth of at least two percent per year, achieve three percent annual growth in GDP and eliminate the trade deficit so we can stop relying on foreign capital to finance our private and public debt.

New technology can and does improve productivity. But significant growth requires vast amounts of new financing generated domestically, not through constant borrowing overseas if we want higher standards of living at home.

To get this done, we must save more and invest it better than we have in the past two decades. Here's how we can save more:

Cut federal deficit spending. American government dis-saving destroys what little private savings corporations and families manage to accumulate.

Encourage American families to save. Issue tax refunds in the form of negotiable savings certificates similar to U.S. savings bonds, so people can either accumulate tax free interest or get the cash if they need it.

Encourage American families to save even more. Expand IRAs by placing a minimum -- not a maximum -- limit on tax deductible contributions or tax deferred earnings. For example, assume the minimum limit is two percent of annual household income. A family earning $25,000 gets to deduct IRA savings exceeding $500. A family earning $150,000 can deduct savings above $3,000 per year.

Encourage people to invest in American corporations. Eliminate the double taxation of stock dividends.

Encourage people to invest more and hold their investments longer. Provide favorable treatment of capital gains on equities held for at least one year, and increase the preferential treatment the longer the stock is held. Grant a deduction on gains of 10 percent if held one year, 20 percent for two years and so on, up to 50 percent deduction of gains for equities held for five years or more.

Encourage workers to save. Let companies make retirement programs available to their workers for voluntary savings without forcing employers to make contributions on the employee's behalf. The current laws discourage marginally profitable companies from helping their employees save.

Increasing the pool of money available for business expansion is part of the solution. But unless we spend money wisely, we still won't achieve real growth in living standards. Some priorities for spending:

Don't eat the seed corn. As the Federal government eliminates deficit spending (and congratulations to President Clinton and Congress for actually starting this!) don't eliminate programs that help re-train displaced workers or help give basic job and learning skills to young people. Continue Federal support for the Goals 2000 public schools program.

Invest in tomorrow. Nurture and expand scientific experimentation that has a long development cycle. Continue Federal subsidy for civilian research through the Advanced Technology Program and the

Manufacturing Extension Program. License patents that result from government funding to industry-wide consortia for exploitation, not to individual companies.

Invest even more in tomorrow. Re institute the research and experimentation tax credits that expired June 30, 1995.

To make American truly competitive for the long run, we're all going to have to give up something in the short term. That may mean higher taxes for those who can pay, and fewer social benefits for others. But with some intelligent sacrifice today, we all have a lot to gain tomorrow.

Robert Nelson is a Presidential appointee to the United States Competitiveness Policy Council, a bi-partisan commission appointed by the President and the Congress. He is chairman of Nelson Communications Group, a company with offices in California, Arizona and Washington, D.C. He served as national director of Republicans for Clinton/Gore and was the only Republican member of the Presidential Transition Team.

(9-18-95)

THE PRESIDENT
9/18/95

Dear Lloyd—

Thanks for sending your remarks to the Jefferson Foundation—I enjoyed and agreed with them—I only hope I can repeat Mr. Jefferson's feat—

Sincerely,
Bill Clinton

Lloyd Cutler
Wilmer, Cutler and Pickering
2445 M Street, N.W.
Washington, DC 20036

1995 Thomas Jefferson Memorial
Foundation Award Talk

PUBLIC DISDAIN OF PUBLIC OFFICIALS

by

LLOYD N. CUTLER

April 13, 1995

When I selected my topic for this talk, I did not appreciate its close connection to the public career of Mr. Jefferson. Until I looked into it, I would have thought that media attacks on public officials have reached a much higher level of vituperation today than in Mr. Jefferson's or any other time. It may be nothing new to this audience of Jeffersonians, but I was truly surprised by what I found.

The newspapers of the day were even more scurrilous and slanderous about public officials than today's *American Spectator*, *Washington Times*, *New York Post*, or Rush Limbaugh. They were filled with malicious gossip even about President Jefferson, including allegations about his private personal behavior long before he became President. He was accused of a continuing affair with a female slave, Sally Hennings, and of having one or more children with her, an unproven rumor historically that will now become widely accepted as a docudrama fact, because of the new Merchant and Ivory film called "Jefferson in Paris". A former supporter accused him of attempting to seduce the wife of a friend, John Walker, with both Walkers confirming the account. He was also accused of failing to pay a debt to another friend, Gabriel Jones, and of attempting to satisfy it in worthless revolutionary currency. The articles

about his sexual behavior were full of obscene and vulgar references.

Remarkably, and unlike our modern politicians, Jefferson chose not to answer any of these attacks. He said, "I should have fancied myself half guilty, had I condescended to put pen to paper in refutation of their falsehoods, or drawn to them respect by any notice from myself." (Malone, Jefferson the President 2/4-5).

Even unanswered, the attacks had little effect on Jefferson's approval rating or his election and re-election. In Jefferson's time, there were no independent counsels, congressional oversight committees or what we now call investigative reporters. The circulation of the newspapers containing the scurrilous articles was small, and of course there were no radio talk hosts or TV "Hard Copy" tabloid shows.

But many of the slanderous articles were of course seen by Mr. Jefferson himself (and the other public officials inside the Beltway of those days), and his abhorrence of the press made the resentments of more recent Presidents -- or of Speaker Gingrich -- seem mild by comparison. In 1802, he said "Our newspapers, for the most part, present only the caricatures of disaffected minds. Indeed, the abuses of the freedom of the press have been carried to a length never before known or borne by any civilized nation." (Ibid, p. 22 4-5).

In a famous passage of his second Inaugural Address, in words that President Clinton would love to be able to repeat in January 1997, Jefferson described his reelection as an "experiment" in "whether a government ...can be brought down by falsehood and defamation. The experiment has been tried; you have witnessed the scene; our fellow citizens have looked on, cool and collected; they saw the latent source from which these outrages proceeded... and when the Constitution called them to the decision by suffrage, they pronounced their verdict, honorable to those who had served them." (The writings of Thomas Jefferson, Vol. VIII p. 44 (1871).

Despite his reelection, Jefferson remained bitter about the press. In 1807, he said that "a suppression of the press could not more completely deprive the nation of its benefits, than is done by its [own] abandoned prostitution to falsehood. Nothing can now be believed which is seen in a newspaper. Truth itself becomes suspicious by being put into that polluted vehicle." (Letter to John Nowell, June 11, 1807, Ibid., Vol. V, p. 92 (1871). And just before leaving office he wrote: "The papers have lately advanced in boldness and flagitiousness beyond even themselves. Such daring and atrocious lies as fill [a certain paper] have never before, I believe, been published with impunity in any country. (Letter to Mr. Short, Sep. 6, 1808, Ibid. p. 362.) Having looked it up, I can tell you that "flagitiousness" means shamelessness, exactly what you might have

guessed! And six years later, he wrote to Dr. Walter Jones: "I deplore, with you, the putrid state into which our newspapers have passed, and the malignity, the vulgarity and the mendacious spirit of those who write for them." (January 2, 1814, Ibid, Vol. VI, p. 284.)

These were the views of the same President who had said, long before he reached the White House, that he preferred newspapers without a government to a government without newspapers. But Jefferson's subsequent mistrust of the press was generally shared at the time. Under the preceding administration of John Adams, it was the Federalists, not the Democratic Republicans, who had enacted the Alien and Sedition Act, making it a criminal offense to utter false charges against government officials. To his credit, Jefferson opposed that infamous measure and argued it was unconstitutional, even though as Vice President he was nominally part of the Adams administration. But throughout his public career, he was a strong supporter of civil suits for libel and slander and state common law prosecutions for criminal libel. One wonders what he would have thought about modern developments such as the public figure defense, the requirement of reckless malice, and the almost limitless discovery into the plaintiff's life history available to a libel or slander defendant today.

Press criticism of public officials may well have been even more virulent in Jefferson's time than now. But I would

submit to you that general public disdain for public officials and institutions is much higher now than then. The press attacks on Jefferson did not prevent his reelection by a landslide; the 1804 electoral college vote was 162 to 14. Mistrust by a portion of the press did not translate into mistrust by the public.

Today, it is virtually the entire public that mistrusts public officials and institutions. Poll after poll shows widespread distrust of government, at least at the national level. While public service was once supposed to be a noble calling, a majority of us now think that anyone willing to run for federal office or accept a federal appointment must be a knave or a fool or both.

Mind you I am speaking of a distrust, a disdain, that goes beyond disappointment with the decisions and non-decisional deadlocks of government. We all have concerns about the hazards and frustrations of our lives, and we have an understandable tendency to blame the government for failing to alleviate those concerns, even when they relate to consequences of technological developments and social changes about which the government may promise much, but can actually do precious little. We distrust government much more than our neighbors the Canadians, who, while sharing most of our attitudes, continue to believe that government is part of the solution rather than part of the problem.

Life has always been harder and more unfair than we thought it ought to be, even though deep down every generation must have known that its own lives have been longer, richer and more satisfying than those of its predecessors. But what is truly different today is the degree to which we now blame government and government officials for our continuing discontents.

Public opinion polls show consistently that most candidates (challengers as well as incumbents) have negative ratings (i.e. more people disapprove them than approve). The same is true of our political institutions. The bureaucracy is widely distrusted, Congress has approval ratings in the teens, twenties and thirties, and we are beginning to lose our reverence for the presidency itself. One remarkable difference between my White House service under President Carter and the same post under President Clinton was the difference in the tone and virulence of the hate mail -- and the frequency of four-letter words -- not just toward the personality of the President, but toward the White House itself and anyone foolish or crooked enough to work in the building.

In July 1994, the Los Angeles Times polling center did a survey of voter attitudes. They found that the percentage dissatisfied with the way things are going in the country had risen steadily from 40% in October 1988 to 68% in January 1992, with a drop to only 50% dissatisfied immediately after President

Clinton's election, but a rise to more than 70% in 1993 and 1994. 66% now believe that government is almost always wasteful and inefficient; 54% believe that regulation of business usually does more harm than good; 71% believe that elected officials in Washington lose touch with the people pretty quickly; only 25% feel that those we send to Washington try hard to stay in touch with people back home; and 65% feel that most elected officials don't care what "people like us" think.

An exit poll conducted for the New York Times during election day 1994 confirmed these conclusions. 58% thought the country was "seriously off on the wrong track;" almost 40% had little or no confidence in the government's ability to solve the major problems facing the country, and blame for failure to resolve these problems was placed about equally on Congressional Democrats, Congressional Republicans, the Clinton Administration and special interest groups.

Of course, as a people who migrated across oceans to free themselves from official repression, who fought a revolution to break away from a despotic monarch thousands of miles and weeks of travel away, we have always had a healthy historical basis for being wary of government institutions and officials. But for two centuries, up to and including our own lifetimes, we have repeatedly called on the government to do much more than defend our shores, deliver the mail, patrol the streets and otherwise stay out of our way. Think of free public education,

the land grant railroads, the opening of the West, the public works that helped end the Great Depression, the health and social security safety net and the nurturing of scientific research and development that have all been so vital to improving the quality of our lives. With all that affirmative government intervention has done for us, why have we become so suspicious and resentful of the government's considerable presence in our daily existence today? Perhaps it is because we have prospered so well under the government's nurturing that we now think we did so all by ourselves. Perhaps we chafe under the government's continuing tutelage for the same reason that children on the verge of maturity chafe at the continuing tutelage of their parents. Jefferson's maxim that government is best when it governs least is becoming more popular every day, even among the young who depend on government loans for their higher education and the old who depend on government social security and medicare payments many times the value of their own contributions for those purposes.

There is of course much to be admired in the qualities of self-reliance and skepticism about Big Brother that account for this growing disdain for public institutions. The pendulum will swing again, and the cutbacks of the Republican Contract with America may bring us back to a healthier balance between affirmative government and every-man-for-himself individualism. But there is much <u>less</u> to admire in the growing public disdain

for the persons who serve us as elected or appointed public officials, and no sign at all that a healthier balance will soon be reached. There is an ironic fallacy in this disdain; at my age and level of experience with Washington ways, I feel certain that today's elected and appointed public officials are better educated, more highly principled, more thoroughly vetted, more decent and competent than their predecessors of thirty, forty or fifty years ago, when public respect for public officials was considerably higher than it is today. I can personally remember when I was a young lawyer watching plain white envelopes full of cash passing in congressional offices and in the White House, washed down with a round or two of bourbon and branch water, leaving no trail of who paid whom or what was the quid pro quo. There were no congressional ethics committees or Office of Government Ethics. There were no laws governing campaign financing, the acceptance of political gifts, or conflicts of interest on either side of the revolving door.

Why is it that as the quality and behavior of public officials has been steadily improving, the public's general admiration for its public servants has turned into general disdain? There of course is no single explanation. But here are what I believe to be some of the major components:

- First, there is the growth and the success of negative advertising in radio-TV election campaigns. Michael Huffington spent $31 million in his unsuccessful campaign against

Dianne Feinstein, virtually all of it on negative ads. Senator Feinstein spent about half that amount, also mostly on negative ads. As a result, both candidates had negative poll ratings on election day. Mean, negative personal attacks are so successful they are now the order of the day, even on the floor of the House and Senate and in media conferences and interviews.

- Second, there is the switch from political analysis to investigative reporting as the most preferred and rewarding field of print and television journalism. Could the widely and justly admired President Kennedy have survived full court investigative reporting, before or after his election, into the true state of his health, his love life or how his father financed all the family political campaigns?

- Third, there is the growing skepticism among all of us about the existence of honor and virtue in anyone else, especially in those who hold public office. We even question honor and virtue as goals for ourselves. I was recently a member of a committee looking into the breakdown of the Naval Academy Honor Code. At a meeting with the faculty, we were told that when incoming plebes -- the pick of young Americans -- are asked whether they cheated on their high school examinations, the great majority raised their hands. In this take-care-of-yourself-first, cheating-is-all-right world, virtue and honor are among the disappearing family values whose loss we all deplore. We are less and less disposed to credit their existence in others.

My greatest concern is that our visible disdain for our incumbent public officials and election candidates is bound to discourage the best among us from seeking or accepting public office. A decade or so ago, our distrust was focused on those in the bureaucracy -- best expressed in the aphorism: "We are the government and we're here to help you." Then we turned on those we elect to Congress, culminating in the current term limits notion that serving time in Congress is almost as unworthy as serving time in jail, and that the prophylactic rule for Congressmen as well as criminals should be, "Three strikes, you're out!" Now, I am afraid, we have even turned on the White House and whoever happens to be its incumbent. While we focus today on President Clinton, it is worth remembering that despite President Bush's 90% approval rating immediately after the Gulf War, in the crucial election year 1992 he never got above 38%, even during the month or two when Ross Perot withdrew as a candidate.

Think of what we now do to people who run for President or serve on the President's staff. Before election or appointment, we subject them to the most minute examination of their entire personal lives, including their financial status and transactions, the reports of their neighbors everywhere they ever lived, their personal habits and medical histories, including the details of any visits to psychiatrists, their tax status including tax withholding for household help, and anything --

literally anything -- else that might prove embarrassing if generally known. Vetting was part of my responsibility as President Clinton's Counsel. I made a calculation that despite a sizeable vetting staff, the process has become so layered and detailed that even though we radically reformed it, the President's term will be over before he can possibly fill all the appointments he has to make.

When our officials finally <u>are</u> elected or appointed, they run a high risk of having to undergo one or more independent counsel or congressional investigations for which they will need to retain a private lawyer. They will need private lawyers because under our present laws no government lawyer can preserve the normal attorney-client privilege if the lawyer learns of any evidence indicating a possible violation of federal law. This need to hire a lawyer arises even if the official is not personally a target of the investigation, but merely an incidental witness. This is what happened to President Reagan and Vice President Bush in the Iran-Contra investigation, in which both had to disclose their personal diaries to the Independent Counsel, to President Bush in the Clinton passport investigation, and to President Clinton in the Whitewater investigations. None of them was ever a subject or target of these investigations; they have been merely witnesses. In the Whitewater investigations, I can name perhaps twenty other White House and Treasury officials who have been called to testify on

three to five occasions by the Independent Counsel or a Congressional Committee. Most of them were mere witnesses, but all of them had to retain private counsel and pay legal fees amounting to as much as half of their meager government salaries. The same need to hire a lawyer has been imposed on Cabinet Secretaries Espy and Cisneros and members of their staffs in this Administration, and to Cabinet Secretaries Meese (three times), Donovan, Shultz, Weinberger, Pierce and Baker, CIA Director Casey, and White House aides Donald Regan, Michael Deaver and Lynn Nofziger in the Reagan and Bush administrations.

With these very high personal and financial costs, are there any mothers left who want their children to grow up to run for President or Congress or be appointed to executive office?

When the Philadelphia Convention ended, a journalist asked Benjamin Franklin, who was the most reliable anonymous source of what went on in that secret conclave: "Mr. Franklin, what have we got?" He supposedly answered: "A republic, if we can keep it!" My question to you today is whether we are now in danger of losing our capacity to keep it. Can we still govern this complex, rapidly changing nation, and still lead the rest of the world toward peace, democracy and economic growth, if our growing disdain and vilification of public officials makes us unable to attract the best people among us to devote at least a part of their careers to public service?

I do not know if we can reverse this trend, but there are a few specific measures that might help.

