

THE WHITE HOUSE

Chief of Staff

97 JUN 5 PM 5:20

Send to TDD Staff
to handle in order
appropriate manner

6/5/97

Send to DSC?

Yes ☒

No ☐

& coordinate with
DSTP if
necessary, C.
T.

Chron

—
↓

Duke University
Durham
North Carolina 27708-0871

Terry Sanford
President Emeritus

June 2, 1997

The Honorable William J. Clinton
Office of the President
The White House
1600 Pennsylvania Avenue, N.W.
Washington, D.c. 20500-2000

Dear Mr. President:

For several years I have had an association with Russian scientists developing hydrogen technology at our Research Triangle Institute under grants from the U.S. Army. Whenever I have met a new Russian scientist, I have inquired about the status of Soviet nuclear fusion technology.

I have been led to believe that there has not been a substantial amount of exchange on this subject between the Russian laboratories and U.S. agencies and institutions. I have no way to verify that contention.

Several weeks ago, two Russian scientists came to consult on our hydrogen project, but their chief interest was in talking with me about nuclear fusion. They were both from the State Scientific Research Institute of Chemistry and Technology of Organoelement Compounds (GNITChTEOS), in Moscow.

I immediately assembled a "Duke team", of our Dean of the School of Engineering, plus senior members of our Chemistry, Physics, Mechanical Engineering and Materials Science, plus a senior staff member of Research Triangle Institute.

These faculty members discussed the matter with the Russian representatives, and are convinced that we should proceed, and have prepared the following suggestions.

Currently, laser fusion methods require a pellet or drop, which must be as rich as possible in deuterium and tritium. Deuterium and tritium (D-T) can combine to produce helium plus a neutron, with the release of 17.6 million electron volts of energy per pair of deuterium and tritium atoms that combine. This D-T fusion reaction is the most easily achievable at all known fusion reactions and in consequence, is the only one under serious consideration. The visiting Russian scientists indicated that they have a technology for producing deuterium-tritium drops having exceptionally high density of deuterium and tritium. Since they are both organic chemists, we presume their drop or pellet consists of a deuterated or tritiated organic material of some kind.

The most advanced laser fusion facility in the US is at the Lawrence-Livermore laboratory, where an array of powerful lasers (64 in all, possibly) can be simultaneously fired at deuterium-tritium pellets or drops. The resulting neutron flux reveals the number of fusion reactions which have occurred. The Russian scientists have indicated that a single test of one of their pellets has shown an increased neutron yield compared to the result with normal pellets, but that their Russian facility is effectively now closed.

Terry Sanford Institute
of Public Policy
Box 90871

Telephone 919/613-7317
Facsimile 919/684-2153

Our conclusion is that these scientists should work with someone in Lawrence-Livermore to have at least one of their deuterium-tritium pellets tested. I would think that the exact nature of the pellet must be revealed before it is tested. Also, it is apparent that some understanding of intellectual property issues will probably need to be ascertained simultaneously, and I have asked our patent people to be prepared to take the appropriate action.

It is my request that the Secretary of Energy authorize the appropriate action at Livermore so that these tests on the Russian material might be conducted.

With best wishes always.

Sincerely,


Terry Sanford

'97 JUN 4 PM 7:51

THE WHITE HOUSE
WASHINGTON

June 4, 1997

MEMORANDUM FOR THE PRESIDENT

FROM: Richard Socarides *RS*

RE: Your note to Sylvia Mathews regarding Nancy Gist at DOJ

Sylvia passed along to me your note to her regarding Nancy Gist and her participation in the White House Conference on Hate Crimes. Actually, the monograph her office at DOJ issued and which she sent to the First Lady has already been helpful to us in the initial planning of the Conference. At Sylvia's suggestion I have spoken with Ms. Gist today and updated her on our work, on your decision to convene the Conference and the plan to announce it in your Saturday radio address. We have also invited her to be a part of the combined White House/DOJ working group we have put together to plan the conference. She very much appreciated being included. I also told her how helpful the monograph had been.

cc: Sylvia Mathews

*Copied
Socarides
COS*

*Good
This is very sharp*

THE PRESIDENT HAS SEEN
6-5-97

'97 JUN 4 PM8:23

THE WHITE HOUSE
WASHINGTON

June 4, 1997

MEMORANDUM FOR THE PRESIDENT

FROM:

CHARLES F.C. RUFF
DAWN CHIRWA
BILL MARSHALL

Chirwa / one

one

one / one

OK - a gey
B C

Copied
Ruff
Chirwa
Marshall
COS

CC:

ERSKINE BOWLES
SYLVIA MATHEWS

SUBJECT:

1. Board of Education of the Township of Piscataway v. Taxman
2. Adarand v. Peña

I. Piscataway v. Taxman

We wanted to inform you of the Justice Department's intention to file **tomorrow, Thursday, June 5, 1997**, a brief as amicus curiae in the case of Piscataway v. Taxman. The current brief is being filed pursuant to a Supreme Court order, entered on January 21, 1997, requesting the views of the United States in the case.

Briefly, the case arose after the Piscataway school board decided to eliminate a position within the business department of the district's high school. Faced with two teachers who were equally qualified and similarly situated with respect to seniority -- one white and one black -- the board decided to retain the black teacher in favor of the white teacher on affirmative action grounds. The board stated that affirmative action was warranted in this case in order to preserve a racially diverse business department within the high school.

Taxman filed suit and won at the district level and the school board appealed to the Third Circuit. In 1992, at the district court level, the Justice Department joined the case on Taxman's behalf. On appeal, however, Justice sided with the school board and submitted a brief defending a school's ability to use affirmative action -- both in hiring and lay-off situations -- for purposes of promoting racial diversity. The Third Circuit dismissed Justice from the case and ruled in favor of Taxman on the merits. The court held that non-remedial affirmative action is impermissible under Title VII. The school board has petitioned for certiorari.

In the brief to be filed tomorrow, Justice argues that certiorari should not be granted because this case is not an appropriate vehicle for the Supreme Court to decide the important question of whether Title VII permits non-remedial affirmative action. Justice's rationale is that because of its inadequate record and its unique factual circumstances, the case is not suitable to

further the principles announced in our post-Adarand memorandum which sets forth Administration policy on the appropriate use of affirmative action. (Justice's brief was filed after the Office of Legal Counsel post-Adarand memorandum was finalized). Therefore, Justice's brief does not need to address the same issue it addressed before the Third Circuit; i.e. whether affirmative action is permissible in this particular case.