First, we could change the campaign financing laws to discourage negative political commercials. We could provide limited and equal amounts of public financing to all candidates, on condition that they do not raise or spend any other funds. We could extend the radio/television "personal attack" rule, so that any personal attack in a paid political commercial entitled the subject to equal or greater broadcast time to answer the charge, perhaps at the expense of the attacker.

Second, we could compensate incumbent government officials for legal fees incurred to defend themselves, or to appear as witnesses, in any law enforcement proceeding or congressional investigation related to their election, appointment or conduct in office, unless they are convicted of a crime or removed from their posts.

Third, we could amend the Independent Counsel law to allow the Attorney General to subpoena witnesses and use a grand jury during the 90/150 day period before she has to refer a charge to an independent counsel. Without these powers, she has to ask for an independent counsel almost every time a charge is made. Since the public considers this to be tantamount to a verdict of guilty, and since most independent counsels take years to reach their conclusions, the subject of the investigation is effectively crippled throughout his or her term of office.

Fourth, we could change our defamation laws, at least insofar as they apply to election candidates or holders of public office, so as to adopt the English/Canadian rule that the defendant must prove the truth of the charges, rather than requiring, as we now do, that the plaintiff must prove their falsity. Within constitutional limits, we could also narrow the public figure rule, at least where the defendant is also a public political figure.

Given the present disdain for public officials and candidates, it is doubtful whether any of these proposals could be adopted. Even if they were adopted, they would not necessarily reduce the present level of public distrust. That distrust lies deep within ourselves -- in our lifestyles, our anxieties and our personal value systems, especially the values we assign to honor and virtue in me as well as in thee. It may well be that we will not think more highly of those who enter the public service until we think more highly of ourselves.

THE PRESIDENT HAS SEEN
9/18/95

BUSINESS WEEK, Sept. 25, 1995 p. 67
(Best Copy Available)

NANCY — DID THE POTUS see this — LS

Washington Outlook

EDITED BY OWEN ULLMANN

WILL REPUBLICANS MAKE CLINTON THE EDUCATION PRESIDENT?

Education is one of those perennial issues that's wildly popular with voters yet never hits any hot buttons during Presidential campaigns. But 1996 may be the exception.

Congressional Republicans, determined to balance the budget, are targeting virtually every federal education program from Head Start to college aid to the war on drugs in schools. What's more, most GOP Presidential candidates are signing on to the Christian Coalition's crusade to strip Washington of any say over what goes on in the classroom. Topping the group's agenda: closing the Education Dept., providing vouchers for private schools, and allowing school prayer.

But the White House believes the Republicans are handing a winning issue to President Clinton, who's even picking up some support from GOP pals in Corporate America, such as TRW Corp. and United Parcel Service Inc. "The information era and the knowledge-based economy are driven by education," says Education Secretary Richard W. Riley. "It's foolhardy to retreat now."

That has become a prominent campaign mantra for Clinton, who has been on a frenetic journey to classrooms across the country since Labor Day. At a Sept. 11 roundtable with college students in Carbondale, Ill., he railed against the GOP for producing a balanced-budget plan that would "make the American people less well-educated."

INCENTIVES. To drive home the point, the President is enlisting corporate chieftains, who worry that Republican cuts in education will make it difficult to maintain a highly skilled workforce. On Sept. 6, a small group of CEOs met with Clinton and promised to lobby the Senate to maintain $372 million for Goals 2000, a program that provides money to states that raise achievement. States can adopt standards created by federally funded panels or develop their own. But critics argue that the feds should have no role in standards, even voluntary ones, and the House has voted to end the program.

The CEOs—including Joseph T. Gorman of TRW, John E. Pepper of Procter & Gamble, Louis V. Gerstner Jr. of IBM, David R. Whitwam of Whirlpool, and Kent C. Nelson of UPS—helped lobby for passage of the bill last year. Now, they're writing to senators to save it. Gorman says he hopes business can "depoliticize" the issue "and get the facts on the table so that people understand how critically important this really is." Adds Nelson: "Public education is key... to our continued ability to compete."

Under such pressure, Senate Republicans are likely to restore some Goals 2000 funding. But the GOP still thinks the theme of government encroachment plays well on the campaign stump. GOP Presidential hopefuls stepped up the attacks at the Christian Coalition's annual convention Sept. 8-9 in Washington. Vows by Senate Majority Leader Bob Dole and his rivals to shut down the Education Dept. won the loudest applause. They also think calls for vouchers will woo voters who believe tax dollars are funding inferior schools.

The louder the cheering, the better, say Clintonites. They believe harsh GOP rhetoric will lead voters to conclude that Republicans don't care about education. Some proof: polls showing 80% of respondents oppose elimination of the Education Dept. The White House also is betting that most Americans will feel uneasy about GOP ties to the Christian Coalition.

In his fight for more education dollars, Clinton must be careful that he doesn't come off as a defender of the status quo who thinks every problem can be solved with more federal bucks and rules. The public rejected that approach last fall. But when it comes to education, the voters may yet give the President an A and send Republicans to the corner.

-By Susan B. Garland

To Bennett
Bell → right to Bonus Excellence
not $ —

THE WHITE HOUSE

WASHINGTON

September 15, 1995

The Reverend Brian L. Harbour
First Baptist Church
Post Office Box 832427
Richardson, Texas 75083

Dear Brian:

Thanks for your letter of August 15 and for sending the photograph you took in London. I got a kick out of it and appreciate your sharing it with me.

Thanks, too, for letting me know about your upcoming trip to Washington. I'd be delighted to see you when you're here, and I'll have someone from my office call you.

See you soon.

Sincerely,

Bill

cc C Huber
UH

Clinton
PARIS
LONDON

First
Baptist
Church
Richardson, Texas

Brian L. Harbour, Ph.D.
Pastor

August 15, 1995

President Bill Clinton
The White House
Washington, D.C. 20500-2000

Dear President Clinton,

This has been an extremely busy summer for us here in Richardson. Jan and I spent three weeks in England during July. Nine of those days were with our choir and orchestra as we did a mission venture in Yorkshire. The last nine days, Jan and I enjoyed London and the surrounding area. We made it to Bath and Windsor and Oxford and Stratford. It was an exciting trip. Walking down Fleet Street in London, we noticed your name and took a picture.

The pressures of decision making continue on your shoulders unabated. I know the burden is heavy, but you are doing an outstanding job. I pray for your leadership now, and pray that you will be able to give our country four more years of leadership.

Jan and I are going to be in that area in November. I am speaking at a family conference at Ocean Springs, Maryland on November 3-5. We are planning to be in the Washington/Baltimore area from November 6 through November 9. When you were here, you offered an invitation for us to come see you. If it would be possible on ~~November 6, 7, or 8 to visit~~ with you and Hillary, have a meal with you, or even possibly stay in the White House, it would be a memory we would cherish forever. Let us know if this is a possibility.

If there is any way I can help you, please call on me. Hope to see you in November.

Sincerely,

Brian L. Harbour

1001 NORTH CENTRAL EXPRESSWAY • RICHARDSON, TEXAS 75080
P.O. BOX 832427 • RICHARDSON, TEXAS 75083-2427
PHONE (214) 235-5296 • MUSIC OFFICE (214) 235-0059 • FAX (214) 705-2999

We Need to THE PRESIDENT HAS SEEN
9/18/95
We on top of this

THE WASHINGTON POST
SATURDAY, SEPTEMBER 16, 1995

Testers Allege Bias Against Minorities Seeking Homeowners Insurance

By H. Jane Lehman
Special to The Washington Post

Minorities shopping for homeowners insurance continue to encounter significantly more obstacles than whites, according to undercover tests in nine cities conducted by a fair housing advocacy group.

The National Fair Housing Alliance said this week that minority investigators posing as homeowners seeking insurance coverage experienced discrimination more than half of the time where it tested, while whites were most often given the information they were seeking.

"In some markets, discrimination was a virtual statistical certainty," said Charles Kamasaki, senior vice president of the National Council of La Raza, a member organization of the alliance.

He singled out Chicago in particular, where Latino testers ran into problems in more than 95 percent of their attempts to obtain insurance.

Representatives from the three insurance companies that were investigated denied that their firms discriminate and questioned the reliability of the testing.

The release of the three years of testing results by the alliance comes at a critical time for fair housing advocates.

On Wednesday a Senate committee joined the full House in approving legislation that would strip the Department of Housing and Urban Development of its authority to enforce the nation's fair housing laws. It would transfer the responsibilities to the Justice Department, which has handled broad pattern-and-practice discrimination cases while HUD has fielded discrimination complaints lodged by individuals.

The $20.5 billion HUD appropriations bill, which is expected to go to a vote of the full Senate next week, specifically forbids HUD from further involvement in property insurance discrimination matters.

"This would be an unprecedented disruption of ongoing legal proceedings with individuals losing their right to counsel," HUD Secretary Henry Cisneros said this week in opposing the pending changes.

The insurance industry, which is championing the changes, claims HUD is illegally usurping the states' authority to regulate insurance matters.

Leo T. Jordan, a lawyer for State Farm Insurance of Bloomington, Ill., said the firm has a "strong preference for state insurance regulation. It is closer to the people."

Al Orendorff, a spokesman for Allstate Insurance Co., based in Northbrook, Ill., said the insurance industry is "extremely accountable to state regulators, who in turn are extremely accountable to the public. We think state regulation works very well and federal regulation is unnecessary."

Orendorff said Allstate would not be the "largest insurer of Latinos and African Americans in the country if our aim was not to insure them."

The Insurance Information Institute, an industry group, said its members condemn discrimination in insurance coverage matters and have not engaged in such behavior. Recent studies, the trade group said, show that 98 percent of homeowners in urban markets are covered by insurance.

However, Shanna Smith, executive director of the fair housing group, said the testing, partially conducted with $800,000 in HUD funding over 4½ years, found "consistent and clear evidence" of discrimination in the policies and practices of State Farm, Allstate and Nationwide Insurance.

In some instances, repeated phone calls by African Americans and Hispanics posing as property insurance customers went unreturned while those from whites were answered, according to the alliance. Other times, the callers were told their homes were too old, not valuable enough or would have to be physically inspected or measured before an agent could offer a price quote. Some minority shoppers also were informed they would be subject to a credit check. White callers did not encounter similar restrictions or preconditions, the alliance said.

In cases where a minority caller obtained a verbal or written price estimate, the rate often was twice as high as the premium quoted to the white caller and sometimes for less comprehensive coverage, the fair housing group said.

The alliance also said it has obtained copies of underwriting standards used by the three companies that places what it believes are discriminatory restrictions on their best policies. These policies reimburse homeowners in the event of a total loss at the home's re-

See INSURE, E4, Col. 1

INSURE, From E1

placement cost, even if it exceeds the home's market value. Only homes that were 30 years old or newer and worth at least $30,000 to $45,000, or in some cases $100,000, qualified for the best coverage, Smith said.

The insurance companies "have to have known that setting minimum age and value standards is going to have an impact on older African American and Hispanic neighborhoods," Smith said.

The homes selected as the basis for the insurance quotations over the three years of testing were of comparable value, age, size, style and construction.

All of the homes in the test were in middle-class areas, but half were in predominantly minority neighborhoods and the remainder in white neighborhoods.

Voice inflections of the testers, as well as surnames and the phone prefix and address of the property on which an insurance quote was sought all could be used by an insurance agent to make determinations over the phone as to a caller's voice or ethnicity and the neighborhood in which the property was located, Smith said.

The testing, consisting of 20 to 39 matched pairs of undercover shoppers, was carried out in Baltimore, Atlanta, Chicago, Los Angeles, Memphis, Milwaukee, Louisville, Toledo and Akron, Ohio. The Washington area was not part of the study.

Smith rejected the industry's arguments that HUD is operating outside of its jurisdiction, noting that two federal circuit courts have ruled otherwise.

Victor Bolden, assistant counsel with the NAACP Legal Defense and Education Fund, said state regulation of the insurance industry is not enough.

"We must never forget that it was the work of civil rights groups and the federal government which resulted in the vigorous investigation and $16.5 million settlement of the claims of African American homeowners in Milwaukee" against American Family Insurance. "It was not a state agency in Wisconsin which handled this issue," Bolden said.

Toledo resident Deborah Quinn-Lucy said Allstate canceled her insurance after determining her home presented an "unacceptable exposure to loss" because her garage backed up to an alley and because of broken and boarded-over windows in her house, none of which was true.

Quinn-Lucy eventually won a settlement and reinstatement from the company, but not before an unidentified midnight caller threatened her if she pursued her claim. Quinn-Lucy said she believes she was canceled because she is black and her home is located in a predominantly black neighborhood.

Laura W. Murphy, a director with the American Civil Liberties Union, said "people ought to have all the mechanisms [possible] to uphold the Constitution and the Bill of rights. This is the kind of discrimination that rises to that level."

Assistant Attorney General Andrew Fois said the Justice Department opposes the transfer of HUD's fair housing responsibilities to it because the agency is unequipped to handle the nearly 10,000 individual complaints alleging discrimination in home sale transactions, rentals, mortgage lending and property insur-

THE PRESIDENT HAS SEEN
9/18/95

Seminar - Big support
(Broad base in area
favoring good, balanced plan
Sen

Chicago Tribune
Thursday, September 14, 1995

Don't alienate Pakistan

By Howard Hart

It is time to improve U.S. relations with Pakistan. Surprisingly, the Clinton administration, generally so inept in matters foreign, is attempting to do just that. Opposition to the policy changes needed to bring about an improvement comes primarily from the Senate, where concerns over Pakistan's nuclear program prompted the complete cut-off of military sales and aid to Pakistan in 1990. This resulted in a U.S. refusal to deliver $1.2 billion worth of military equipment, including 28 F-16 aircraft, for which the Pakistanis had already paid.

Efforts to limit the proliferation of nuclear weapons are salutary. Like it or not, however, Pakistan has turned the nuclear corner, and the fact is that a continued U.S. refusal to make good on the F-16 deal, and to resume sales of conventional military equipment, is now nothing more than a punitive measure.

The Senate should now approach the issue of U.S. relations with Pakistan by looking at present realities and future possibilities. It is time for creative long-term policy making based on a sophisticated appraisal of the situation in the Middle East and South Asia in general. It's a situation that doesn't give the U.S. the option to be either vindictive or short-sighted.

Pakistan is in deep trouble on many fronts. Its economy is growing more slowly than expected; inflation is rising; employment opportunities are very limited; and the budget deficit is considerably larger than is healthy.

Pakistan's divisive, chaotic (and sometimes deadly) political scene is marked by increasingly serious regional animosity, conflicting interests and political opportunism. Witness Karachi, the country's largest city and only real port: So far this year at least 1,000 people have died violent deaths in that city as a result of political unrest.

All of this is not news about a country that has struggled with the problems of governance and economic development since its creation 48 years ago. What is the new ingredient in this bubbling pot is a growing fundamentalist Islamic nationalism accompanied by anti-Western xenophobia.

While created to be an Islamic state, Pakistan has in many ways operated in a secular (read Western) manner. That is changing—rapidly. The appeal and power of what the West calls resurgent fundamentalist Islam is growing. Many politicians pander to this new type of religious nationalism which, in the end, could completely change the way (and by whom) Pakistan is run.

The Iranian example comes quickly to mind, as do Algeria's present problems and the situation in Egypt.

While most well-educated Pakistanis do not support the drift to a more theocratic state, they constitute only a small minority of the population. As the shah, the Iranian Army and Iran's small

The United States should do what it can to encourage moderation, stability, economic growth and a sense of a continuing, mutually beneficial relationship with the West.

1978-79, the religiously motivated masses can radically alter a society.

That is not the direction the United States should wish to see Pakistan go. The United States should do what it can to encourage moderation, stability, economic growth and a sense of a continuing, mutually beneficial relationship with the West.

Pakistan is a proud and robust country. Pakistanis believe, rightly or wrongly, that India wishes to see Pakistan collapse into a melange of relatively trivial separate states, which India could deal with like Nepal, Bangladesh and Sri Lanka.

Pakistan elected to go the nuclear route after losing its 1971 war with India, an event that was closely followed by the shock of India's exploding its own nuclear devise in 1974. Americans might not like it, but in the wake of these events Pakistan considered a nuclear capability to be its only real guarantee of national survival.

Would an amicable settlement of the F-16 issue and a resumption of U.S. military sales to Pakistan of itself serve to solve the problems of a resurgent Islamic movement? Absolutely not.

But it would be a dramatic gesture, in Pakistan's parochial political environment, demonstrating that Pakistan can work with the West. It would deny critics their most potent argument for disengagement with the U.S. It would significantly bolster the moderate elites. And it just might enable those moderates to channel the raw energies of the burgeoning fundamentalist movement into positive channels.

And yes, India would protest mightily. On the other hand, one suspects that wiser heads in New Delhi would not like to see Pakistan turn into a radical fundamentalist Islamic state.

Pakistan is the most powerful Muslim country in the world. It has excellent relationships with its near neighbors, Saudi Arabia and the small Gulf states. U.S. interests in both South Asia and the Middle East would be well-served by restoring a sensible working relationship with Pakistan. It is time for positive, creative movement in the Congress, where a little foresight now may pay great dividends later.