We believe that this brief achieves two necessary goals: (1) answering the Court's request; and (2) forestalling potential criticism that Justice has distanced itself from its position before the circuit court. It also represents a sound legal position. Because of its unique and troublesome facts, Piscataway does not invite a favorable decision on affirmative action. For this reason, it is notable that no civil rights organizations are filing briefs in support of the school board in the case.

II. Adarand Constructors, Inc. v. Pena

On Monday, the district court for the District of Colorado ruled on Adarand v. Pena which had been remanded back to the district court by the U.S. Supreme Court in order to review the Department of Transportation affirmative action program at issue under a "strict scrutiny" standard. The district court found that while there was a compelling governmental interest in this program, it was unconstitutional under the strict scrutiny standard because it was not narrowly tailored. Among other aspects of the affirmative action program which the court found troubling, the court ruled that the statutory presumption which provides that members of specified racial minorities are presumed to be socially and economically disadvantaged was not narrowly tailored.

Thus, although the court's finding that there is a compelling governmental interest in affirmative action programs is encouraging, the finding that the statutory presumption undergirding the federal government's SDB programs fails the narrow tailoring prong of strict scrutiny is extremely troubling. In addition, the court entered an injunction against the particular Transportation program at issue. However, the court left unclear how broadly the injunction applies -- i.e. whether it applies to all federal programs which contain the racially based presumption, including 8(a) and other federal SDB programs.

The Department of Justice intends to file a Motion to clarify the extent of the court's injunction. Once the motion is decided, Justice will review what further litigation steps are appropriate. We also believe that Justice's procurement reform proposal will address most, although possibly not all, of the constitutional problems found by the court.

~~THE PRESIDENT HAS SEEN~~
~~1.6-5-97~~

~~CAROLYN~~

~~STUBB~~

Palmer

anything in there?

Be

copied
Emanuel
COS

Breaking the Rules

As Congress frets over Clinton, two of its most ethically challenged Republicans are getting off scot-free

BY NURITH C. AIZENMAN

BACK IN FEBRUARY OF 1996, normally easygoing Gary Ruskin was on the warpath. His call to arms: news reports that two of the most prominent Republicans in Congress, Representatives Bud Shuster and Tom DeLay, had handed out legislative favors to family, friends and financial contributors. As director of The Congressional Accountability Project, a Ralph Nader watchdog group, Ruskin felt it was his job to make sure they didn't get away with it. His plan was simple; he'd file a complaint with the House Ethics Committee so that it would be forced to investigate the allegations.

It wasn't long before Ruskin realized that he had chosen a mission impossible. Just lodging the complaints was a Herculean chore. Outsiders are not allowed to file directly. Instead, the House's quirky rules required Ruskin to either find a Congressman to sponsor his complaint, or obtain three letters from members officially *refusing* to do so. Ruskin figured Republicans would be less than happy to help him attack two of their own, so he went straight to the Democrats. But the reception from the minority party was equally cool. Why? Possibly because Majority Whip Tom DeLay is the third most powerful member of the House; and as Chairman of the House Transportation Committee, Bud Shuster effectively controls the funding for roads in every member's district. No one, it seemed, was eager to cross them. And even if Ruskin did manage to file his complaints, sympathetic Democrats warned, his chances of ultimate success were nil. "I knew [the Ethics Committee] wasn't going to do anything about it," recalls former Representative Patricia Schroeder. "I felt like I was telling him there was no Santa Claus!"

Sixteen months later—and over two-and-a-half

years after Shuster and DeLay first engaged in their dubious activities—the Ethics Committee has yet to launch even a "preliminary inquiry." At a time when members of Congress insist on analyzing every drop of President Clinton's coffee, Shuster and DeLay appear to have escaped notice. The story of how they did so reveals as much about the troubled ethics process as it does about the questionable morality of these two members.

The Hammer

What is particularly disturbing about the charges against both Shuster and DeLay is that they involve the most pernicious form of political corruption. These are not your run-of-the-mill tax evasion or petty theft cases. Instead the two men are accused of the kind of *quid pro quo* that most fundamentally threatens our democracy: the exchange of money and friendship for legislative influence.

Perhaps the starkest example of this was the allegation that DeLay had directly linked campaign contributions to official actions. *Washington Post* reporters David Maraniss and Michael Weisskopf described how corporate lobbyists meeting with DeLay were instructed to look themselves up in a book listing the "amounts and percentages of money that the 400 largest political action committees had contributed to Republicans and Democrats over the last two years. Those who gave heavily to the GOP were labeled 'Friendly,' the others 'Unfriendly.'" One of the lobbyists interviewed by the *Post* learned the hard way that his PAC was in the wrong category. "By the time [he] left the congressman's office, he knew his group would have to give the party a lot more money."

As for those in the "Friendly" camp, there's little doubt that they were rewarded with unprecedented perks. During the 104th Congress, DeLay

openly invited favored lobbyists to write the legislation deregulating the very industries they represented. Some were even spotted sitting on the dais during committee hearings.

DeLay's fundraising tactics were in direct violation of House ethics rules barring "considerations such as political support, party affiliation, or campaign contributions," from affecting "either the decision of a Member to provide assistance, or the quality of the help that is given." His blunt approach earned him a new nickname: "The Hammer."

Questions have also been raised about DeLay's work on behalf of interests represented by his lobbyist brother, Houston lawyer Randy DeLay. The younger DeLay got into the lobbying business almost immediately after his brother was elected majority whip. The clients came running. According to Frank Greve of Knight-Ridder, Randy DeLay raked in over \$550,000 during his first year in business.

Among DeLay's customers was a Mexican cement company called Cemex, which was involved in a trade dispute with the United States. Cemex had been slapped with an anti-dumping tariff for selling its cement over the border at unfair prices. According to Greve, Randy DeLay met or called his brother 21 times for the specific purpose of lobbying him on the Cemex issue. In August of 1995, Congressman DeLay wrote letters to the U.S. Trade Representative and the Secretary of Commerce unsuccessfully urging that the tariff be lifted. DeLay also helped draft a failed bill which would have accomplished the same thing. And both DeLays got other prominent Republicans to sign letters in support of Cemex.

This was not the only time the brothers DeLay worked in tandem. When Congressman DeLay fought to allow Union Pacific Railroad to acquire Southern Pacific for \$54 billion, some Texas voters were confused. There was significant concern that the merger would have anti-competitive effects—particularly in Houston, where the deal would give Union Pacific control over 11 of the city's 13 rail lines. Why would DeLay act against his constituents' interests? Perhaps because Union Pacific was one of his brother's clients. Rep. DeLay was also a major supporter of the I-69 Mid-Continent Highway Coalition's bid for designation as a federal highway. Randy DeLay is—you guessed it—a lobbyist for the coalition.