Howard Hart is a former U.S. State Department

South Dakota

THE PRESIDENT HAS SEEN
9/18/95

U.S. Senator
Washington, D.C.

FYI

September 6, 1995

As you may know, I am the author of the Pressler Amendment, a federal law that prohibits the United States from providing foreign aid or military assistance to Pakistan, if it possesses a nuclear explosive device. This crucial element of American nuclear policy is under attack. I need your help to preserve the Pressler Amendment.

The Clinton Administration and others are doing all they can to work around the Pressler Amendment. They want to provide military equipment to Pakistan which would enable them to upgrade their ability to deliver nuclear weapons. This is wrong. I hope you agree we must not allow those efforts to succeed.

That is why I need your advice and support. I need your help in blocking efforts to weaken or repeal my amendment. If we don't stop the ongoing multi-million dollar Pakistani lobbying effort, the risk of nuclear confrontations in South Asia could become a tragic reality. We must preserve the Pressler Amendment.

In addition to my fight to help India and other nations that oppose the proliferation of nuclear weapons, I have been involved in other key issues in the U.S. Senate. I thought you might wish to be brought up to date on some of these items.

As Chairman of the U.S. Senate Commerce, Science and Transportation Committee, I have been deeply involved in legislation to reform our nation's telecommunications and liability laws. Already this year, the Senate has passed my bills to reform our tort system-limiting frivolous lawsuits-and introducing more competition into the telephone, television, cable and computer services. This will lower rates and clear the way for a technological explosion-more and better jobs for our children and grandchildren.

Paid for by Friends of Larry Pressler

On the Senate Finance Committee, I am working to reduce taxes and to eliminate the deficit. I am proud to have been part of the historic budget agreement that will eliminate the deficit, preserve Medicare, lower taxes and protect Social Security. A balanced federal budget will result in new jobs and lower interest rates. This will be good medicine for our economy!

I know that you have an interest in Medicare and Medicaid programs. The budget plan, which I supported, preserves these essential programs. We do this by slowing the Medicare growth rate and by reducing paperwork and other burdensome federal regulations. It is essential that we do not restrict the ability of an individual to select a physician of his or her choice.

I would deeply appreciate your contribution of $250, $500 or whatever you can afford, to my campaign committee, Friends of Larry Pressler. I face a difficult re-election battle next year, and I expect to have an opponent whose voting record is dramatically different than mine.

With your help we can reduce military tensions in South Asia, eliminate excessive federal regulations of the health care industry and expand U.S. trade with India and other nations.

Thank you for supporting my efforts here in the U.S. Senate. Be sure to let me know your thoughts on any specific issue of concern to you. I look forward to hearing from you.

Sincerely,

Larry

Larry Pressler
United States Senator

P.S. Your generous campaign contribution will help us stop nuclear proliferation in South Asia.

Paid for by Friends of Larry Pressler

housing subcommittee, is aimed at reining in skyrocketing federal housing costs while preserving incentives for landlords to continue offering affordable rents to low-income families.

Bond, a former governor of Missouri, has repeatedly warned that housing outlays, which have grown from $5.5 billion in 1980 to $23.7 billion in 1994, must be brought under control now or more abrupt cutbacks later will have a "devastating" impact on low-income tenants.

But Senate aides said yesterday that changing the current system inevitably involves up-front costs.

That is essentially the problem Bond ran into this week, when the CBO, Congress's budget analyst, informed him his plan would result in $590 million in cash outlays in 1996 not allowed under his subcommittee's budget allocation.

Most of the cash would go as payments to owners of older units built with extremely low-interest, subsi-

lords, HUD prefers freeing them to sell their units and giving displaced

concerns that both committees will claim the same economy.

Judge Prohibits Extraditions by U.S.

State Department Voices Concern About Impact on Foreign Policy

By Toni Locy
Washington Post Staff Writer

A federal judge yesterday prohibited the United States from extraditing anyone—fugitives from other nations or U.S. citizens—to foreign countries, rejecting arguments by the State Department that the ruling would have serious effects on foreign policy.

U.S. District Judge Royce C. Lamberth issued the injunction after deciding to certify as a class all people against whom the U.S. government has sought or will seek extradition. The judge said the State Department can initiate legal extradition proceedings but cannot physically turn anyone over to a foreign government.

Lamberth's decision had an immediate impact on a case in Florida involving Carlos Remo Manrique Carreno, who is wanted in Peru for allegedly defrauding 160,000 people of $350 million. The judge said Carreno cannot be turned over to Peru.

It is unclear how many other fugitives could be affected by Lamberth's order. Lawyers involved in the case said the number could range from 50 to 250. Justice Department lawyers said they do not know how many people could be affected.

The State Department's legal bureau has refused to give other State Department divisions any statistics on the number of pending cases or the names of any individuals whose extradition is pending.

Last month, Lamberth found the 150-year-old federal extradition statute unconstitutional because it violates the separation of powers principle by allowing the secretary of state to review legal decisions by judges.

The judge also found that the federal extradition law improperly allows the secretary of state to hide the true motives for extradition decisions—politics or foreign policy considerations—by blaming judges and the law when it suits the secretary's purposes.

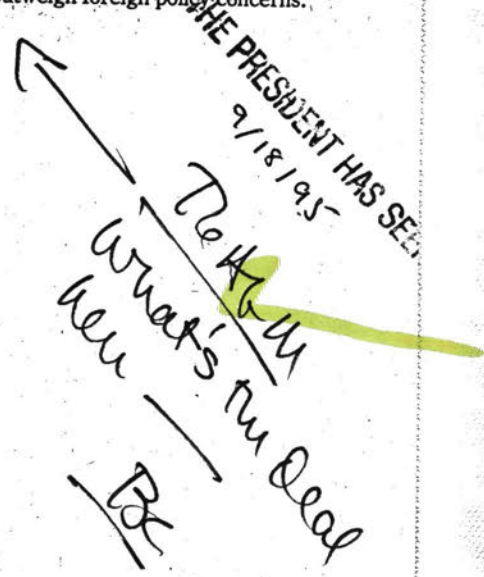
Richard Brown, an attorney for the Justice Department, which is representing the State Department in the case, said, "I expect that the department will seek review of this matter."

The Justice Department lawyers already have filed an appeal of Lamberth's original order of last month. Lamberth refused to issue a stay pending appeal of yesterday's broader injunction.

The case originally was brought by lawyers representing two off-duty Chicago police officers accused of kidnapping by Canadian authorities.

The two officers, Anthony Lobue, who has retired, and Thomas Kulekowski, who has been suspended from the force, allegedly agreed to help another man bring his mentally and physically impaired wife back to the United States to prepare for a lawsuit the couple had filed. The officers went to Canada to get her but were stopped at the border and not allowed to bring her into the United States.

Attorney Gregory B. Craig asked Lamberth to broaden his original order, which applied only to the two Chicago officers. Then, Lamberth had refused to certify a class. Yesterday, he concluded that constitutional rights of people facing extradition far outweigh foreign policy concerns.



THE PRESIDENT HAS SEEN
9/18/95

THE WHITE HOUSE

WASHINGTON

September 16, 1995

MR. PRESIDENT:

Attached are the following weekly information items:

(A) Weekly Economic Briefing.

(B) Interest rates and stock market.
Week ending September 15, 1995

(C) Cabinet Report.

(D) CEQ Weekly Report.

Phil

Phil Caplan

THE PRESIDENT HAS SEEN
9/18/95

THE WHITE HOUSE

WASHINGTON

95 SEP 15 P9:12

September 15, 1995

MEMORANDUM FOR THE PRESIDENT

FROM: **KITTY HIGGINS**

SUBJECT: **Summary of Cabinet Weekly Reports**
September 11-15, 1995

Budget Amplification: Approximately 60 members of the Cabinet and Sub-Cabinet participated in 90 events throughout the country promoting your education budget message. Next week will be an equally busy week with the Cabinet focusing on education and Medicare.

DEPARTMENT OF TREASURY

- **Secretary Rubin's Activities:** On Monday, Secretary Rubin will participate in an EITC event at the National Press Club, and do radio interviews on the EITC. On Tuesday, Sec. Rubin will address the North Carolina Chamber of Commerce Washington Issues Seminar. He will meet with Abe Rosenthal of the Wall Street Journal, and appear on NPR's "Talk of the Nation" radio show. He will also meet with Mexican Finance Minister Ortiz.

  On Thursday Sec. Rubin will meet with Chairman Greenspan and travel to Miami to address the "Spirit of Excellence" dinner hosted by the Miami Herald. On Friday, he will participate in a Medicare event, and address the Banker's Roundtable in Florida.

DEPARTMENT OF JUSTICE

- **Detroit Newspapers:** As a result of the antitrust investigation being initiated by the Justice Department, the Detroit newspapers will begin publishing in the near future. Associate Attorney General John Schmidt spoke to Tom Donahue this past week.

- **Brady Act Upheld:** Mact v. United States, (9th Cir.; D. Ariz.); Printz v. United States, (9th Cir.; D. Mont.). This is the first appellate decision to address the constitutionality of the Brady Handgun Control Act.

- **KS Three Strikes Defendant Sentenced to Life:** The first defendant in Kansas, and the second in the country to be sentenced under the "three strikes" provision of the Crime Bill has been sentenced to life in federal prison. Robert Lee Willis, 43, Kansas City, Missouri, was sentenced on September 11, 1995. This was the "fifth serious violent felony" conviction for Willis.

- **Border Fence to be Built in New Mexico:** On September 11, INS Commissioner Meissner announced the Service's decision to build a border fence west of El Paso, Texas, in response to recent dramatic increases in banditry, smuggling, and violent crime in the area. Fence construction is supported by the Mexican Government, which has pledged its own enhanced enforcement measures aginst border crime in the area.

- **Joint Hearings On Affirmative Action:** On September 22, the House Judiciary Constitution Subcommittee and the Senate Judiciary Federalism and Property Rights Subcommittee will hold a hearing on affirmative action, with a focus on the impact of the Adarand v. Peña decision. Assistant Attorney General Deval Patrick has been invited to testify.

- **Court Grants Preliminary Injunction in Yakama Nation Case:** On September 7, 1995, in confederated Tribes of the Yakama Nation v. Baldrige, (W.D.Wash.), the district court entered a preliminary injunction that prohibits the State of Alaska from continuing any further commercial salmon fishing off the Alaska coast for the balance of this year's accounting season. Alaska has filed a notice of appeal and stated its intent to seek a stay from the 9th Circuit.

- **FBI Lab:** FBI issued a press release this week stating that they have investigated concerns about forensic protocols and procedures employed in the FBI Laboratory. The FBI alone has reviewed more than 250 cases involving work previously done by the Lab. To date, the FBI has found no evidence tampering, evidence fabrication or failure to report exculpatory evidence. In addition, the Justice Inspector General's office is conducting an investigation.

DEPARTMENT OF THE INTERIOR

- **Grazing Update:** The Department of the Interior is proceeding with the implementation of the new grazing regulations. Next week, Secretary Babbitt will be attending the first meeting of the Arizona Resource Area Councils and RAC meetings are also being held simultaneously in seven other states. The meetings will begin the process of developing regional standards and guidelines. Part of the meeting will be a

teleconference with all the RAC meetings being held throughout the West. Congressional action is also proceeding. On Tuesday, the House Resource Subcommittee on National Parks, Forests and Lands approved Rep. Cooley's Livestock Grazing Act with a vote along party lines. This bill is similar to the bill passed by the Senate Energy and Natural Resources Committee last July. The Subcommitteedefeated an alternative bill by Rep. Bill Richardson who throughout the hearing effectively articulated the Administration position. The Subcommittee did adopt an amendment by Richardson that would prevent grazing permittees from obstructing access for hunting and fishing. The Department of the Interior continues to oppose the grazing legislation and does not believe it will be passed in its present form.

- **National Park Service Update:** National Park Service Director Roger Kennedy has met with key Members on the National Park Service (NPS). As a result of the meetings: Senator Johnston agreed to oppose and filibuster any attempts to establish a "park closing commission;" Representatives Kasich, Kolbe and Regula supported the Interior Department's versions of fees and concessions bills; Senator Murkowski came closer to the Department's version of the fees and concessions bills.

- **Recent Court Rulings:** On September 13, 1995, Justice Sandra Day O'Connor issued a stay of the August 14 order of the U.S. District Court for the Central District of California requiring the Fish and Wildlife Service to make a final decision on listing the California red-legged frog as an endangered species by September 15.

  On September 12, U.S. District Court Judge Sporkin overturned a U.S. Court of Appeals ruling and said that the National Park Service's new sales regulation for the National Capital Area banning the sale of message-bearing T-shirts violated the First Amendment. The Department of the Interior is working with the Department of Justice to pursue an appeal.

  Wednesday, U.S. District Court Judge Hogan overturned the Administration's interpretation of the 1995 Recissions Act. He ruled that timber sales must proceed on thousands of acres of forest in the Pacific Northwest previously set aside to protect wildlife and water quality. If upheld, the ruling would allow an additional 170 million board-feet to be harvested, including old-growth. The Interior Department along with Justice and Agriculture is discussing the appeal strategy.

- **Endangered Species Act Hearing:** The House Natural Resources Committee will hold a hearing next Thursday on the Endangered Species Conservation and Management Act. George Frampton, Assistant Secretary for Fish and Wildlife and Parks will be testifying for the Department of the Interior. The Assistant Secretary's testimony will point out the problems with the bill, H.R. 2275, and indicate that the Administration cannot support the bill as currently written. The Assistant Secretary will also praise the proposal of the Western Governor's Association on this issue.

DEPARTMENT OF AGRICULTURE

- **Long Island Fires:** The Department of Agriculture in coordination with the Forest Service is preparing a report on their response to the Long Island Fires. They will deliver that report to the White House by the end of next week.

- **Appropriations Update:** The full Senate Appropriations Committee approved the proposed FY96 Appropriations Bill for USDA. The Senate bill is an improvement of its House counterpart because it provides funds above the House level for a number of critical Administration priorities: rural development, meat and poultry inspection and school nutrition. Funds for these initiatives are obtained through savings connected with proposals to limit the Export Enhancement Program, the new Wetlands Reserve Program, and the Conservation Reserve Program.

  There is a serious issue related to proposals by Senator Stevens to prohibit funding for the USDA Under Secretary for Natural Resources and Environment (Jim Lyons). This proposal was not adopted by the full Appropriations Committee, but is likely to be pursued on the Senate Floor.

- **USDA Holds Public Meetings On Food Safety Reform:** USDA is holding a series of public meetings to discuss significant issues raised by the Pathogen Reduction/Hazard Analysis and Critical Control Points (HACCP) proposed rule to reform the meat and poultry inspection system. Three meetings will occur this week, as well as three additional meetings the week of September 25. Meetings have been well-attended by industry, consumer, and employee organizations, and have generated good discussions about the reform proposals.

- **Administration Position Announced On U.S.-Canada Grains Issues:** On September 12, USDA and the Office of the U.S. Trade Representative announced the Administration's position regarding U.S.-Canada grains issues in light of the expiration of the U.S.-Canada Memorandum of Understanding on Grains. The Administration reiterated its position that it will not accept market disruptions from imports of Canadian wheat. The United States will also monitor exports of Canadian grains to the United States closely through September 11, 1996, and will consult with the Canadian government to discuss potential problems before imports from Canada reach disruptive levels.

- **National Service/AmeriCorps Update:** The USDA Forest Service faces greatly reduced funding under language currently in the House Interior Appropriations bill, which would prohibit the agency from working with AmeriCorps projects of any type. The Senate Interior Appropriations bill would allow the Forest Service to continue working with, but would not

provide any funding for AmeriCorps projects.

- **Pacific Northwest Economic Adjustment Initiative/Forest Plan:** Linn County, Oregon has been awarded a USDA Forest Service grant for $149,250 for Tourism Coalition Community Action projects, and the state's Port of Bandon has been awarded a $170,000 grant through the Forest Service's Rural Community Assistance program. These grants were made through the Pacific Northwest Economic Adjustment Initiative. The initiative brings together several federal, state, and local entities to fund projects that are community priorities.

  On September 8, the USDA Siskiyou National Forest (Oregon) Supervisor announced the temporary immediate closure of the Sugarloaf Timber Sale area. Boise-Cascade has begun harvest operations in this area. The sale has been controversial because it involves old-growth logging. Over 20 protesters were arrested since harvest operations began and the Forest Service has found evidence of tree spiking and changing markings on trees slated for harvest.

- **New England Threatened By Potential Fires:** New England is currently experiencing extremely dry conditions, and fire danger in most Northeastern states is high to extreme. The USDA Forest Service and Department of the Interior's National Park Service have prepositioned firefighting resources in Manchester, New Hampshire in the event of wildfires.

- **Crop Outlook:** On September 11-12, official USDA supply, demand, and price forecasts for 1995/96 crop markets were revised. The September crop production survey indicated that hot weather during August and increased pest and disease problems are reducing crop production prospects. The 1995 corn crop is 22 percent below last year. The average corn price is now forecast 13-31 percent above a year ago. Wheat production was also reduced and the wheat price raised 13 to 22 percent above a year ago. Wheat and corn supplies are the tightest in several decades. The hot weather reduced cotton crop prospects, but a record-large crop is still expected, with continued strong prices and adequate stocks.

  Most of the eastern United States continues to suffer from drought conditions, with extremely dry conditions in the northeast states, especially New York, which is suffering the worst drought in 20 years. USDA reports that agricultural losses due to drought in the Northeast are estimated to be close to $6 million.

DEPARTMENT OF COMMERCE

- **Secretary Brown's Travel Schedule:** Friday, Secretary Brown traveled to

Boston for an insurance industry roundtable, then to Rhode Island for an event with Representative Patrick Kennedy. On Monday, September 18, he travels to Detroit to address the Detroit Economic Club, award an Advanced Technology Program (ATP) grant to a local company and to host a National Export Strategy Roundtable. Tuesday, he will be in Toledo to open a District Export Assistance Center, tour Commerce's Manufacturing Extension Partnership and meet with local manufacturers. On Friday he travels to Philadelphia to open the U.S. Export Assistance Center.

- **The Census Bureau will release the following:** Manufacturing and Trade: Inventories and Sales for July 1995 (9/18); Housing Starts and Building Permits for August 1995 (9/19); Investment Plans Survey for 1995 (revised) (9/22).

- **State Log Exports:** Commerce's Bureau of Export Administration (BXA) is drafting an order for the secretary's signature which would establish the level of timber from state lands in Washington subject to export restriction after January 1, 1996. According to Commerce, this order could be quite controversial with environmentalists seeking a low timber cutting cap and timber interests seeking a high cap. Commerce is required to sign the order prior to September 30.

- **Selection of the Conference Board:** Last Thursday Secretary Brown held a press conference along with Under Secretary for Economic Affairs Everett Ehrlich to announce the selection of The Conference Board as the private sector steward to continue the collection and publication of the Cyclical Indicator Series, most notably the Leading Economic Indicators. This is a prime example of a successful government reinvention effort, freeing up nearly a half-million dollars to fund more pressing projects. A substantial amount of media attended, including the Wall Street Journal, New York Times, and the major wire services, and they received considerable positive press accounts.

DEPARTMENT OF LABOR

School-to-Work Grant Announcements: The second year of state School-to-Work grants will be announced on Tuesday, September 19. Amounts are currently being finalized, but grants are slated to be made to the following states: Alaska, Arizona, Colorado, Florida, Hawaii, Idaho, Indiana, Maryland, Nebraska, New Hampshire, North Carolina, Ohio, Oklahoma, Pennsylvania, Vermont, Washington, and West Virginia. Secretary Riley andSecretary Reich will each do satellite press feeds into several of these states to announce the grant awards.

- **International Child Labor Study and Press Conference:** Secretary Reich will

join Senator Tom Harkin in a press conference on Wednesday, September 20, in a press conference to announce the release of DOL's International Labor Affairs Bureau's (ILAB) 2nd Congressionally-mandated child labor report, "*By the Sweat and Toil of Children (Volume II): The Use of Child Labor in U.S. Agricultural Imports & Forced and Bonded Child Labor.*"

- **Speech Before the American Business Council:** On Wednesday, September 20, Secretary Reich will deliver remarks before the American Business Council. Approximately 55-60 corporate CEOs will attend.

- **Retiree Health Benefits Press Conference:** Next week, possibly September 21, Sec. Reich will hold a press conference to release a CPS report showing that the percentage of retirees currently receiving health benefits from their prior employer declined from 44% in 1988 to 34% in 1994. Senator Daschle (D-SD) and Representative Gephardt (D-MO) have been invited to participate in the press conference.

- **Garment Retailers Summit:** Secretary Reich was joined by 21 retailers and two retail associations at a Garment Retailers Summit on Tuesday, September 12 at New York's Fashion Institute of Technology. This summit was a follow-up to the well-publicized August 2 raid conducted by federal and state investigators in El Monte, California. During this raid officials discovered more than 70 workers forced to work up to 16 hours a day for as little as 70 cents per hour. This summit brought together DOL officials and retailers from around the country to find ways to protect workers and consumers from the abusive practices of production contractors in the garment industry. After the summit, Sec. Reich had a roundtable discussion organized by the garment workers' union UNITE with workers who discussed garment sweatshop conditions.

DEPARTMENT OF HEALTH AND HUMAN SERVICES

- **Department May Approve Waiver for Illinois in the Next Few Weeks:** The Illinois proposal, called the School Attendance Demonstration, is statewide and requires caretakers to participate in a plan to improve poor elementary school attendance. Failure to improve poor attendance would result in the establishment of a protective payee and the removal of the caretaker's portion of the AFDC grant.

- **Department to Issue Report to Congress on Out-of-Wedlock Births:** The Violent Crime Control and Law Enforcement Act of 1994 requires the Secretary, in conjunction with the National Center for Health Statistics (NCHS), to prepare an analysis of the increases in out-of-wedlock births,

provide comparative data from foreign nations, and identify potential causes, antecedents, and remedial measures. The report stresses that out-of-wedlock childbearing has increased steadily for the last several decades among women of all reproductive ages, all racial and ethnic backgrounds, all socioeconomic levels, in urban as well as non-urban areas, and in almost all industrialized countries. The one encouraging note is that from 1991-1993 rates of unmarried births have leveled off. However, 31% of all children in the United States are born out-of-wedlock.

- **1996 Medicare Announcements:** HCFA will announce, before the October 1 deadline, the 1996 Medicare Part A inpatient hospital deductible and coinsurance, the Part B monthly premium rate, and the Part A monthly premium for the uninsured aged. Each of these rates is determined by statutory formula.

  The 1996 Part B rate of $42.50 will be a reduction of $3.60 from the $46.10 premium rate for 1995. The reduction is a result of a change in methodology (mandated by the Omnibus Budget Reconciliation Act of 1993), but not policy, in determining the premium. Congressional Republicans are currently considering a proposal that would increase the premium level to 31% (from 25%). Republicans estimate that the proposal would save an estimated $60 billion over 7 years, but it has not been scored by the Congressional Budget Office. In the middle of the budget debate it may appear strange that the Part B premium goes down. We are required by law to publish this number in the Federal Register; however, we believe it is not advisable to publicize this decrease unnecessarily. Chris Jennings has spoken to HCFA Administrator Bruce Vladeck, who concurs.

  The new Part A deductible for a hospital stay will be $736 (up from $716 in 1995); the new daily coinsurance amounts will be $184 for the 61st through 90th days of hospitalization in a benefit period (up from $179 in 1995); $368 for lifetime reserve days (up from $358 in 1995); and $92 for the 21st through 100th days of extended care services in a skilled nursing facility (up from $89.50 in 1995).

  The 1996 monthly Part A premium of $289 (up from $261 in 1995) for certain uninsured individuals and the reduced Part A premium will be $188 (up from $183 in 1995).

- **Breast Implant Protest:** The National Breast Implant Task Force (an outside activist group) has notified FDA that on Monday, September 18, more than 1,000 women from across the nation who have experienced breast implant problems will rally in front of the Capitol.

- **HHS Reports on Barriers to Health Care in the Elderly:** As early as next week, Secretary Shalala will issue a report to Congress showing that the low-income elderly face greater barriers to care than older Americans with higher incomes, despite almost universal Medicare coverage for individuals over 65.

- **Research Conference on Genetics and Criminal Behavior:** On Sept. 22-24, a conference will be held to discuss the scientific, ethical, and political implications of research on the genetics of criminal behavior. This conference, which is partially supported by the National Center for Human Genome Research, was originally organized for 1992 but was canceled amidst criticism from the Congressional Black Caucus and other groups.

- **Press Conference on Breast Cancer Gene:** On Sept. 28, NIH will convene a press conference to announce results of a follow-up study on the breast cancer gene, BRCA1. Working with colleagues in Israel, National Cancer Institute and Human Genome researchers have found a linkage that may affect Jewish people of Eastern European descent.

- **Teen Births in 1993 Down; Teen Pregnancy in 1991-2 Down:** CDC data to be released next week will show that teen births and teen pregnancy rates declined in the above years in most states. This data shows that after increasing steadily between 1986 and 1991, the birth rate for teenagers 15-17 years old was unchanged in 1993; the birth rate for older teens was down 3 percent in 1993. Still, the 1993 teen birth rate was higher than it was 20 years ago. Pregnancy rates for teens declined in 31 of 41 reporting states and the District of Columbia from 1991 to 1992. ~~These decreases in teen pregnancy~~ are reflected in a decline of both abortion and birth rates~~, with greater declines~~ noted in the abortion rates.

- **Syringe Exchange Programs (SEPs) in the United States:** According to a preliminary draft of a CDC article the number of SEPs operating in the U.S. in 1994 has increased more than 80 percent over 1993 levels. The number of actual syringes exchanged through these programs has increased three-fold since 1992. The seven most active programs are in New York City (2), Chicago, Philadelphia, San Francisco, Seattle and Tacoma. It does not appear that the article makes any claims about SEP's effect on the transmission of the HIV virus.

- **FDA Issues Thalidomide Warning Letters to Buyers' Clubs:** After several months of communications with AIDS buyers' clubs about the serious risks associated with the uncontrolled use of thalidomide, FDA recently sent letters to three of the organizations warning them to stop illegal sale of the drug. Thalidomide, which has never been approved for general use in the United States, has been used in clinical trials to treat Hansen's Disease (leprosy) and

several other conditions. The drug poses potential adverse effects on fetal development and on an individual patient's nervous and immune systems; use of thalidomide requires appropriate medical supervision and informed consent, which are not usually available outside carefully monitored clinical trials. (However, FDA allows AIDS patients with aphthous ulcers to obtain the drug through their doctors by means of a single-patient investigational new drug application. In addition, as was reported last week, the FDA has recently given approval for an expanded access program to determine if the drug is effective for AIDS-related wasting and weight loss.) The buyers' clubs have reportedly been buying thalidomide from a Brazilian source. FDA has received a letter of criticism from AIDS activists in California in response to the buyers' club warning letters. **(This is an issue that you had questions about in last week's weekly report.)**

- **Informed Consent Requirements:** Next week, the FDA will publish a proposed rule to amend its current informed consent regulations to permit harmonization of FDA and NIH policies on emergency research. The regulations provides a narrow exception to the requirement for obtaining and documenting informed consent from each human subject prior to initiation of an experimental treatment. FDA is proposing this action in response to growing concerns that current rules are making high quality acute care research activities difficult or impossible to carry out at a time when the need for such research is increasingly recognized. FDA and NIH developed this policy because of concerns expressed by the research community and patient advocacy groups that emergency research is at a virtual halt pending a revision of both FDA's informed consent regulations and a waiver of the HHS regulations for the protection of research subjects. **(This is an issue that you had questions about in last week's weekly report.)**

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

- **Chicago Housing Authority Update:** Demolition of Cabrini Green -- The Department of Housing and Urban Development is on schedule to tear down two buildings at Cabrini Green by the end of the month. Conversations are taking place on the possibility of the Vice President participating in the demolition event with Mayor Daley.

- **Two-Day City Symposium:** Next week, September 20-21, Secretary Cisneros will host a symposium which will enable Administration officials, mayors, Members of Congress, industry leaders, renowned urban thinkers, academics, and opinion molders to discuss, in a bipartisan and candid spirit, the future of our cities.

DEPARTMENT OF TRANSPORTATION

- **Chicago Air Route Traffic Control Center (ARTCC) Outage:** On Tuesday, September 11, at 10 P.M. CDT, the Chicago ARTCC experienced a Desplay Channel Complex (DCC) problem. Technicians scheduled an equipment shutdown to diagnose an interface problem in the DCC, and air traffic operations were transferred to backup systems. There were 35 delays, and one operational error is known to have occurred during this event. Federal Aviation Administrator Hinson held a press briefing in Chicago on September 14 to discuss this and other outages. In a related matter, the Blue Ribbon panel that I convened to address this issue made its first site visit this week. The final report is scheduled to be completed by November 8. [Note: Leon Panetta has convened a meeting on Tuesday to discuss the FAA and plans to address all the problems currently plaguing this agency. Several press stories are in the works.]

- **Implementation of Increased Security Measures in the United States:** Industry preparations to implement additional aviation security measures at AVSEC Level III are proceeding well. Most air carriers and airports report they can perform the additional measures. The most difficult to implement are the anti-car bomb measures at airports and the limited passenger-bag match measures that air carriers must carry out for a small proportion of passengers. The FAA continues to work with the industry to ensure the measures will be properly implemented on short notice.

- **Alert for Members of "Yousef Conspiracy" Still At Large:** On September 11, the FAA issued a security directive applicable to foreign locations where U.S. air carriers perform extraordinary security measures. It requires additional searches of passengers whose names match those of suspects in the Yousef (Asia-Pacific) conspiracy (and their aliases).

- **$8 Million Grant to MetroLink:** Illinois Democratic Congressmen Costello and Durbin are scheduled to join Federal Transit Administrator Linton for the September 18 announcement of an $8 million grant for the preliminary engineering phase of an extension of the MetroLink light rail project in St. Clair County, Illinois. White House staff is considering whether you should put out a statement regarding this grant.

- **U.S. - U.K.:** Talks on the second-phase United Kingdom-liberalization issues (limited Heathrow/Gatwick access, cargo, charters, pricing liberalization and Fly-America) resumed in London on September 11.

- **U.S. - India:** No dates have been scheduled for future negotiations.

- **U.S. - Hong Kong:** U.S. authorities have confirmed to Hong Kong that we are prepared to try to close on a new agreement on U.S. - Hong Kong services, separate from the U.S. - U.K. Air Services Agreement. Talks are scheduled for the week of September 25, in Hong Kong.

- **U.S. - Japan:** The first round of broad-scale cargo talks are scheduled to take place in Tokyo September 26-28, 1995. The two countries agreed to enter into cargo talks following the resolution in July of the Federal Express issue, which involved FedEx's request to operate several new routes via Japan to Subic Bay, Philippines. The two sides intend to complete the cargo talks by March.

- **Federal Aviation Administration (FAA) Reform:** Administrator Hinson and Secretary Pena participated in a press conference with Senators McCain (R-AZ) and Ford (D-KY) on September 12 to advocate a bill to transform fundamental aspects of the FAA without making it an independent agency. The Senate proposal would accomplish many objectives of the National Performance Review, providing the FAA with freedoms from the standard federal procurement, personnel, and budgeting requirements that interfere with the efficient provision of air traffic services. User fees are a fundamental element of the financing structure. The Secretary acknowledged that the Administration is no longer pursuing our proposal for a government corporation to run air traffic control, but noted that this administration has sought reform for the last two years and the Congress has responded to the goals we laid out.

- **The National Highway (NHS) -- Full Committee Markup:** On Thursday, September 7, the House Transportation and Infrastructure Subcommittee on Surface Transportation met to mark up the NHS legislation. Several controversial provisions were adopted, including repeal of the motorcyle helmet law and the national speed limit. The bill also takes the highway trust fund off-budget.

- **Amtrak Reauthorization Legislation:** Amtrak unions have expressed concern that the House Transportation and Infrastructure Committees draft reauthorization bill, which eliminates the existing labor protection afforded Amtrak employees (effective 254 days after enactment), may affect the labor protection accorded freight railroad employees. The Federal Railroad Administration's Chief Counsel preliminarily has concluded that freight railroad employees would not be affected adversely by the House bill.

- **Automobile Content Labeling:** On September 15, the National Highway Traffic Safety Administration (NHTSA) will publish a final rule, in response to petitions for reconsideration of the agency's final rule implementing the American Automobile Labeling Act. That Act requires passenger cars and

other light vehicles to be labeled with information about their domestic and foreign content. In response to the petitions, NHTSA made several changes to its implementing regulations. These changes will reduce the burdens on the manufacturers associated with making content calculations and will result in more accurate information.

- **Chrysler Minivan Latch Liftgate Owner Notification:** On September 8, Chrysler Corporation began notifying owners of 1984-1995 model minivans that they can take their vehicles to a dealer to have stronger, safer liftgate latches installed. Chrysler's action will be completed in December and is being taken in response to a defect investigation conducted by NHSTA. Press interest is significant.

- **Indianapolis to Privatize Airport to Cut Costs:** Indianapolis International Airport will become the biggest U.S. airport under entirely private management with a contract signed Tuesday between its governing authority and a British company. The Indianapolis Airport Authority said the agreement with BAA USA, Inc., should save it $100 million over the 10-year contract because of more efficient management and new sources of income.

DEPARTMENT OF ENERGY

- **39th Regular Session of the General Conference of the International Atomic Energy Agency (IAEA):** Secretary O'Leary will also lead the U.S. delegation to the 39th Regular Session of the General Conference of the International Atomic Energy Agency (IAEA) in Vienna.

- **Russians to Demonstrate Improved Security for Nuclear Materials:** Several tons of nuclear weapons materials -- enough to build hundreds of nuclear bombs -- are now better protected as a result of a cooperative project between DOE's National Laboratories and a major nuclear research institute in Russia. The results of the project will be demonstrated next week (September 21) at the Institute of Physics and Power Engineering in Obninsk, 70 miles from Moscow. DOE labs have been working with the Institute at Obninsk since last winter to install new security procedures designed to "bottle up" tons of plutonium and highly enriched uranium at the research facility. With these new systems in place, the risk of these materials falling into the hands of terrorists or unfriendly counties has been reduced dramatically.