At the very least, the elder DeLay's relationship with his lobbyist sibling violates the House prohibition against "discriminat[ing] unfairly by the dispensing of special favors or privileges to anyone."

Shuster's Shenanigans

Tom "The Hammer" DeLay may be the master of influence peddling, but when it comes to mixing politics, money, and friendship, Bud Shuster is the Chuck Yeager of Congress—continually pushing the envelope of what is permissible. Perhaps his smelliest achievement has been the mutually lucrative alliance he has forged with longtime aide Ann Eppard. In November of 1994, after over 20 years of service, Eppard resigned from her job as Shuster's chief of staff and started her own lobbying firm, Ann Eppard Associates. Her timing couldn't have been better. The Republicans had just retaken the House, and her old boss was poised to become Chairman of the Transportation Committee. Apart from controlling billions of dollars of government spending on federal highways, the committee oversees the nation's railroads, aviation, trucking and shipping industries. Possibly encouraged by Shuster's declarations that Eppard had been his "right hand for over a quarter of a century," representatives of these industries practically fell over themselves to sign her on. In a matter of months Eppard became a hired gun for Federal Express, Amtrak, Conrail, Frito-Lay, and the Outdoor Advertisers Association of America. Ann Eppard Associates was an overnight success; according to William Roberts of the *Journal of Commerce*, it racked up over \$1 million in its first year alone—over \$600,000 of that from transportation clients.

During that first year, federal law prohibited Eppard from directly lobbying Shuster; but she hardly kept her distance. Instead, Eppard stayed on as assistant treasurer of Shuster's campaign, drawing a salary of \$3,000 per month and helping to raise over \$655,000 for his re-election. Eppard also chaired a fund-raiser to collect \$40,000 to finance a portrait of Shuster which was hung in the Transportation Committee hearing room. And Eppard continued to perform many of her former duties for the congressman—representing him on an advisory panel on base closings, vetting county commissioner candidates, and driving him around Washington. According to *Roll Call's* Timothy Burger, Eppard's car even sported the license plate "US House PA 9." No need to mention which Congressman represents the Ninth District of Pennsylvania.

Then there was the creative use of Eppard's Alexandria, Virginia home. Shuster has described Eppard's waterfront town house as "the legal repository for our campaign documents," and the base from which Eppard did her fundraising. Yet this is

the same home out of which Eppard runs her lobbying practice, serving clients with interests before Shuster's committee. And—as if things weren't murky enough—it is the same home at which Shuster regularly spent the night while Congress was in session, presumably without paying rent. This, despite the fact that House rules then in place clearly stated that a member could not accept hospitality from a personal friend for more than 30 days a year without obtaining a prior written waiver from the House Ethics Committee.

The overlapping ties binding Shuster and Eppard caused some alarm among her competition; so did Eppard's reportedly daily presence in Shuster's office during the period she was forbidden to lobby him. The two friends could certainly be insensitive to appearances—once holding a meeting in a back room at the precise moment the Transportation Committee was passing a bill on ocean shipping reform in which Eppard's clients had a major stake. Shuster's office has maintained that the two were discussing a completely unrelated matter, and both Shuster and Eppard have insisted that they scrupulously avoided any discussion of issues affecting Eppard's clients during the "cooling off" year.

Nonetheless, Eppard's clients have every reason to be pleased with her work. Her former boss has fought hard in the interest of many of them. Thanks to Shuster, Frito-Lay and FedEx won relief from regulations on mid-weight delivery trucks—over the protests of trucking safety proponents. The Outdoor Advertisers of America should also be grateful to the chairman for persuading the House to slip a provision into the National Highway System bill that has made it easier to place billboards on scenic federal roads. And last year, Eppard lobbied Shuster on behalf of Carnival Cruise Lines for his support of a "technical amendment" tacked onto the Coast Guard re-authorization bill that would have protected cruise companies from lawsuits by women raped aboard their ships unless the woman had also suffered "substantial physical injury."

Ethics Shmethics

As soon as the allegations against Shuster and DeLay began to surface, watchdog groups like the Congressional Accountability Project (CAP) and Common Cause sprang into action. CAP's Gary Ruskin began the laborious task of gathering the signatures he needed to file each complaint. No one was biting. "There was this period of months where everybody we'd call up was not interested. I don't

know if you've had the experience of calling up 70 people who all say no to you. It's pretty tiresome."

Tiresome, but typical. Although, as Newt Gingrich's case demonstrated, members are occasionally roused to attack high-profile opponents, Gingrich is the exception that proves the rule: Most of the time congressmen are loathe to file—or even facilitate—a complaint. Many worry about inviting scrutiny of their own ethics by the opposing side. Even if a member's record is squeaky clean, a complaint may come back to haunt him in other ways. If you are a congressman and you file against a colleague "that member will remember it FOR THE REST OF YOUR LIFE!" notes longtime congressional aide Dan Buck. "Members think, 'Why get involved? The downside is incredible and the upside doesn't exist.'" As a result, members are rarely aggressive in pursuing even less powerful colleagues. "The American people have this funny notion that there is deathly serious warfare between the parties," observes Ruskin. "But what really happens is that there are all sorts of areas that are off-limits, and ethics is one of them."

While Ruskin was starring in his own private version of *Death of a Salesman*, the folks at Common Cause were trying the different—but equally fruitless—approach of urging the Ethics Committee to open its own inquiry into Shuster. The committee can (and, once in a blue moon, does) initiate complaints against members. But in this case the request was greeted with deafening silence.

Common Cause's Meredith McGehee was disappointed, but hardly shocked. If the general membership of the House is reluctant to pursue their colleagues, members of the Ethics Committee regard the prospect with horror. It's hard to blame them. Once an investigation is in full swing, the Ethics members are in the unenviable position of having to dig up dirt on the same people with whom they must trade favors and votes in the course of their other business. Not surprisingly, Ethics is the only committee which members actively lobby *not* to be on. "It is the least desired assignment in Congress," says Rep. Ben Cardin, formerly the ranking Democrat on Ethics. "No one serves on this committee by choice." Those who do get corralled into service are usually bribed with plum assignments on the Appropriations or Ways and Means Committees. And Ethics is almost always the last committee to be filled.