DEPARTMENT OF EDUCATION

- **FY 1996 Appropriations:** The Senate Appropriations Subcommittee marked up the Department's 1996 appropriations legislation on September 13. The Subcommittee bill would provide $28.6 billion for the Department over the next year -- an increase over the House bill of $1.5 billion, but a drop of $2.2 billion from the 1995 level and $3.8 billion from the President's request.

- **Department Shutdown:** In response to OMB's request, the Department of Education has prepared a draft plan for shutting down operations in the event of a lapse in appropriations. The Direct Loans expenses are covered by a permanent appropriation, and the National Institute for Literacy has a multiyear account, so staff members from these two programs will continue working. Other than that, only the 16 Presidential appointees and one assistant for each will continue working during a shutdown.

- **Hispanic Drop-Out Project:** Secretary Riley will hold a press conference September 18, with Senator Jeff Bingaman, to announce the Department of Education's new effort to examine the issue of the high drop-out rate among Hispanics.

- **New Hampshire Trip:** At the request of the White House, Secretary Riley will speak at the Manchester High School Anniversary Banquet on September 23. While in New Hampshire he will also attend a reception sponsored by the Hillsboro Democrats in Merrimack, and will be interviewed by WMUR-TV in Manchester.

- **Budget Reconciliation:** The House Economic and Educational Opportunities committee plans to mark up the budget reconciliation package during the week of Septmeber 18. The Committee is expected to recommend eliminating or capping the Direct Loans program, as well as reducing Federal Family Education Loan subsidies for lenders and implementing other measures that will affect guarantors, secondary markets, parents, and students. The full House is expected to consider the budget reconciliation legislation during the week of September 25. On September 20, the Senate Labor and Human Resources Committee is scheduled to mark up its budget reconciliation recommendations.

DEPARTMENT OF VETERAN AFFAIRS

- **Hearings and Mark-ups -- Week of September 10-16, 1995:** The Senate Appropriations Committee's recommendation's for the Department of Veteran Affairs Medical Care is $511 million below the requested level and $327 million below the House-passed amount. This would result in a reduction of 6,500 health-care FTE and denial of care to 113,000 patients -- the equivalent to

closing four VA medical centers. MAMOE, which funds the Veterans Health Administration's Washington headquarters, was reduced $8.66 million (12%) from the requested level, the same as in the House-passed bill.

ENVIRONMENTAL PROTECTION AGENCY

- **Regulatory Reinvention:** The Environmental Protection Agency issued a new policy this week which will allow its inspectors to reduce the frequency of their inspections at waste water discharging facilities which have good compliance records and which are handling lower risk materials. This policy targets inspection and enforcement resources on the more serious compliance problems and situations that pose the greatest risk to public health and the environment.

- **President's Northwest Forest Plan:** A ruling by a federal judge in Oregon opening up thousands of acres of forest to timber cutting is a major blow to progress being made under the Administration's Northwest Forest Plan. EPA is a major participant with other Federal agencies in the implementation of the Forest Plan which focuses on sustainable commodities and sustainable environments. The ruling affects a major aspect of the Agency's participation in the Plan -- ensuring forested setbacks from river and streams. Forested setbacks -- areas around a river in which no logging or limited logging is permitted -- helps protect the water quality of these waterways (by providing benefits such as maintaining cool water temperatures, and the filtering effect that is provided by the adjacent forest during rainfall). Maintaining water quality is important for the overall health of the environment as well as the health of species that depend on thse waterways (i.e., native fish).

- **Travel:** Over the next few weeks Administrator Carol Browner will be traveling around the country to amplify your budget message and educate the American public about the effects of the Republican budget cuts on public helath and environmental protection. On Monday Administrator Browner expects to be in Orlando, Florida to highlight the budget cuts with a water event. On Thursday and Friday, she will travel to Cleveland, Ohio for a media event on the Cuyahoga River and to Pittsburgh, Pennsylvania for another media event to further highlight the impact of the Republican budget.

UNITED STATE TRADE REPRESENTATIVE

- **France Telecom and Deutsche Telekom Investment in Sprint:** The United States Trade Representative Ambasador Mickey Kantor met with German Post and Telecommunications Minister Wolfgang Boetsch to discuss the recent $4.2

billion investment in Sprint by France Telecom and Deutsche Telekom. Minister Boetsch sought the Administration's support of the deal. Amb. Kantor indicated that the Administration may weigh in on the FCC review of the deal if Germany indicates a credible commitment to more competition. (9/11)

OFFICE OF NATIONAL CONTROL POLICY

- **Marijuana Eradication:** On Tuesday the Office of National Drug Control Policy reports that a marijuana eradication event will take place in Kentucky, involving the Kentucky Governor and key elected officials. The ONDCP expects vigorous area press coverage, showing the administration taking an aggressive stance on marijuana.

SMALL BUSINESS ADMINISTRATION

- **United States Export Assistance Center Opens:** The United States Export Assistance Center (USEAC) in New York City was opened September 11 by Secretary Ron Brown, Tino Kamarck of the ExIm Bank and Administrator Phil Lader. USEACs provide easy access to export promotion and trade finance services particularly for small and medium-sized businesses. The event was covered by local and national media. On September 22, Administrator Lader will participate in the opening of the USEAC in Philadelphia, PA.

- **Minority Pre-QualificationProgram Announced:** On September 11, the Small Business Administration announced the Minority Pre-Qualification Program. The program is designed to increase the number of loan guarantees for minority business owners and is being piloted in 16 cities across the U.S. Under the program, minority business owners can qualify for a guaranteed loan with the agency before approaching a lender, thus making access to captial easier.

UNITED STATES INFORMATION AGENCY

- **First Lady Coverage:** The foreign media published rave reviews of the First Lady's addresses to the UN Conference on Women and and the NGO Forum. Editorialists from around the world praised Mrs. Clinton for speaking out on human rights abuses. Her performance drew approval even from those who thought she should not have gone to China, including Taiwanese journalists and the UK conservative press.

- **Bosnia:** USIS Geneva continues to provide extensive public support to Assistant Secretary Holbrooke's ongoing efforts to establish a basis for peace in the former Yugoslavia.

- **Fulbright Anniversary:** The committee charged with coordinating and planning Fulbright 50th anniversary projects met September 6 to discuss a wide range of activities, including the opening event, a symposium in Fayetteville, Arkansas planned for February 1996.

OFFICE OF PERSONNEL MANAGEMENT

- **Career Transition** - Early next week, OPM will provide agencies preliminary guidance on implementing the President's September 12 memorandum on Career Transition Asssistance for Federal Employees who may be seperated from government service in a reduction-in-force(RIF). More detailed guidance will follow in 45 days. OPM, with the Department of Labor and local government officials, is already working to establish job placement centers in the District of Columbia, Maryland and Virginia.

GENERAL SERVICES ADMINISTRATION

- **Federal Building Needs in Oklahoma:** GSA distributed today to the Oklahoma delegation and to key members of House Public Buildings and Senate Environment and Public Works a report on federal buildings needs and security requirements of Oklahoma City. The report recommends utilizing leased space and not constructing a new building to replace the Alfred P. Murrah building.

SOCIAL SECURITY ADMINISTRATION

- **Governors to be Advised of Impact of Possible Funding Lapse:** In preperation for a possible appropriations lapse, a letter from Commissioner Chater to all of the Nations's Governors will be mailed this week advising them that funding for State Disability Determination Services would cease in the event of a lapse of appropriations for SSA. These State agencies process initial disability claims for SSA, and while they are staffed by State employees, they are not 100% Federally-funded and their funds are contained in SSA's annual administrative appropriation.

- **National Commission on Childhood Disability:** The National Commission on Childhood Disability held its final meeting on September 11, in Washington, D.C., to review and discuss its final report. Of the 10 members present, all but

one indicated support for the report which will include an additional recommendation to continue cash as the principal form of support for some children with disabilities. The Commission expects to submit its report to Congress by the end of October.

DEPARTMENT OF STATE

- **Croatian Visit:** In Secretary Christopher's meeting with Foreign Minister Granic, he urged the Croatian Government to support U.N. diplomacy and to exercise military restraint while our peace initiative is in play. Granic emphasized that a peace settlement must address Serb-held Eastern Slavonia, making a strong case for keeping sanctions on Milosevic until this problem is on the road to resolution. Secretary Christopher weighed in about Croat treatment of Serbs in continuing Croatian military offensive. Granic admitted problems in avoiding human rights abuses, but he seems to have soft-pedaled the message back home.

- **Budget Cuts:** Following the Senate CJS Subcommittee's mark up last week, Secretary Christopher has been making a full court press with Congress and the media to ensure there is a full appreciation that what is at stake is State's ability to serve our citizens, support our businesses and protect our national security. Secretary Christopher has written and met with Senators Hatfield, Gramm, Byrd and Hollings, and given interviews to the press and radio. Next week Secretary Christopher will give a speech on the subject. The State Department will need continued White House support to get their budget levels back up where they need to be to pursue effectively your foreign policy agenda.

- **Fast Track:** With fast track legislation in jeopardy in Congress, U.S. trading partners in the hemisphere are watching closely. Chili has said it will not negotiate NAFTA accession without fast track, and the bill's failure would delay progress for others joining NAFTA and the Free Trade Area of the Americas. The House Ways and Means Committee's decision to pull CBI from its reconciliation package and to drop the Trade Adjustment Assistance Act portend poorly for fast track. Central American and Caribbean nations are dismayed at the prospect of losing CBI parity.

- **Kashmir Kidnapping:** The four Western hostages, including one American, were reported alive as of September 12. While continuing to threaten to execute the tourists, Al-Faran has fallen off its earlier demand for the release of prisoners held by the Indian government, and is now asking Indian negotiators for $1.6 million to release the four. State Department officials believe the kidnappers may be looking for a face-saving resolution.

- **Northern Ireland:** The peace process has stalled on the thorny issues of IRA

disarmament and the timing of all-party talks. State Department officials are pressing Gerry Adams during his visit this week to moderate Sinn Fein rhetoric and to work to build confidence among unionists in Northern Ireland. The election of David Trimble, a relative hard-liner, as leader of the Ulster Unionist party, Northern Ireland's largest, may make progress even more difficult. Trimble may visit Washington soon.

- **Israeli-Palestinian Signing:** Israeli and Palestinian negotiators have been making progress and appear to be negotiating with an eye toward the endgame. Their plan at the moment is to resolve nearly all outstanding issues, except those Peres and Arafat will close during their meeting September 16. They very much want to conclude an agreement and, assuming they do, would like to come to Washington next week for a signing ceremony.

- **Refugee Consultations:** On September 13, Secretary Christopher conducted the annual legislatively mandated refugee consultations and presented your proposed admissions level for FY96 (90,000; down from 110,000 this year). Members questioned continuation of the "Lautenberg" program granting refugee status to Jews and other religious minority members from the former Soviet Union. Representative Conyers urged greater consideration of African refugees in the allocation of admissions numbers, citing it as an issue of fairness. In response to Chairman Hyde's account of Chinese women asylum seekers brought to a congressional hearing this summer in shackles, Secretary Christopher noted you recently decided on administrative procedures to ensure legitimate victims of coercive population policies are not deported.

DEPARTMENT OF DEFENSE

- **Pakistan:** In attempting to implement your decision to sell the Pakistani F-16s, the Defense Department has concluded that due to the ready availability of alternative aircraft, it will be necessary to offer them at a price significantly lower than their full contract price of $18 million per aircraft -- perhaps as much as $8.2 million below contract. The DoD General Council -- with support from the State and NSC legal advisors -- has argued that due to the risk of litigation from U.S. failure to refund Pakistan's full investment in the F-16s ($658 million), it is imperative that the U.S. offer the aircraft, at least initially, at full contract price. If a customer makes a counter offer, the U.S. will seek Pakistani approval before agreeing to sell the aircraft at the lower price.

- **Jordan:** King Hussein has indicated in a recent letter to you and in press interviews that he plans to come to Washington soon. The DoD would expect him to press for F-16s and upgrades to Jordan's fixed site I-HAWK missile systems.

THE PRESIDENT HAS SEEN
9/18/95

THE WHITE HOUSE

WASHINGTON

September 16, 1995

MR. PRESIDENT:

Attached are the following weekly information items:

(A) **Weekly Economic Briefing.**

(B) **Interest rates and stock market.**
Week ending September 15, 1995

(C) **Cabinet Report.**

(D) **CEQ Weekly Report.**

Phil
Phil Caplan

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

THE PRESIDENT HAS SEEN
9/18/95

Kathleen A. McGinty
Chair

95 SEP 15 P7:26

September 15, 1995

MEMORANDUM FOR THE PRESIDENT

FROM: KATHLEEN MCGINTY

CC: LEON PANETTA

RE: CEQ WEEKLY REPORT

PACIFIC NORTHWEST TIMBER

As you know, part of the timber-related provisions of the Rescissions Act dealt with releasing sales of green, old growth timber as opposed to salvage sales that were the purported rationale for these provisions. Immediately after passage of the bill, we were sued by both industry and environmental group representatives on two issues related to the old growth sales; the geographic scope of the requirements and our interpretation of "nesting" in relation to endangered and threatened birds. This week, Judge Hogan in federal district court in Eugene, Oregon, issued the first of these decisions by ruling against our ~~interpretation of the geographic scope of the requirements~~. Frankly, this loss was not unanticipated but the expectation is we have a better chance of success on appeal. If allowed to stand, the decision could jeopardize the balance that you have struck between moving timber and protecting the environment. We anticipate seeking appeal, but the judge departed for Europe without actually issuing an order, so we are not yet in a position to announce an appeal.

ARTIC NATIONAL WILDLIFE REFUGE (ANWR)

We have a copy of the House Resource Committee's reconciliation mark which opens ANWR to drilling, repeals all environmental laws, and institutes a $10,000 per day penalty for any person, including federal officials, who fail to comply with the leasing provisions or mandates.

WARD VALLEY

Despite two months of negotiating (which was nearing completion) between the Department of Interior (DOI) and the State of California, we learned that the State is likely to declare an impasse and will pull out of the negotiations. This is a complete surprise to DOI negotiators

and we are checking to see if we can restore the damage. There is a possible link to House and Senate decisions to include the transfer in reconciliation, which would transfer the federal land to California without condition. Senator Johnston has said the Senate Energy Committee will include this in reconciliation. Congressmen Lewis and Bilbray have authored legislation to transfer the land.

ENVIRONMENTAL BUDGET

The Vice President spoke out on the environmental budget several times this week, Monday at a conference on climate change and human health, Tuesday in a live CNN interview that ran all day, Wednesday in a satellite feed to the sustainable communities workshop involving 180 communities, and Friday before a roundtable of 25 Knight-Ridder environmental journalists. Next week, he will have a public event in Tampa, Florida. Finally, we are working to prepare a "Project XL" reinventing environmental regulation event.

CLIMATE CHANGE

CEQ and OSTP hosted a conference this week on Climate Change and Human Health. Among other things, speakers addressed the many heat-related deaths around the US this summer (more than 500 in a few days in Chicago alone) and the impact of climate change on the spread of infectious disease (dengue fever, for example, now threatens the US for the first time in 50 years). The Vice President's keynote speech was widely hailed and received good press coverage.

Climate change programs remain a particular target of Hill Republicans. This week, Senate appropriators cut the Administration's request for EPA climate change activities by almost 70%. The proposed reductions in Energy Department climate programs is approximately 50%. These cuts would eviscerate your Climate Change Action Plan.

APPROPRIATIONS FOR ENVIRONMENTAL PROGRAMS

The appropriations process moves forward for environmental programs, especially EPA, Interior and DOE.

The VA-HUD appropriations bill which includes funding for EPA is expected on the floor next week. Although the level of funding is higher than provided by the House, it is still 23% below the Administration's request. Also, although the Senate Appropriations Committee did not adopt the 17 appropriations riders passed by the House, it did add six restrictions of its own regarding various air and water pollution programs.

Conferees are nearing completion on work on the Interior appropriations bill. However, problems continue on certain major issues including significant shortfalls in funding for Bureau of Indian Affairs, the National Biological Service, and DOE's energy efficiency programs. Other objectionable provisions included: timber harvesting in the Tongass National Forest; an initiative that resulted in the lifting of court injunctions and the resumption of economic activity (PACFISH) in Washington and Idaho; and cut in funding in

ESA prelisting that help us prevent species trainwrecks like owls in the Pacific Northwest.

CEQ APPROPRIATION

The Senate Appropriations Committee ratified the VA, HUD, and Independent Agencies decision to continue funding for CEQ but with a 54 % reduction in funds from our requested $2.188 million.

The House has terminated CEQ. Therefore, we will be an item in conference. Senator Hatfield has told CEQ that he expects this bill to be vetoed (includes EPA, Americorps, etc.) and therefore changes are expected. He made no promises concerning CEQ.

CONFIRMATION HEARING FOR KATIE

You may recall that Katie was appointed Chair of CEQ by a recess appointment in December 1994. Senator Chafee and his staff recommended waiting on confirmation despite the fact her nomination papers were submitted with the recess appointment. Now they have scheduled confirmation hearings for Wednesday, September 27. Confirmation for Katie was a long shot a few months ago. It looks at least like a possibility now. Pat Griffin is on the case.