Not only did the Ethics Committee decline to investigate Shuster, but its chairwoman, Nancy John-

son (R-Conn.), pushed the committee to exonerate him. In February of 1996, Shuster released the transcript of a conversation he had recently had with an Ethics Committee staffer and tried to claim that it somehow absolved him. It didn't. Shuster had been short on specifics and had only been asking about future actions under newly passed rules. And even if he had been asking about his past actions, oral advice is not an acceptable substitute for the prior written waiver members must obtain to get around the gift rule. Nonetheless, Johnson sought to have the committee write a letter which would memorialize its conversations with Shuster. This was too much for the Democrats, who charged that, at Shuster's urging, Johnson was trying to force through an after-the-fact written waiver to shield him from subsequent inquiry. After much wrangling, the committee produced its compromise: a bizarre letter to Shuster which was "not intended to express approval or disapproval of any actions you have taken in the past," but instead contained "the committee's general guidelines on the issues raised." Ironically, a reading of the letter would seem to indicate that Shuster had indeed violated the rules. Yet Shuster bandied the letter about as if it cleared him. As for DeLay, he was completely off the radar.

Hurry Up & Wait

By September, Gary Ruskin was beginning to lose hope. After seven months of going door-to-door, he had yet to collect a single signature—and the deadline for complaints (which must be filed 60 days before an election) was fast approaching. Then, at the last minute, he had a breakthrough. Rep. Luis Gutierrez (D-Calif.) agreed to sign a letter of refusal for both the Shuster and DeLay cases. "Now there's a man with a vertebrae!" exulted Ruskin. Retiring Democrats Patricia Schroeder and Pat Williams quickly followed suit on the Shuster complaint. And

Representatives Robert Matsui (D-Calif.) and Thomas Barrett (D-Wis.) signed off on DeLay. Hours before the deadline, Ruskin rushed into the Ethics Committee with his completed complaints. "That was a crazy day!" he remembers.

If you're wondering what progress was made since then, the answer is: Absolutely None.

The committee has taken full advantage of its own procedures to accomplish as little as possible. And opportunities for foot-dragging abound. Once a complaint is filed, the accused party is given 30 days to respond. During that period, the committee's staff can begin to collect information on the case. However

this is a purely optional step—and one which congressional sources say was not taken in either the Shuster or DeLay complaints.

By the time the 30 days were up, Congress had adjourned, temporarily halting all action on complaints. Normally this would not have been a problem because traditionally complaints have carried over into the next Congress. But once again, Nancy Johnson threw a wrench in the works. Johnson asked the House parliamentarian for advice on whether the pending complaints

should automatically carry over. He responded that since the Ethics Committee would have to be reconstituted for the new Congress, it would be up to the new committee to decide. Johnson seized on this interpretation. The Ethics committee's end-of-the-Congress report stated that the parliamentarian had "ruled" that the complaints had "expired." "Technically, everything is over," proclaimed Chief Ethics Counsel Ted Van Der Mied. The status of both the Shuster and DeLay complaints was suddenly thrown in doubt.

It is as yet unclear whether either complaint will be put back on the agenda. If they are not, Ruskin will face an uphill battle to refile them. Two of the members who signed the letters of refusal he needed to file his Shuster complaint have since retired.



Representative Tom DeLay (R-Texas)

AP/WIDE WORLD PHOTOS

And there is speculation that Congress will soon vote to close the letter of refusal route—leaving Ruskin with the near impossible task of finding someone willing to actually *sponsor* complaints against Shuster and DeLay.

In any event, it will be a while before the committee has a chance to even contemplate the issue. So far only two of the 10 slots on the Ethics Committee have been filled. And as of late January a moratorium was declared on all complaints until a special task force could come up with recommendations for improving the Ethics Committee. The moratorium's ostensible purpose was to clear the air after the House voted to reprimand Gingrich for ethical violations and "assess" him \$300,000. This breathing space might have been a good idea if it had lasted a few weeks—but the moratorium has now been in place for four months. "It's the equivalent of the police saying, 'We're not going to have any arrests until we figure out what we're doing!'" says Dan Bück. Confidence in the task force was also shaken earlier on when Co-Chair Bob Livingston announced he was bringing in Washington lawyer Richard Leon as the task force's legal counsel. Leon happens to be the attorney for none other than...former Bud Shuster aide Ann Eppard. Meanwhile the task force keeps pushing back the deadline for concluding its work. And few expect its recommendations to involve anything more than marginal tinkering.

Cleaning House

That's a shame. Although a system that relies on members to judge each other has unavoidable pitfalls, there are a number of measures that can and should be taken to force members into doing a better job. To start with, given the reluctance of members to follow up on reports of even obvious wrong-doing by their colleagues, the rules should be changed to allow outsiders to file complaints directly. Although the Senate employs this system with-

out problems, there is legitimate concern that allowing outsiders to file will unleash a flood of frivolous complaints designed to harass members or hurt their chances for re-election. This danger could be avoided by prohibiting the filing of complaints less than 90 days before an election—in contrast to the 60-day deadline currently in place. Filers could also be made liable to a fine or reprimand for complaints deemed groundless.

Once filed, complaints should be automatically assigned to an outside investigator who would gather evidence and make a recommendation as to whether a preliminary inquiry is warranted. A good

outside counsel is necessary because it is simply unrealistic to ask members to aggressively probe colleagues with whom they must simultaneously maintain cordial relationships based on mutual assistance. Shifting the investigatory burden to a fair and committed outsider gets around the problem. The Gingrich case—which did not get off the ground until outside attorney Richard Cole was brought in—demonstrated how once members are confront-



Representative Bud Shuster (R-Pa.)

ed with hard evidence gathered by an outside investigator, it is harder for them to keep their heads in the sand. But at present, the decision to bring in outside counsel is purely optional, and members often resist doing so. Making that step automatic would free members from having to take the politically unpalatable decision of moving forward on a case—they would no longer have a choice.

Of course the success of an investigation would be entirely dependent on the character of the outside counsel—and knowledgeable, but nonpartisan lawyers are not a dime a dozen in Washington. Nonetheless, as Richard Cole proved, such people do exist. In order to ensure that the committee always chooses them, it should be required to assemble a pool of possible counsels in advance. The counsels would then be "on call"—picked from the pool at

random whenever a complaint was filed. Since there would be no way of knowing whether candidates selected for the pool would end up investigating a Republican or a Democrat, committee members would have an incentive to choose individuals likely to be fair to both.

The Ethics Committee should also be put on a strict timetable. Shortly after the outside counsel comes back with his initial recommendation as to whether a preliminary investigation is warranted, the committee should be required to vote. Similarly, once the counsel has completed his preliminary investigation, the committee should have a deadline for voting as to whether to adopt a "Statement of Alleged Violation"—the committee's version of an indictment. And the same holds true for the judgment hearings the committee would hold once the final inquiry is complete.