THE PRESIDENT HAS SEEN
9/18/95

To Laura | cc Joe Stiglitz
This is very interesting and
may explain a lot of US issues
we've been grappling with — BC

RESOLVING THE US PRODUCTIVITY PARADOX

- Innovation versus Investment in Global Competition -

Prepared for
President William J. Clinton
The White House

- September 7, 1995 -

by
Horace "Woody" Brock

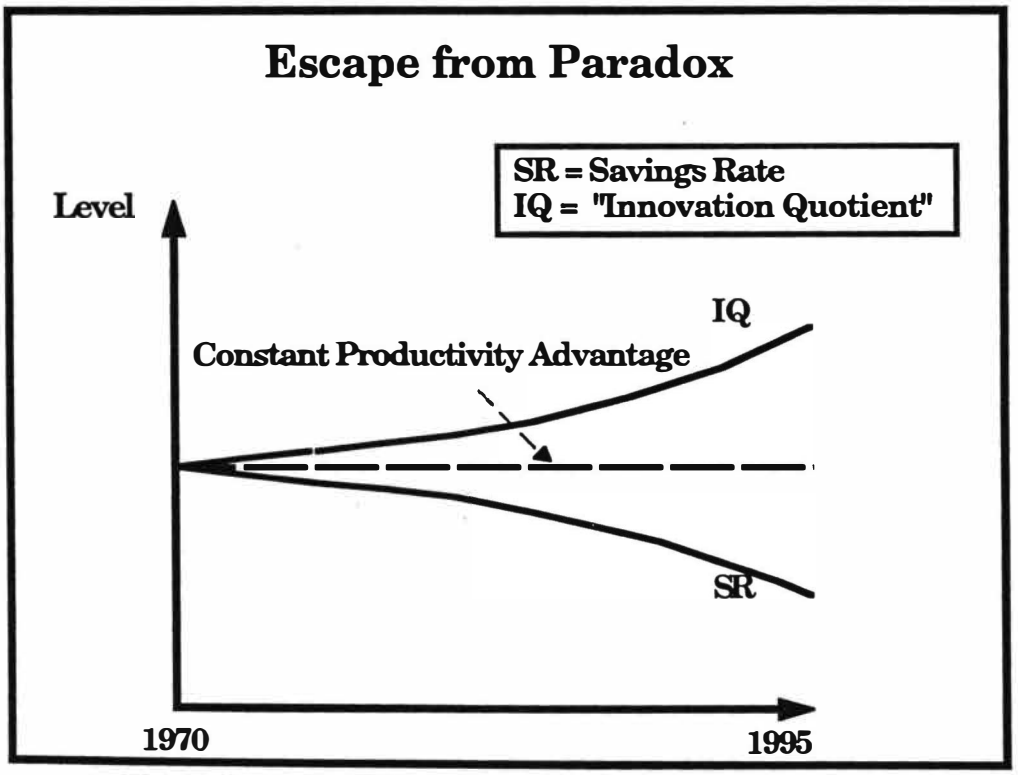
Strategic Economic Decisions, Inc.
905 Sherman Avenue
Menlo Park, California
TEL: (415) 854-2404 • FAX: (415) 854-2415

EXECUTIVE SUMMARY

It is well known that the savings rate of the United States during the past thirty years has remained consistently below that of Germany and Japan; moreover it dropped dramatically throughout most of this period. According to the prevailing wisdom, this would imply the relative competitiveness of the United States should have deteriorated in like manner given the Savings = Investment identity. Surprisingly, recent data suggest that this did not take place. Indeed, the United States has retained its output-per-person advantage over its principal economic rivals in both manufacturing and services during this long period.

What explains this ostensible paradox? According to the logic set forth below, the answer can be found in a new construct of economic theory, that of a "Multiplicative Innovation Regime". In such regimes, an economy experiences a marked *acceleration* of technological innovation due to the increasing rate at which revolutionary "core technologies" such as the microprocessor become absorbed into the economy's interstices over time. The result is an Escape from Paradox along the lines sketched below in an informal graphical manner.

While the proposed logic is consistent with advanced macro-economic theory, its implications for policy differ significantly from what usually is asserted by policy-makers and economists. Per our previous discussion, the Oval Office should focus more on strategies for innovation and less on strategies for savings and investment. This is not to say that we do not need to boost savings and investment, for all would agree that we do.



1. Introduction and Overview

Figures 1 and 2 contrast savings rates and productivity growth rates in both manufacturing and services across the three largest G-7 economies: the US, Japan, and Germany. The savings rate figures represent net national savings, which conflate personal, corporate, and government savings (dissavings in the case of fiscal deficits).

The productivity numbers are taken from pioneering studies on manufacturing and service sector productivity undertaken in the early 1990s by McKinsey & Company's Global Institute (1992, 1993) in Washington D.C., and Pilat and Van Ark (1991). Regrettably, the kinds of historical time series data on service sector productivity we would like to have on hand are not available, so we must make do with late 1980s data.

It is important to note that the productivity data generated by McKinsey & Company are stated in Purchasing Power Parity terms. That McKinsey invested the effort to generate not only PPP measures, but properly-benchmarked PPP numbers is extremely important. For as we have argued in past commentaries, the ultimate purpose of productivity growth comparisons across nations is to contrast the level of real output of goods and services per employee-hour worked. If arbitrary currency market distortions are not removed from the measurement of output and hence of productivity, then the results are largely meaningless for the purpose of transnational comparisons.

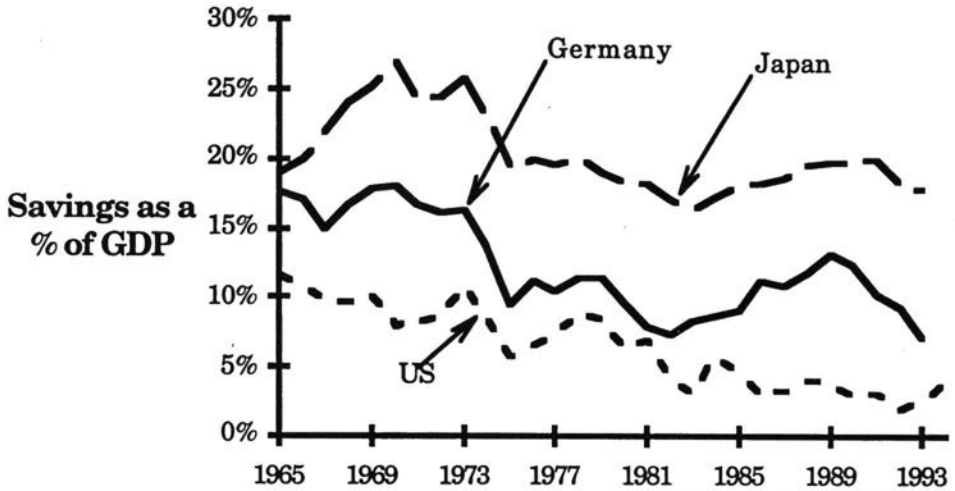
Service Sector Problems: McKinsey made another important contribution. They confronted head-on the vexing problem of defining and measuring output in the case of the service sector. To do this, they proceeded "bottoms-up" by starting at the industry level. Specifically, they measured suitably defined output-per-person-hour levels in five different industries in five different countries.

The results appear in Figure 2, where it should be understood that the US represents the base case of 100 in each industry. In only one case did an industry in another country outperform that in the US: restaurants in France! Several missing entries reveal that the requisite data could not always be obtained. The chosen industries account for 21% of the non-governmental service sector output of the nations in question.

> **The Paradox:** The paradox revealed by the data in the two figures is straightforward: the US maintained a fairly constant productivity lead over Japan and Germany despite having a savings/investment rate which was not only the lowest for three decades, but which *declined* sharply throughout most of the period as well.

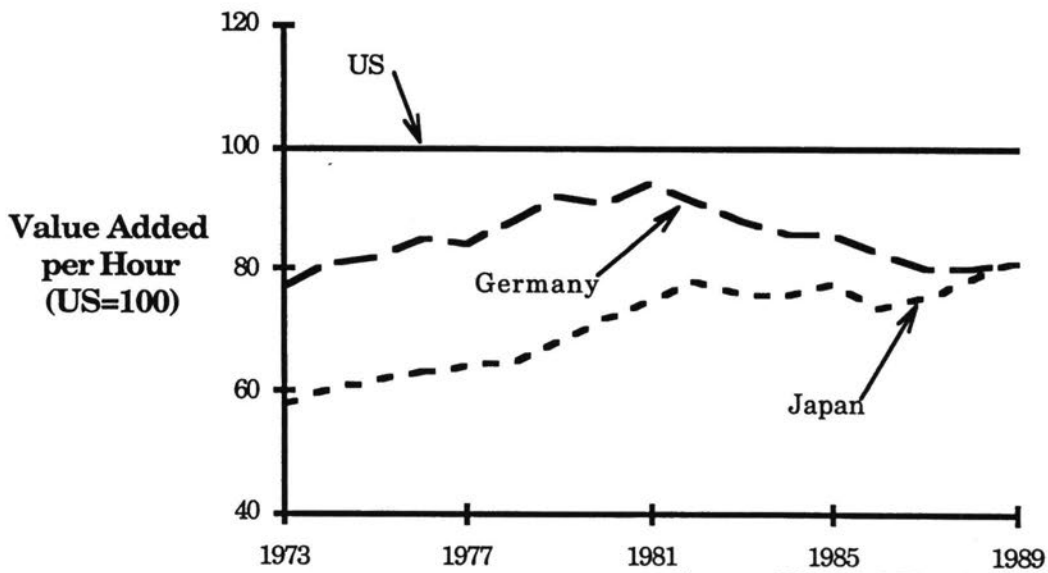
FIGURE 1: THE US PRODUCTIVITY PARADOX

Net Savings Rates



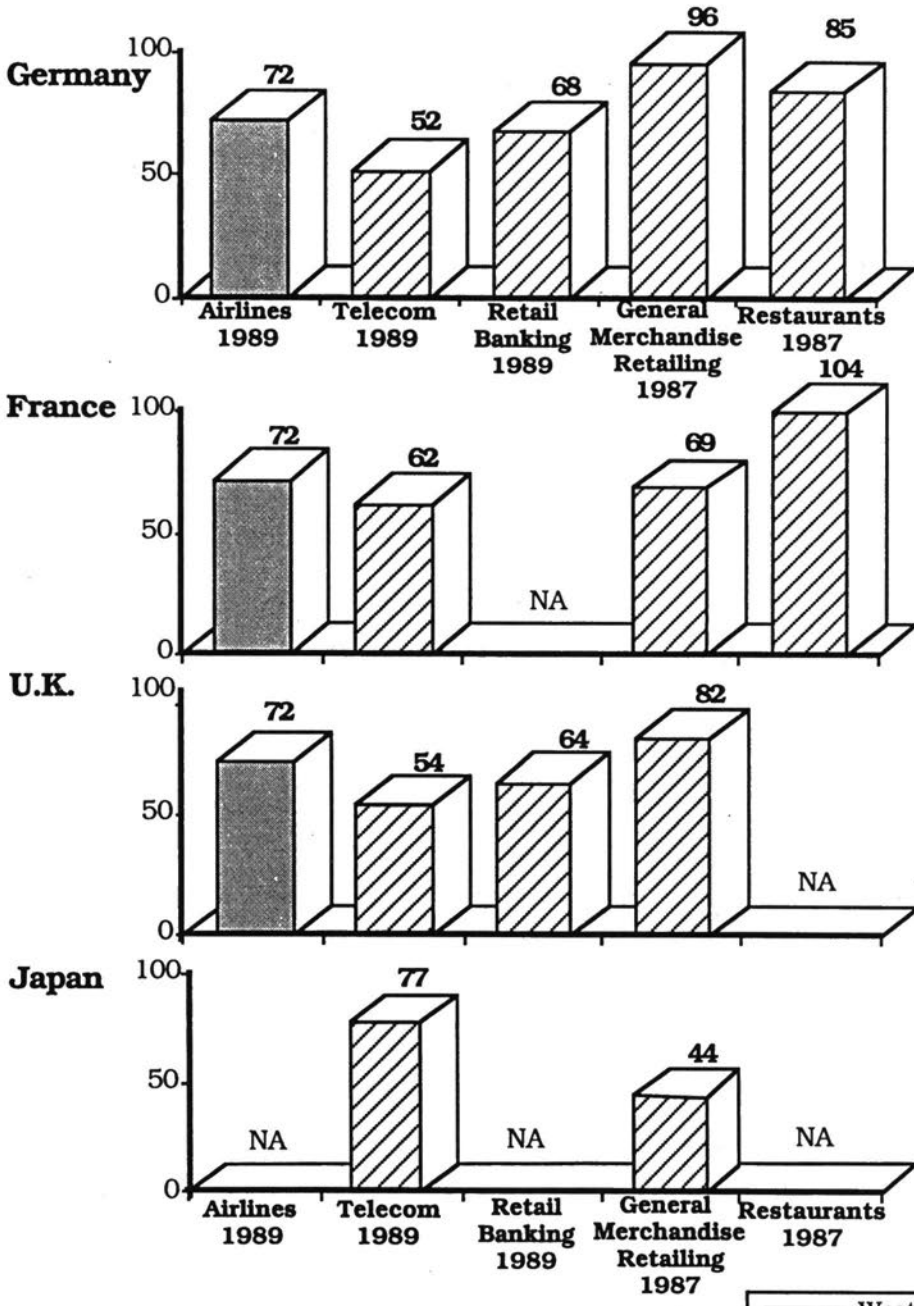
Source: OECD National Accounts

Manufacturing Productivity



Source: Pilat and Van Ark (1991)

FIGURE 2
LABOR PRODUCTIVITY COMPARISON – SERVICE SECTOR
(U.S. Equals 100 in Each Industry)



Source: McKinsey & Company (1992), p.2.

To appreciate the magnitude of this paradox, suppose that back in 1970 a clairvoyant had revealed to investors this particular savings rate data. What would they have inferred from it? Most certainly that the US would end up the *least* productive of the three nations by the mid-1990s, not the most!

The purpose of this essay is to reveal what was wrong in the way we thought then and indeed think now about productivity growth, and thus about economic growth in general.

Overview: In Section 2, we show how the paradox can be resolved at a fairly abstract level. The principal condition is that the technology regime of the economy must exhibit what we shall call multiplicative rather than additive spillover effects. This leads to a discussion in Section 3 of "Multiplicative Innovation Regimes". The concept of "General Purpose Technologies" introduced by Timothy Bresnahan of Stanford University offers real-world examples of how such regimes are propagated. These are discussed in Section 4.

Our sought-after escape from paradox arrives in Section 5. It arises from the commanding lead assumed by the US early in the history of the most important General Purpose Technology of our century: the binary logic of the modern electronic circuit. Next, in Section 6, we assess whether or not the great microprocessor revolution of the past two decades is losing steam. The answer is no, and this is explained in terms of five types of lags which cause such technology cycles to much more long-lived than one might expect.

Finally, we discuss some loose ends in our concluding Section 7. These include Paul Krugman's controversial views that the remarkable growth of the Asian tiger economies is not what it is cracked up to be.

2. Resolution of the Paradox

As Paul Romer pointed out in Chapter III of our May 1995 report, Adam Smith and his followers rarely got things wrong. But one mistake they did make was their identification of high rates of economic growth with high levels of savings/investment. It turns out that both in theory and practice, a high savings rate is neither a necessary nor a sufficient condition for national wealth.

Romer gave us a good example of why this is true. Suppose everyone saves a lot and invests in the one and only capital good produced in the nation, namely the forklift. Then the growth rate of the economy will eventually slow to zero as the marginal productivity of each additional forklift goes to zero. "Factor accumulation" via high savings thus does not guarantee ongoing economic growth.

Role of Innovation: The problem with the classicists and their "Save More!" mantra was their failure to give proper emphasis to the role played by *technological innovation* in stimulating capital and labor productivity growth, and thus economic growth per se. This deficiency in the foundations of macroeconomics would first be redressed by Joseph Schumpeter (1942) – the great economist famous for equating capitalism with "creative destruction" – in the first half of the century. In our forklift example, wealth will come to the nation whose inventors discover a better-and-cheaper replacement for the forklift.

Several decades later, M.I.T. economist Robert Solow (1957) created one of the first and certainly the most celebrated formal models of economic growth in which innovation played an important role. However, innovation was treated as an "exogenous" phenomenon: it emerged randomly from nowhere, outside of human and governmental control. Innovation as an "endogenous" phenomenon was first satisfactorily captured by Romer (1986, 1990) who built upon a pioneering and much earlier paper by Arrow (1962).

It is thus now accepted that *two* conditions are necessary for ongoing economic growth: savings and investment on the one hand, and innovation on the other.

Conditions for Escaping the Paradox: From this elementary observation, it becomes clear how it is *logically possible* to escape the paradox presented above. What first comes to mind is the fact that a low savings nation like the US could maintain its productivity lead by *compensating* on the innovation front. Specifically, it need only maintain a high "innovation quotient" that offsets its low savings rate. (Please see accompanying Figure 3).

> *But this argument will not do the trick. For what must be explained is more difficult, namely that the US maintained a fairly constant productivity differential over time despite a rapidly declining savings rate.*
>
> *The mathematics here are simple, and dictate that the only egress from the paradox lies in a nation's ability to sustain an increasing innovation rate over the decades in question.*

Be sure to note the logical twist that arises here. It does not suffice to cite the official data which show that US productivity growth tripled over the past quarter century, rising from an average all-time low of 0.7% in the 1970s to 1.9% in the 1990s (2.9% if properly measured). For rival countries experienced much the same phenomenon, and as the above data make clear in the case of manufacturing, the productivity differential between the US and its rivals has not changed much.

Thus, to escape the paradox, we must go one level deeper. Since productivity growth is a function of both savings and innovation, and since the savings rate of the US declined precipitously relative to that of other nations, then its innovation rate proper must have risen dramatically.[1]

But what exactly does this mean? And how can we establish that the US exhibited an accelerating innovation quotient? Since there is virtually no pre-packaged data available summarizing the "evidence", we must *deduce* what happened to innovation according to the aggregate data on productivity and savings from a theory of the nature of innovation. In doing so, we shall introduce two interrelated concepts. The first is that of a Multiplicative Innovation Regime. The second is that of a General Purpose Technology. The second is a special case of the first.

Note: Henceforth, some shorthand. When referring to a nation's savings rate, we shall write **SR**. When speaking of its innovation quotient, we shall write **IQ**, a Multiplicative Innovation Regime will be written as **MIR**, and a General Purpose Technology as **GPT**. Doing so will speed things up a bit.

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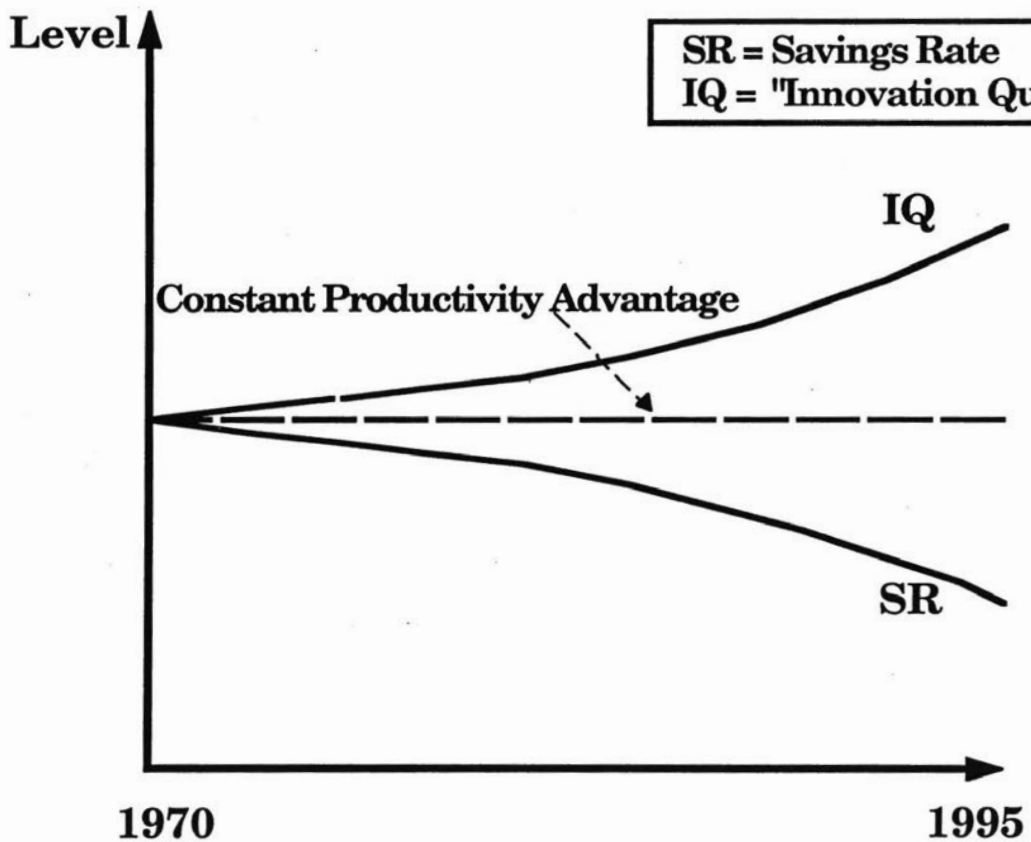
[1] Some might argue that the decline in the US savings rate is overstated in the above data since they fail to capture the inflow of foreign investment mirroring the US current account deficits which arose in the mid-1980s. But adjusting for such inflows does not materially change the above argument.

Figure 3: Escape from Paradox



3. Multiplicative Innovation Regimes (MIRs)

To make sense of the concept of an accelerating **IQ**, we must clarify the precise relationship between the individual innovations that arise within industries (sectors of an economy) on the one hand and aggregate productivity growth of the economy on the other hand. [1]

To make this linkage clear, we need to utilize the concept of a MIR. Since this is quite abstract, let's start off with an example. Consider the invention of the Gutenberg press in the 15th Century. This revolutionized the life of scribes in monasteries, and raised productivity fantastically. But automated printing did little or nothing for the blacksmith and the farmer, at least for the first hundred years or so.

> *It can be shown that, when all technological innovations are "separable" in this sense, the aggregate productivity growth of an economy is an arithmetic function of the individual innovations begetting it.*

Conversely, consider the invention of the steam engine, or the electric motor, or the microprocessor. In each case, the initial innovation was seen to boost productivity growth in a host of downstream industries impacted by the original innovation. These secondary innovations would in turn feed back upon the original invention, and boost its productivity in turn.

> *When all innovations possess this spillover property, aggregate productivity growth becomes a multiplicative function of the individual innovations.*

A technology regime with this latter property is clearly going to be much more productivity-enhancing than one without it, and this is precisely what a MIR is. We have of course stated two polar extremes above. Most real-world cases lie between these polar extremes, with the level of productivity growth dependent upon the degree of spillover effects ("innovational complementarities") between sectors. This concept is illustrated in Figure 4, and explained in more depth in footnote 2 below [2].

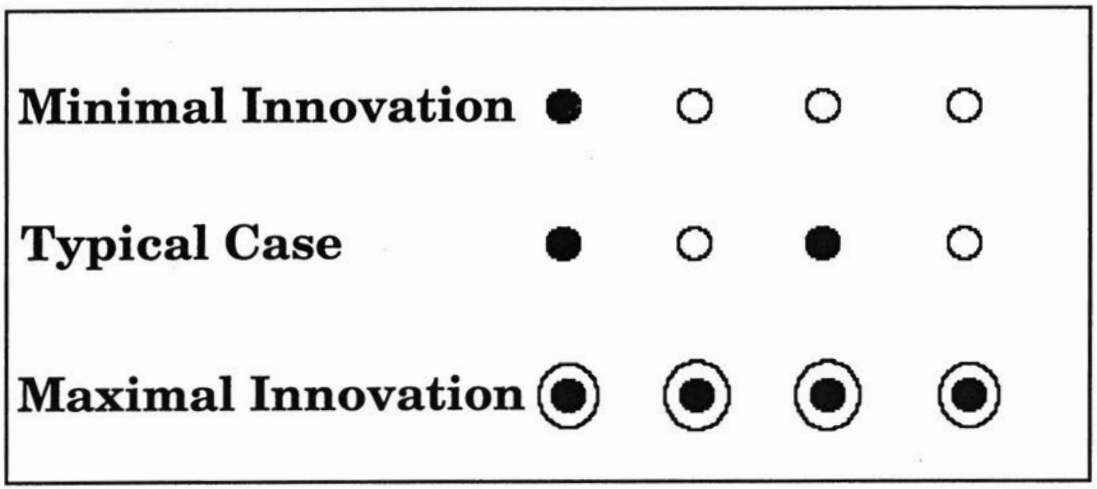
---

[1] Paul Romer and others rightly extol the virtues of "exponential growth", in particular how economic growth is an exponential function of the rate of growth of productivity. And indeed it is – the laws of compounding guarantee this. But what is not usually addressed is the precise way in which the (productivity growth) rate at which economic growth compounds is *itself* a function of the structure of innovation-induced productivity gains across different industries. It is this complex linkage we are focusing on here.

[2] To understand this in more detail, contrast the aggregate growth rate in two economies identical in all respects except the degree of "separability" between the innovations of different sectors. [Complete separability implies *no* spillover effects from an innovation in one sector to other sectors.] Our aim is to create two polar cases. Let Economy **A** have **N** equal size sectors, each of which is completely "separable". Let Economy **B** have the same **N** sectors, but this time each exhibits *maximal* innovational spillovers across sectors. That is, an innovation in any one

Figure 4

Multiplicative Innovation Regimes



● Denotes an innovation which is sector–specific

◉ Denotes an innovation with maximal spillover effects

4. General Purpose Technologies (GPTs)

In a fascinating paper, Timothy Bresnahan of Stanford and Manuel Trajtenberg of Tel-Aviv University (1992) discuss the nature and implications of what they call "General Purpose Technologies". Loosely speaking, these are the core technologies which drive downstream areas of technological innovation and economic growth over fairly long time spans ranging from 25 – 50 years. For our purposes, familiarity with GPTs is important because these technologies when they arise *cause* innovation regimes to become *multiplicative* in nature. By understanding them, we can thus better understand the conditions required for MIRs to exist and indeed flourish.

These GPTs have three properties which play an important role in shaping the nature and magnitude of productivity growth over time. The analysis of this point by Bresnahan and Trajtenberg is well worth citing:

> We think of the technologies prevalent in any given period as structured in a hierarchical pattern (i.e., as forming a sort of "technological tree"), which in the simplest case would consist just of two levels: a handful of "basic" technologies at the top (perhaps just one), and a large number of product classes or sectors that make use of the former at the bottom.
>
> Those at the top are characterized first of all by their *general purposeness,* that is, by their performing some generic function that is vital to the functioning of a large segment of existing or potential products and production systems. Such a generic function would be, for example, "continuous rotary motion," performed at first by the steam engine and later on by electrical motors. "Binary logic" would be the corresponding generic function for electronics, the obvious GPT candidate of our times.
>
> The second distinctive characteristic of GPTs is their *technological dynamism*: continuous innovational efforts, as well as learning, increase over time the efficiency with which the generic function is performed. This may show up as reductions in the price/performance ratio of the products, systems or components in which the GPT is embodied, or as multidimensional qualitative improvements in them. As a consequence, the costs of the downstream sectors that use the GPTs as inputs are lowered, they may be able to develop better products, and moreover, further sectors will find it profitable to adopt the improved GPT, thus expanding the range of applications.

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sector of Economy **B** raises productivity by every bit as much as it does on its own sector. *How then do the growth rates of the two economies compare?* The answer is that if each economy experiences the same total number of innovations, then the growth rate in economy **B** will be **N** times as great as that in Economy **A**. To state this somewhat differently, innovation *per se* is effectively **N** times more important to growth in Economy **B** than in **A.**

Third and last, GPTs are characterized by the existence of *innovational complementarities* (spillover effects) with the application sectors, in the sense that technical advances in the GPT make it more profitable for its users to innovate, *and vice versa.*

The precise route of escape from our paradox is now at hand. We shall demonstrate how the US assumed a commanding lead several decades ago in what is arguably the most important GPT of the century. In doing so, the US was able (via the algebraic logic of an MIR) to compensate for its declining **SR** with an increasing **IQ**. As a result, it could maintain the productivity differential it has enjoyed over its principal competitors for many decades.

5. The US and "Binary Logic": A Case Study of a GPT

There is little disagreement in the growth literature that the US has traditionally evinced a high level of technological innovation during the entire twentieth century.[1] This is evidenced by **(1)** the predominance of its research universities; **(2)** its number of Nobel laureates; **(3)** the number of its patents in leading-edge technologies; **(4)** its productivity dominance in manufacturing and services as evidenced in the McKinsey data; **(5)** its widely respected tradition of entrepreneurship; **(6)** its absence of those product and labor market rigidities that now burden continental Europe; **(7)** its unique venture capital industry, and **(8)** its increasing dominance in many leading-edge industries of the next century. These include telecommunications, consumer electronics, computer software, computer hardware, video-and-entertainment, and biotechnology.

Electronic Circuits – Today's GPT: It is this last strength **(8)** we wish to focus on. How can the US simultaneously be the leader in virtually *all* of these industries (consumer electronics rejoined this list in 1994)?

The reason is that the US took a commanding lead early in the game in what is arguably the single most important GPT of all time: the logic of binary numbers (formally, Boolean lattices) physically embodied in the (digital) electronic circuit.

This technology gave rise to and interconnected more downstream innovations, faster, than any other GPT in recorded history. But why is this so? What exactly is it that makes (binary) electronic circuits the great driver of progress that they have become? By taking the microprocessor for granted, we lose sight of this all-important issue.

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[1] The criticism launched in the early 1980s that the US had lost its ability to *commercialize* its innovations was true, at least until the 1990s. But this view is irrelevant to our point here.

Happily, Bresnahan and Trajtenberg address precisely this question at one point in their paper, and they answer it better than anyone else we know of. The reader is advised to read twice the following rather challenging passage:

> What accounts then for the 'general purposeness' of electronic circuits? The workings of virtually any system and, in particular, of any electro-mechanical system, can be thought of as (and actually be broken down into) a series of steps that transform a given input into a desired outcome. Thus, a traditional watch transforms the power of the spring into an analog signal, depicting time; a washing machine transforms electrically-induced continuous mechanical traction into a series of actions involving movement of parts, the opening and closing of valves, etc.
>
> Despite their variety, a vast majority of these intervening steps can in principle be done (or be replicated) by the application of binary logic, that is, by activating a circuit consisting of a series of binary elements (e.g., gates, flip-flops, etc.). This is a striking *technological* fact that has reaching *economic* implications. What it says is that the enormous variety of seemingly disparate products, materials, methods of production, etc. conceal the *uniformity* of a few underlying technological principles; these principles, in turn, give rise to potent economic forces that would shape the (endogenous) process of technical change.
>
> Contrary to popular perceptions, substituting binary logic for mechanical parts is in many cases extremely *inefficient*, if measured by the number of steps required by the former, and hence by the number of circuit components and operations involved.
>
> However, as the price and size of circuit components decrease dramatically, and as their reliability improves, it becomes eventually cost–effective to use *them* rather than the old electro-mechanical parts. And, in turn, these dramatic advances in costs, size and reliability are due to a large extent to the tremendous increases in the volume of production of *standardized* circuits, where 'learning' plays a key role.

The authors then demonstrate that the electronic circuit is the dominant technology of our time, and that it exhibits very clearly the key features of a GPT reviewed above. *First,* it has proven to have the inherent potential for persistent and manifold technical advances along its main performances dimensions. *Second,* these advances impinge upon a wide range of applications which, when coupled with complementary innovations by the user sectors, have brought about a reshaping of the universe of goods and services at our disposal.

Resulting Prediction for the US: When these aspects of the digital revolution are factored into our earlier arguments about the nature of MIRs and their implications for aggregate productivity growth, the following theoretical prediction emerges:

As the leader exploiting these new technologies, the US should have been experiencing an increasing rate of growth in its IQ during the 1970 – 1995 period.

Note that this was the period when the electronic circuit GPT was domesticated via the ever-more-powerful "chip", with the result that new applications and downstream innovations proliferated profusely. A significant sector of the US economy became a MIR.

Happily, this prediction seems to fit the empirical facts. It also explains away the paradox with which we began in Section 1.

6. The Future – Is the Revolution Over?

Is the revolution launched by the GPT of binary logic nearing its completion? No. Moreover, the greatest risk to investors is that they will think "Yes", and jump ship. But why will the revolution continue? The answer is subtle, and can best be understood by citing four obstacles which explain why it took so long for productivity gains from the digital revolution to show up in the official numbers in the first place. [Keep in mind here that the digital computer has been around since the late 1940s.] The nature of these lags also clarifies why GPT-based technology waves are particularly long waves – a phenomenon with which most investors are both uncomfortable and unfamiliar.

1. Lags in the Innovation Process Itself: The great economic virtue of the chip is that it raises the benefits and/or lowers the costs of innovation in so many related fields. But precisely because this is true, the *total* impact of the microprocessor on productivity and growth will not be realized until its spillover effects (complementarities) are recognized and in turn acted upon by other entrepreneurs throughout the economy.

2. Lags in Business Applications: Suppose that entrepreneurs do comprehend the possibilities inherent in a GPT, and attempt to create the downstream innovations stipulated by **(1)** above. Suppose, moreover, that these innovations become economically viable once the microprocessor arrives on the scene. For example, some farsighted entrepreneur perceives that the "fax machine" will become a commercial success, because businesses will eventually deem the technology to be "indispensable". He creates the blueprint and prototype. What next? Who has benefited?

The truth is that there will be no increase in *aggregate* productivity until the fax machine is *widely* used years later. But this will only happen once people take "faxing" for granted. But for these downstream users to take the new technology for granted, a host of related innovations must first be in place: offices with complementary equipment (e.g. computer programs which manage faxes), speedy and reliable links to transmit messages throughout the economy, etc. It takes a lot of time for these related goods and services to accumulate to the extent

required before the fax machine is fully accepted and makes its ultimate contribution to productivity growth.

3. Lags due to Psychology: Resistance to change is pandemic. "We don't really need a xerox machine or a personal computer". [Recall that IBM turned down opportunities to buy both Xerox and DOS for a pittance in earlier days]. The Internet was deemed a hacker's toy for over a decade. Virtual reality was for video arcades, not Boeing. Desktop publishing was a luxury we thought we could never afford. And so on.