There should also be no question as to whether complaints left unresolved at the end of one session will roll over into the next one. Otherwise, Ethics Committee members will have too strong an incentive to drag their feet—just ignore a pesky complaint and it will eventually go away. If automatic carry over cannot be adopted as a permanent rule, it should at least continue to be observed as a strict tradition.

The Ultimate Weapon

But no amount of restructuring can address the Ethics Committee's fundamental problem: When it comes to judging their peers, members of Congress have an inherent conflict of interest. Unfortunately, they are constitutionally mandated to fulfill this responsibility. In order to preserve the balance of power between the three government branches, the Constitution charges Congress with policing itself. The founding fathers certainly meant well, but it's possible that in this particular instance they made a (perish the thought!) unfortunate mistake.

Still, in the founder's defense, they did not completely defang the judicial and executive branches. Many violations of House ethics rules are also federal crimes. And in the absence of vigorous investigation by the Ethics Committee, the Justice Department can and sometimes does pick up the slack.

It was the Justice Department, for instance, not Ethics, which first uncovered the willingness of eight congressmen to take money from Arab sheiks seeking political favors. The sheiks turned out to be undercover FBI agents in the now famous "Operation Abscam." Similarly, if it had not been for the curiosity of Justice Department investigators, Dan

Rostenkowski, the once powerful chairman of the House Ways and Means Committee, would never have been held accountable for using taxpayer money to buy friends expensive gifts and pay them salaries for work they hadn't performed. The Justice Department refused to let the matter rest until Rostenkowski had been sentenced to jail. The Ethics Committee played no role.

The Justice Department has also stepped into the void left by the Ethics Committee in the Shuster case. Interestingly the department appears to be focusing on a whole new set of issues beyond those mentioned in Ruskin's complaint. According to *The Boston Globe*, among other questions, investigators are examining whether Shuster or Ann Eppard helped obtain more favorable settlements for two contributors whose business properties were being seized to make way for the construction of the federally funded Central Artery Project in Boston.

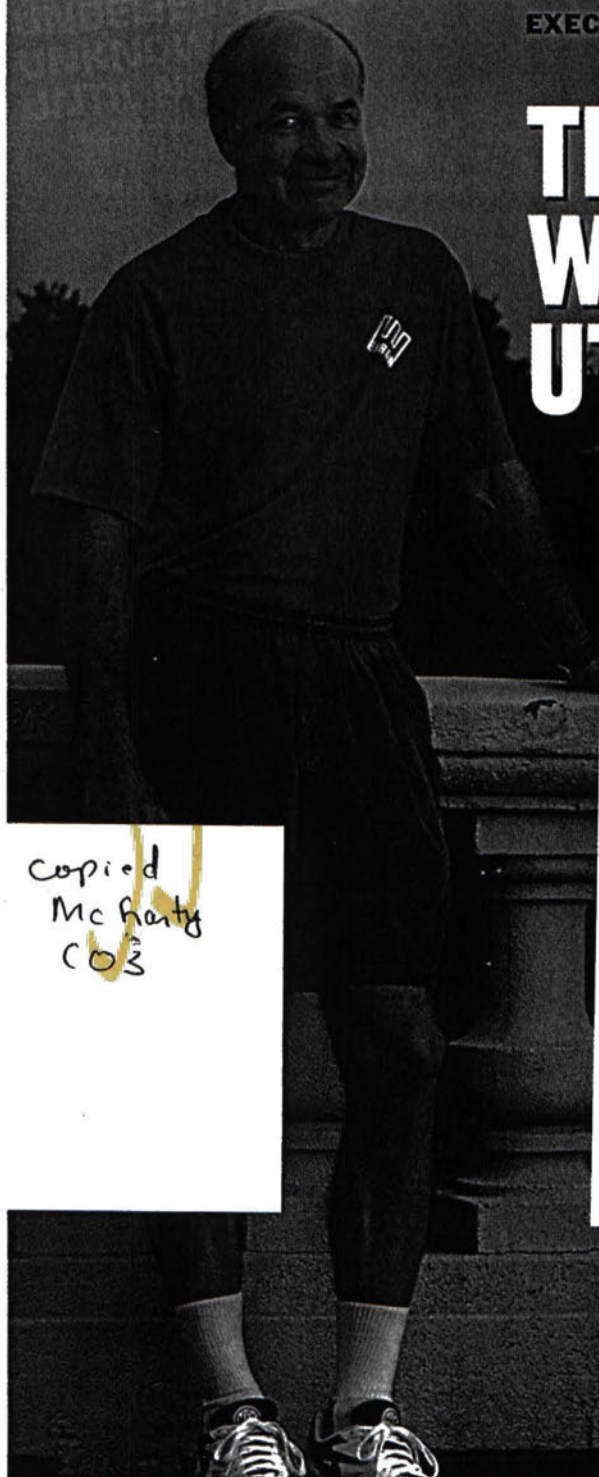
The Justice Department is a crucial means of ensuring that corrupt politicians aren't let off the hook. Its efforts should be applauded—and encouraged. Still, there is only so much that the department can do. Many actions deemed unethical under House rules are not technically illegal under federal law.

Ultimately the best weapon against corrupt congressmen is the ballot box. From this perspective, investigations of politicians are only important in so far as they bring to light misdeeds that voters ought to know about. If it becomes clear that a congressman is ethically challenged, we can vote him out of office—without need of a lengthy and costly inquiry to tease out the finer points of his guilt. But voters can't do their job unless they have the information to make wise decisions. Every effort must be made to get it to them. Reporters like William Roberts, Frank Greve, Timothy Burger, and others mentioned in this story deserve credit for shining their light on Shuster and DeLay—but they are all too rare. More journalists need to follow their example.

The secretive House ethics process must also be flung open. At present, the committee need only reveal its decision to launch a preliminary inquiry, and its final judgment on a case. Instead, at all phases of the ethics process, the status of a complaint, and the findings of the investigating counsel should be made public. To those members who complain that such openness would violate their privacy, there is a simple response: The ethics process is not a criminal proceeding in which the rights of the individual take precedence—it is a forum for public reckoning, fundamental to the safeguarding of our democracy. ●

EXECUTIVE SUITE

THE QUIET MAN WHO'S JOLTING UTILITIES



copied
Mc Harty
CO3

THE PRESIDENT HAS SEEN
Mark Mc 6-5-97

good article
except for his
unfortunate
political
judgments
Bx

CEO Kenneth Lay is getting Enron ready for open electricity markets and shaking up a staid industry

He doesn't make a striking impression. Short, soft-spoken, with the big hands of the Midwest farm boy he once was, Kenneth L. Lay is unlikely to be taken for an energy mogul. Yet even though he's little known outside the insular natural-gas business, Enron CEO Lay is becoming the most visible and feared advocate of opening the nation's \$215 billion retail electricity market to competition.

Bringing to his task a missionary zeal for electric deregulation and the confidence of a master strategist, Lay, 55, has already maneuvered Houston-based Enron Corp. past the nation's largest electric utilities in wholesale markets, which were deregulated three years ago. Selling primarily to utilities and municipalities, Enron saw its power revenues jump 236% last quarter, compared with a year earlier. Altogether, Enron expects

electricity revenues to climb from \$1.2 billion in 1996 to at least \$3 billion this year, equal to a quarter of the revenues it makes in its core gas-trading business. That has put Enron in the catbird seat for the coming electric free-for-all: The company is by far the biggest player in the wholesale market; its 19% share is almost double that of its nearest rival.

Now, Lay wants a clear shot at the far larger retail market selling electricity directly to homeowners, businesses, and industrial consumers. This market has been the preserve of utilities since its inception. But traders such as Enron want to start buying cheap surplus power from utilities around the U.S., supplementing it with power from their own plants, and selling it in pricier markets.

So Lay is making the biggest gamble of his career, trying to supercharge the sputtering pace of deregulation even as he transforms Enron—a company that caters to a few big customers—into a consumer-savvy energy marketer. If deregulation roars ahead, the payoff could be huge. With the combined markets for retail gas and electricity estimated at \$320 billion, Donaldson, Lufkin & Jenrette Securities Corp. analyst Curt N. Launer figures that by 2000, Enron could add \$300 million a year to its profits for each 1% share of the retail market it gains. Enron, now a \$13.2 billion company, could easily triple in size.

A deregulation slowdown would be costly, however: Enron is spending heavily on services and infrastructure. The head of one rival expects Enron to spend up to \$500 million to develop its retail business. "If it takes 10 years to open a sizable residential market, [Enron is] toast," he says. "It'll cost too much."

"RENAISSANCE MAN." Lay's gambit comes at a critical time for the company. Setbacks in Enron's push overseas have already cooled its profit outlook, and its spending to move into electricity has forced Lay to abandon a 1995 pledge to lift profits 15% annually through 2000. Enron shares, now trading at about 40, have significantly trailed the Standard & Poor's 500-stock index for the past two years. So far this year, Enron is off 6%, while the index is up 15.5%.

Deregulation, meanwhile, moves one step forward, two back. After a strong start in California, which will open its \$20 billion electricity market next January, efforts nationwide appear to be faltering. On May 20, passage of a federal law mandating open markets was declared dead for this year by the bill's sponsor. The same day, Texas lawmakers suspended work for two years on a bill to open that state's electricity market.

Pointing out that seven states have approved legislation to open markets next year, Lay is characteristically up-

beat. "If anything, [deregulation is] going faster than we thought," he says. "There's no longer a debate on if it'll happen—it's when it happens." Such talk has made him and his company the bêtes noires of the utility world. "To listen to CEOs in the electric industry talk about Enron, you'd think they were talking about the devil incarnate," says James E. Rogers, CEO of Cincinnati gas and electric utility Cinergy Corp. and a former

Kenneth Lay

BORN Apr. 15, 1942, Tyrone, Missouri

EDUCATION University of Missouri, B.A., 1964, M.A., 1965, in economics; University of Houston, PhD in economics, 1970

CAREER

1965-68 Humble Oil: economist

1968-71 U.S. Navy: Officer Candidate School, then Pentagon

1972-74 U.S. Interior Dept.: Deputy Under Secretary

1974-81 Florida Gas: vice-president for corporate development, then president

1981-84 Transco Energy: president and COO

1984 Houston Natural Gas: CEO

1985-present Enron: CEO

MADE HIS MARK Took deregulation of natural gas as an opportunity to transform the good-oil-boy gas business into a fast-paced financial marketplace

AVOCATION Politics: Chaired Senator Phil Gramm's 1996 Texas Presidential campaign-finance committee, President George Bush's 1990 Economic Summit

FAMILY Married 15 years to second wife, Linda

RECREATION Jogging and skiing

Enron exec. "There is genuine fear."

In nearly every state, Lay is facing off with utilities that are trying to avert or delay competition. In Texas, Enron's 10 lobbyists tangled with an army of 70 utility representatives. If opponents fear Lay, it's because no one else is pushing as fast or as hard—and because he's trying to repeat history. In the mid-1980s, Lay forced the pace of gas deregulation, then beat rivals into new mar-

kets, turning debt-laden Enron into the nation's biggest, most profitable buyer and seller of gas.

One of three kids in a Missouri farm family, Lay, who started hiring himself out as a part-time hand to local farmers at the age of 12, "learned to think on the back of tractors," says Oliver G. Richard III, CEO of Columbia Gas Systems Inc. and a former Enron executive. "I asked him once where he got his good ideas. He says, 'It's riding around on a tractor in the flat plains of Missouri.'" But Lay is no country bumpkin: Texas Senator Phil Gramm, a longtime Republican friend for whom Lay has worked as a fund-raiser, says there's "an element of the Renaissance man" about the well-read Lay, noting that he's "as comfortable talking about the ancient Greeks as he is the competitive selling of electric power." Gramm also credits Lay, who has a PhD in economics, with an ability to separate the important from the trivial. "He has the ability to step back from an issue and see the big picture, something that I don't see in a lot of people in business," says Gramm.

GAS "BANK." Lay also displays an unshakable confidence tempered by more than a decade of taking big risks and winning. In 1985, he helped create Enron, the fruit of a difficult merger between two small, struggling pipeline companies, Omaha-based InterNorth Inc. and Houston Natural Gas Corp., of which Lay was CEO. Abruptly named overall CEO because of infighting brought on by the clash of cultures, Lay quickly ended the squabbling by establishing a single headquarters in Houston.

But soon after, oil prices plummeted, siphoning off gas customers. Then the fledgling company lost \$85 million in a crude-oil trading scandal. Still, Lay moved Enron ahead, building separate units to find, transport, and market gas. Recalls John M. Seidl, president from 1986 to 1988: "He just stood up and said, 'We've got to figure out what's going on here.' He's always calm—asks, 'What are our options? Let's figure it out.'"

Lay also became known as an inspiring manager. "When you join Ken, you believe you are going to change the shape of the industry—that you're on a mission," says Cinergy's Rogers, who worked for him at HNG and Enron. W.J. "Jack" Bowen, a retired gas executive who employed Lay in two earlier energy posts, first at Florida Gas Co. and later at Transco Energy, says Lay motivates by being visible and giving managers freedom to operate, make mistakes, and grow. He reached out to employees at all levels, Bowen recalls: "He enjoyed getting out on the pipeline, going to compressor stations, talking to people, and making sure he really listened." Lay says

People

he gives managers autonomy because that's what he wants himself: "If you get involved in building things, you tend to like being your own boss and being responsible for it."