4. Lags due to Standardization Problems: The full advantages of new technologies stemming from a GPT such as the electronic circuit cannot be reaped until complex sets of uniform standards are in place. Even today, brand name PCs don't communicate with one another. Recall Betamax versus VHS? Digital TV? Putting Lotus Notes up on the Net?

7. Conclusion

In concluding, there are a number of issues we would have liked to address, but could not. For example, Paul Krugman of Stanford University (1994) has re-examined the nature of the success of the Asian Tiger economies from an interesting standpoint. As we have done, he distinguishes the relative contribution to Asian growth due to "factor stuffing" (high SR and capital accumulation) on the one hand, and IQ on the other. He concludes that the tigers' success has largely been "bought" by high levels of savings and investment that are forced, and that will decline. Such growth is expensive (in terms of foregone current consumption), whereas IQ-based growth is cheaper, and thus preferable.

Because of such arguments, Krugman does not believe that the Asian economies will perform in the future as well as they have in the past. Factor stuffing strategies run into laws of diminishing returns, whether of the kind experienced in the USSR, or in Asia. However, we believe that he overstates his case because a good part of the capital accumulation in these Asian economies *does* embody new innovations. These economies are not simply accumulating more and more of the same capital goods (i.e., more "forklifts") as Krugman seems to imply. But this and related issues will have to be postponed to some future date.

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THE PRESIDENT HAS SEEN
9/16/95

Michio Watanabe, 72, of Japan; Powerful Minister Despite Gaffes

By ANDREW POLLACK

TOKYO, Sept. 15 — Michio Watanabe, one of the most influential politicians in Japan and long an aspirant to become Prime Minister, died early this morning in a Tokyo hospital. He was 72.

His aides said the cause of death was heart failure. Mr. Watanabe had been in poor health for three years.

Mr. Watanabe was a leader of the Liberal Democratic Party, which held power for 38 years until being toppled in 1993. He served as Deputy Prime Minister and Foreign Minister from November 1991 to April 1993. Before that he led the ministries of trade, finance, agriculture and health and welfare.

In March, Mr. Watanabe led a delegation to North Korea, where Japan and North Korea agreed to resume talks aimed at normalizing relations. But the talks, which were suspended in 1992, have not yet reopened.

Colorful and outspoken, Mr. Watanabe created some international uproars with ill-considered remarks.

In 1988, for example, he said American blacks had no qualms about not paying their bills. That set off a round of criticism about Japanese racial attitudes, prompting Mr. Watanabe to apologize and retract his remarks.

This past June, Mr. Watanabe again apologized after setting off protests in South Korea by saying that Japan's annexation of Korea in 1910 had been done amicably, with Korean consent.

Mr. Watanabe made little secret of his ambition to become Prime Minister. He lost twice, in 1991 and 1993, in elections to become the president of the Liberal Democratic Party, a post that carries with it the premiership if the party is in power. In 1994, after the Liberal Democrats had lost power, Mr. Watanabe considered jumping to another party if it would support him for Prime Minister, but he gave up after failing to attract enough supporters.

Associated Press, 1992

Michio Watanabe

A man who would be Prime Minister never quite made it.

Mr. Watanabe was born on July 28, 1923, the son of a soldier. His mother died 10 days after he was born, and he was raised by an uncle and aunt on a farm. He graduated from the Tokyo University of Commerce and became an accountant. He was elected to the lower house of Parliament in 1963 and held his seat ever since.

In 1992, when he was Foreign Minister, Mr. Watanabe was hospitalized for what were described as gallstones. Rumors spread that he was more seriously ill, and he resigned as Foreign Minister for health reasons in April 1993.

He is survived by his wife, Sumiko; two sons, Yoshimi and Michiaki; a daughter, Miyuki, and seven grandchildren.

Douglass Cater Is Dead at 72; Educator and Presidential Aide

By ROBERT McG. THOMAS Jr.

Douglass Cater, a soft-spoken student and practitioner of government power who began his working life as a journalist and ended it as a college president —after a heady detour through Lyndon B. Johnson's White House — died yesterday at the guest house at Washington College in Chestertown, Md.

He was 72 and had lived in Montgomery, Ala., since his retirement as the president of the college in 1990.

His wife, Libby, said that her husband, who was stricken during a visit to the college six weeks ago, died of pulmonary fibrosis.

By the time he went to the White House in 1964 at age 40, Mr. Cater was already an old Washington hand. An original editor of The Reporter magazine, he had spent 14 years covering Washington and national affairs, with occasional time off to write books or serve as a Government consultant.

An analyst of power who moved to the center of it.

Indeed, he began his stint as a special assistant to President Johnson two months after the publication of his third book, "Power in Washington."

It was a measure of Mr. Cater's evenhandedness that five years before his journalist's examination of Government power, he had given his own profession the same treatment in "The Fourth Branch of Government."

Mr. Cater, who had written admiringly of Johnson's use of power as Senate majority leader, had been asked to join his Vice Presidential staff in 1963, but had demurred.

At the time, Mr. Cater was on a leave from his magazine working as associate director of the Center of Advanced Studies at Wesleyan University in Connecticut and wanted to finish his book.

The second call — this time from the White House — "got his attention," Mrs. Cater recalled yesterday.

Mr. Cater, who was given a vague mandate to "think ahead" and had been told by other Presidential assistants that they "made it up" as they went along, took a while to find his niche.

The breakthrough, his wife said, came when he noticed that Johnson's face lit up whenever he read a memorandum on education. Taking the Presidential visage as his guide, Mr. Cater became the resident education specialist, with far-reaching results, among them the first legislation establishing Federal aid to education as a national norm.

"It was one of his proudest achievements," his wife said, recalling that another was the spadework her husband did in creating the Public Broadcasting System.

Mr. Cater, who left the White House in 1968 to join Vice President Hubert H. Humphrey's Presidential campaign staff, later worked as an executive of The Observer and joined the Aspen Institute, which became his base as a freelance writer and political gadfly before taking the Washington College post in 1982.

A native of Montgomery, Mr. Cater, whose full name was Silas Douglass Cater Jr., came by his interest in government naturally. His father, Silas Cater, was a politically attuned lawyer who served in the Alabama Legislature and later became Montgomery City Clerk.

After attending Exeter, Mr. Cater went on to Harvard, interrupting his education during World War II to serve as a Russian specialist with the Office of Strategic Services in Washington, an experience he found so dull, his wife said, that he vowed never again to work as a specialist but to operate as a generalist.

By most accounts he did that brilliantly, earning a reputation as a civilizing influence who brought thoughtfulness to both his extensive writings and his other work.

Resorting to reason when others might rail, Mr. Cater was forever preaching the value of civilized discourse.

In 1984, for example, he persuaded two former Presidents and six former Secretaries of State to endorse a bipartisan statement urging Presidential candidates to moderate their comments on foreign affairs.

Mr. Cater, who wrote widely, including a number of Op-Ed articles for The New York Times, had less success a campaign to persuade the news media, particularly television, to moderate their voices in reporting on Government.

Although his published works on Government were widely praised, perhaps his greatest achievement as a writer was his lone and daring venture into fiction, his 1970 novel "Dana: The Irrelevant Man."

There have been many excellent factual accounts of Washington, of course, but in his review in The Times, Christopher Lehmann-Haupt suggested that Mr. Cater had pulled off something of a miracle in a well-abused genre, proving "that wise reporters can write fiction after all."

In addition to his wife, Mr. Cater is survived by two sons, Silas 3d, of San Rafael, Calif., and Ben, of Baltimore; two daughters, Sage, of Montgomery and Morrow Scheer, of San Rafael; a brother, William, of Millburn, N.J., and four grandchildren.

Letters to Jim 9/16

Watanabe +

Cater

Jim Dorskind

Please coordinate the reply.

THE PRESIDENT HAS SEEN
9/18/95

THE WASHINGTON POST
SATURDAY, SEPTEMBER 16, 1995

At Coors, a Brewing Dilemma Over Gay Rights

By Jay Mathews
Washington Post Staff Writer

The Coors Brewing Co. is run by a family that has helped fund a conservative backlash against gay rights, but has become one of the first companies in the country to extend health benefits to the partners of its homosexual employees.

As a consequence, the corporation, whose annual beverage sales total $1.6 billion, finds itself boycotted both by gay and lesbian activists and by anti-gay Christian fundamentalists.

"It's tough," said Earl Nissen, a Coors executive who, as a member of the Lesbian and Gay Employee Resource (LAGER), helped persuade the company to adopt the new policy. "We are caught between a rock and a hard place."

It is too early to see how the conservative Christian boycott has affected the company, but the gay boycott, which has been in effect for more than a decade, has affected sales. "We can't tell you how much we've lost," said Coors spokesman Joe Fuentes, "but we know it has had an impact."

The controversy illustrates the perils for a corporation whose profits and employee morale come in conflict with the personal ideology of important shareholders. It also shows, despite the strong disdain still felt for Coors by many homosexuals, how far the gay rights movement has come in winning corporate benefits many gays and lesbians see as a big step toward full marriage rights for same-sex couples.

The Christian right and the gay protesters appear somewhat disoriented at finding themselves assailing the same enemy. Coors, for its part, says it stumbled into this predicament through sincere efforts to keep its employees happy and politically involved.

Coors's board of directors voted

See COORS, A14, Col. 1

COORS, From A1

unanimously in May to extend full domestic partner benefits to its gay and lesbian employees, as it had earlier done for unmarried heterosexual employees living with a person of the opposite sex. "The company evaluated the proposal and it fit really nicely into our arsenal of benefits that we can offer new employees," Fuentes said.

The move stunned conservative Christian groups that had been accustomed to Coors support for anti-gay rights efforts. Jeffrey Coors, the nephew of Coors Chairman William Coors and the brother of Coors chief executive Peter Coors, is chairman of the Free Congress Foundation, a Washington-based group that opposes the extension of any special rights to homosexuals.

Fred Phelps Sr., minister of Westboro Baptist Church in Topeka, Kan., announced a boycott of Coors and began organizing a picketing and lobbying campaign. In an interview, Phelps said his church has only 150 members, but has 10 fax machines he uses to publicize the boycott. One fax that he said was sent to churches throughout the country said, "The Coors family of hypocrites claim to fear God, but sponsor filthy fags!"

Christine O'Donnell, press secretary of the 600,000-member Concerned Women of America, said her conservative group also opposes the new Coors policy. "We think that it legitimizes the homosexual lifestyle," she said.

O'Donnell said she was sympathetic to those who wished to boycott Coors, but noted that CWA members weren't "very big drinkers" and would not add much to any anti-beer effort.

Gay and lesbians still angry with the Coors family acknowledged that the company's decision to have a domestic partners program would encourage the conservative managers of other firms to do the same. The largest firms to make the change so far often have been entertainment and software companies, such as Time Warner Inc. and Microsoft Corp.

Coors's recent initiatives in the gay and lesbian community, including money for AIDS research and gay community conferences, have softened the resistance of some gays and lesbians, but not all. "I hear from bar owners who say, 'Earl, we have customers coming into our bars asking for Coors, but I am afraid to place your products because I don't want to have activists hassling my customers,'" Nissen said.

The gay and lesbian boycott of Coors grew out of a national labor boycott of the company that ended in 1987. Gay and lesbian organization officials say they know of no national group that formally endorses the boycott any more, but none of them discourages it and many leaders say they still refuse to buy Coors products.

"We are always pleased to see any company make a step in the right direction," said Donald Suggs, spokesman in New York for the Gay and Lesbian Alliance Against Defamation, a media watch group, "but we have to be careful shoppers and look at the big picture."

Coors's new policy, like that of other companies that have taken the step, extends to gay and lesbian partners the same benefits given married spouses: medical and dental insurance, medical leave, vision care and use of company facilities and the employee store. The partners must sign an affidavit that they have been together at least a year and provide further evidence, such as a joint checking account or joint mortgage.

Howard Tharsing of V Management, who publishes in Oakland the Lavender Screen rating of corporate friendliness to homosexuals, said only 21 other publicly traded companies have done as much for their gay and lesbian employees as Coors. Activists hope such initiatives eventually will lead to official recognition of homosexual marriage, with attendant legal benefits.

O'Donnell said she fears the domestic partners' policy will "desensitize" Americans to gay liaisons and lead to legal marriage for homosexuals.

Fuentes said Coors had a policy of encouraging employees to pursue any political ideas they favored, and the Coors family "has the same privilege." Several company officials said they are aware that William Coors's son is gay, but felt this had no significant impact on the decision to have a domestic partners policy.

THE PRESIDENT HAS SEEN
9/18/95

weekly meeting at the Education Department between Rev. Jackson's representatives and White House and Education staff. Education has agreed to virtually all of Rev. Jackson's requests and his representatives seem quite pleased.. Secretaries Riley and Cisneros and other sub-Cabinet officials have participated in Back-to-School Week activities with Rev. Jackson; Rev. Jackson's representatives have not indicated that Rev. Jackson expects you to personally participate in any of the activities with him.

Mikva memo on judge in Oklahoma bombing case. DOJ did join in a request that Judge Alley recuse himself from the case, but not because of any problem with Judge Alley. DOJ's concern was that some future appellate panel might find some prejudice because of the proximity of the bombing to the courthouse and that Judge Alley and his colleagues knew many of the victims. DOJ would rather have the Circuit appoint a new judge, although the intention is still to have the trial take place in Oklahoma City.

Memo from Secretary Ron Brown on Philippine power project. Forwarded by Erskine in response to your request. Dennis Bakke, CEO of AES Corporation, criticized Secretary Brown for favoring another American company over AES in a Philippine bidding competition for a power plant. AES was not the lowest bidder and Commerce was informed by our embassy in Manila that AES was subsequently disqualified from the bidding because it proposed using a technology that was specifically disallowed. Secretary Brown sent a letter to the Philippine government urging that the remaining U.S. firm be favored in the bidding against the remaining foreign firm. As it turns out, AES had not been disqualified as Commerce had been led to believe. The Philippine government has decided to re-open the bidding and Secretary Brown has written to Bakke explaining that Commerce was given the best information available at the time about the disqualification and that he was happy that AES could submit a new bid.

Ickes memo on L.A. Metrorail Red Line. Follow-up to a recent Cabinet Weekly Report. From 1993 - 1995, the number of jobs generated by federal dollars from this project totaled 21,740. If your FY '96 request of $158.9 million is funded, an additional 7,262 jobs will be generated.

Thank you note from Michael Ovitz. Ovitz thanks you for your "kind words and good wishes" and was "quite moved that you had the time to acknowledge this minor event" [you wrote him on August 15 to congratulate him on his new position with Disney].

John Emerson
Wendy Smith

Original to Chris Jennings
M. 9/10

Chris-

This was sent directly to our Nice. I'm not sure who this gentleman is, or whether the President needed to see it.

Please advise.

Thanks,
Phil Caplen

BAKER
&
HOSTETLER

(202) 861-1725

95 SEP 14 A10:11

September 12, 1995

MEMORANDUM FOR THE PRESIDENT

FROM: FREDERICK H. GRAEFE

SUBJECT: Medicare Payments for Home Oxygen

We believe HCFA intends soon to single out the home oxygen Medicare benefit as an illustration of fraud and abuse and as an example of how the Congress can reduce Medicare costs without affecting beneficiaries.

HCFA only recently has embarked on a regulatory process designed to reduce the payment for home oxygen therapy, which on average is $280 per patient per month. While this is a serious statement--we believe HCFA has manipulated the data available to it in order to reach a predetermined conclusion.

We represent, Invacare, the leading U.S. manufacturer of home oxygen equipment. We believe that HCFA is wrong in its analysis of the industry and Medicare payments for oxygen.

HCFA, only two weeks ago, announced its intention to propose rule-making to adjust the payment for home oxygen therapy. Following the announcement, industry representatives met with HCFA officials to review the data supporting its findings. The industry identified serious errors in the conclusions HCFA derived from this data, but HCFA refuses to adjust its findings to reflect the more accurate information.

We request an opportunity to discuss this matter with Secretary Shalala and your advisors. We believe that we can convince them--on the facts--HCFA is wrong and that the current payment structure is supportable.

Thank you for the opportunity to present these views.

THE WHITE HOUSE

WASHINGTON

September 21, 1995

MEMORANDUM FOR OCCUPANTS OF MCLARTY/STERN/CAPLAN SUITE

FROM: CAROL CLEVELAND Carol

SUBJECT: Security and Unsecuring Suite

As you may have noticed, the access switch for our suite has been replaced by a number pad which is on the wall in front of my desk. The Secret Service is still in the process of installing the new security system and at the present time there are no switches to "throw" or numbers to "punch in." Until the new system is operational, the Secret Service has requested that the first person to enter the suite in the morning call extension 54497 and notify the Control Center that you are in the office. The procedure is the same when you are departing in the evening. If you are the last person to leave the suite, please call extension 54497 to notify the Control Center that you are leaving the office.

When the new security system is operational, the Secret Service will issue a PIN number to each of us that we will have to "punch into" the number pad, if you are the first or last person in the suite. This will eliminate the need for us to call the Control Center.

I will keep you updated as things progress.