After its rough start, Enron took off as Lay created a nationwide marketing presence. A breakthrough was the concept of a gas "bank" enabling the company to guarantee firm, fixed-priced gas contracts to industrial customers in a market where prices vary by the minute and regional prices differ widely. Lay's economic insight was to pool scores of long- and short-term contracts to eliminate the supply risk and minimize the company's price risk. Although the bank itself didn't take off, pooling contracts and tracking their cash flows enabled Enron to turn them into financial instruments that could be aggressively traded. "It was the start of a new industry," says Jeffrey K. Skilling, a former McKinsey & Co. consultant who joined the company in 1990 to develop its trading business and who became Enron president in January.

As natural-gas deregulation hit its stride, Lay's economic training and Washington insider's grasp of deregulation—he had done a stint in the Interior Dept. in

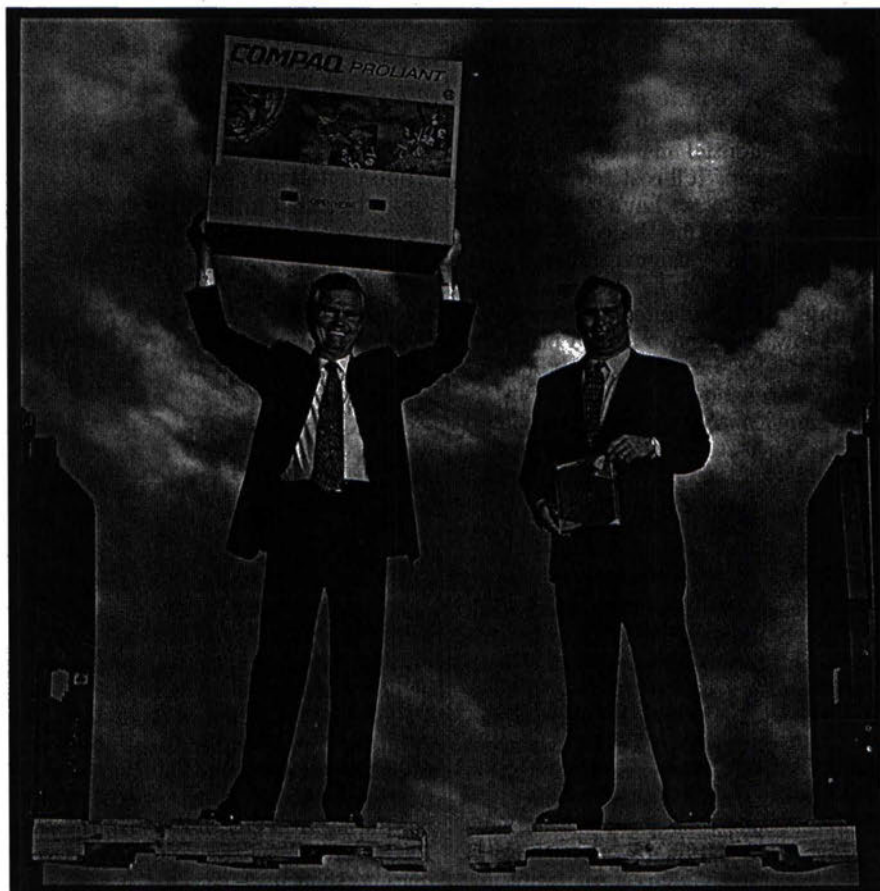
the early 1970s—became Enron's greatest assets. "His economics background gives him an extra edge in taking apart a problem, figuring out the risks—and how to make money," says Seidl, an Interior Dept. colleague before he joined Enron. Recognizing early on that deregulation would turn the good-ol'-boy world of gas on its head, Lay snapped up former commissioners from the Federal Energy Regulatory Commission and regulatory lawyers who didn't wear the blinders of the old era.

"When you join Ken, you believe you are going to change the shape of the industry—that you're on a mission," says Cinergy's Rogers, an early member of Lay's team

Then, having triumphed in the U.S. with gas deregulation, Lay turned his attention in the early 1990s to creating new gas markets overseas, building pipelines and power plants in energy-starved countries. The plan was a hit in places such as Argentina and the Philippines. But in 1995, in Dabhol, India, Enron hit a wall. When the company's proposed \$2.8 billion power plant there became a symbol of too-lenient terms for foreigners, a new government created obstacles leading to a yearlong construction delay. Enron agreed to increase the project's output and reduce its cost, and the plant, where construction is wrapping up, should begin operation next year.

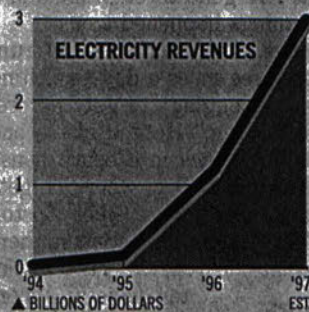
OREGON DUSTUP. Enron is still developing overseas projects, but other delays and rising competition have put it far behind more focused rivals, such as AES Inc. in Arlington, Va. "AES has just sprinted ahead of Enron," says an international energy analyst who declined to be named. One sign of the letdown: Enron on May 14 announced plans to purchase the outstanding shares of Enron Global Power & Pipelines LLC, taking private the 1994 initial public offering it created to draw profits from its international projects. Lay has responded in

SAP, R/3, the SAP logo, and A River Runs On Information are the registered or unregistered trademarks of SAP AG. All other products or companies mentioned in this advertisement may be the registered or unregistered trademarks of their respective companies and are hereby acknowledged. ©1997 SAP America, Inc.



Eckhard Pfeiffer, President and CEO, Compaq Computer Corp.; Gary Greenfield, CEO and President, INTERSOLV

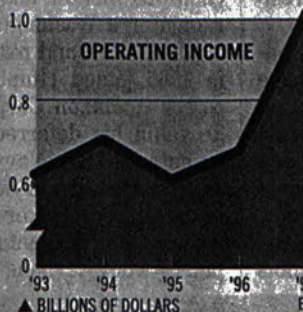
ENRON'S ELECTRICITY SALES ARE TAKING OFF...



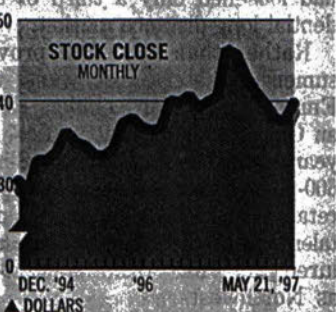
...HELPING TO PUSH UP REVENUES...



...AND EARNINGS ARE PICKING UP...



...BUT INVESTORS REMAIN SKITTISH



DATA: COMPANY REPORTS, BLOOMBERG FINANCIAL MARKETS, JEFFRIES & CO. ESTIMATES

typical fashion, emphasizing Enron's backlog of international projects even as he refocuses on the move into electricity.

But he's encountering roadblocks there as well. Earlier this year, Enron's pending \$3.2 billion bid for Oregon utility Portland General Corp. led to a bitter fight with state regulators over rate cuts the state sought for consumers. At last Lay intervened to settle the protracted fight, agreeing to compensate consumers at the rate sought by the state—but cutting the payment to Portland General stockholders.

Such dustups notwithstanding, Lay is pulling out all the stops to hasten deregulation. In April, he launched a \$25 mil-

lion-a-year nationwide ad campaign and says he'll spend up to \$200 million to argue the merits of free-market electricity. Behind the scenes, he has deployed legislative SWAT teams in front-line states such as New York, Massachusetts, and Texas. Enron lobbyists are joining with retail merchant associations and businesses such as manufacturer Cabletron Systems Inc. based in Rochester, N.H. "It seems there's an Enron person everywhere," says S. William Manteria, a vice-president at the National Retail Federation, another supporter of deregulation.

As he assaults what Enron calls the last bastion of monopoly power, Lay is planning to sell more than gas for the

stove and electricity for lights. He's promising energy-management services to help businesses switch among the cheapest fuels, "green" power for environmentally conscious homeowners, and off-peak pricing for those willing to run the dishwasher at midnight. Enron's power would flow over the existing transmission lines now controlled by utilities. But Stephen W. Bergstrom, president of rival Electric Clearinghouse Inc., a subsidiary of Houston-based NGC Corp., warns that on top of deregulation's erratic progress, customer inertia could be a problem. A decade after AT&T's long-distance telecommunications monopoly was broken up, Bergstrom notes, rivals

ERIC HOFFMAN/VIEW

Their revenues may be different, but their dreams are much the same.

One is an \$18.1 billion enterprise computing solutions company. One is a \$160 million

software company. Both turned to SAP's R/3™ software for help handling their

business volume. With R/3, Compaq was able to cut inventory from

\$2.2 billion to \$1.2 billion, even as revenues increased by 23%.

R/3 allowed INTERSOLV to get real-time information

to their salespeople and dramatically improve

customer satisfaction. With SAP, the size

of a dream isn't limited by the size

of a company. For more

information, call

1-800-283-

1SAP.



A Better Return On Information.™

People

had loosened only a third of the residential long-distance market.

Rather than ally with proven consumer marketers, Lay wants to make Enron a champion retailer. He bought an Ohio retailing outfit in 1994 and last year formed Enron Energy Services, a 600-person unit charged with developing retail services. He is also seeking new talent. In the past two years, Enron has lured 70 MBAs from such B-schools as Northwestern's J. L. Kellogg Graduate School of Management, Harvard, and Wharton. That's up from 10 MBAs prior to 1994.

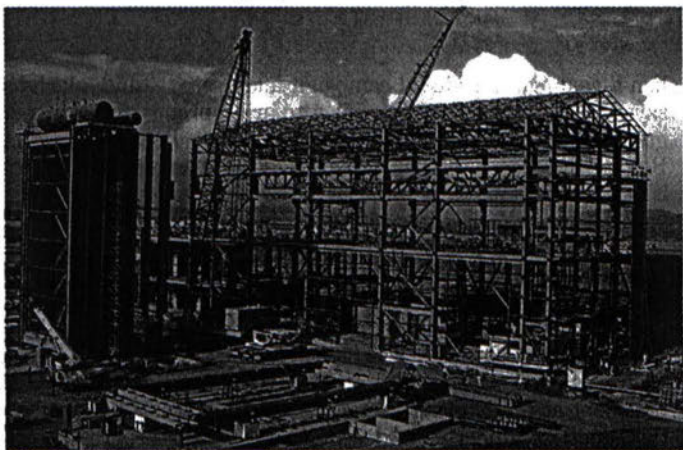
The uncertainty hanging over all these moves: Will the retail market be the gold mine Lay envisions? "Yes, it's a big business," says Edward J. Casey Jr., president of Louisville-based NP Energy Inc., a wholesale power marketer, "but what if competition is so fierce it does not turn out to be profitable?" Notes Howard P. Kagan, managing director at energy investment bankers McManus & Miles Inc.: "Enron enjoyed some high returns in gas deregulation, but it isn't clear that will be the case here. The prices being paid for assets are very, very high."

D.C. INSIDER. Lay says he'll overcome such hurdles by developing high-margin products and services. Just as phone companies get fat profits from services such as call-waiting, he says, Enron plans to make money on innovative services—rolling energy payments into home mortgage payments, for example, or offering longer-term, fixed contracts to offset the risk of dramatic price changes.

In a way, Lay, a lifelong hard worker, has been training for this drawn-out contest since childhood. Lay's father was a Baptist minister as well as a farmer, and both parents valued education. When Lay's older sister exhausted their savings with one year away at college, they moved close to Columbia, home of the University of Missouri, so the kids could live at home and attend classes. Lay's father went to work for a tractor dealership, his mother for a bookstore. "That shows you the benefit, support, and love we got from the family," says Lay.

Lay entered college intending to major in political science but shifted his sights to economics after taking a course taught by Professor Pinkney Walker, who be-

came his mentor and later, as a federal regulator, a Washington ally. After earning bachelor's and master's degrees, Lay in 1965 joined Humble Oil, the predecessor to Exxon Corp., as an economist. To fulfill his deferred Vietnam service, he entered U.S. Navy Officer Candidate School expecting to be assigned to a supply post. But Walker intervened, and he was sent to the Pentagon, where he was put to work devising a modern account-



ing system for military purchases. There, he exhibited a will to get his agenda passed, even at the expense of his ego: Because the project required senior officers to work for him, Lay cajoled an older, higher-ranking officer to act as his proxy in dealing with Pentagon brass, and his proposals were adopted. Later, he moved to the Interior Dept. as Deputy Under Secretary for energy matters.

When he left Washington, Lay had an abiding respect for politicians and wide contacts in the world of federal regulation, both of which served him well once he took over at Enron. But his career-boosting assignments were a matter of chance, he says: "I've never had a life plan, or a 10-year or 5-year plan. It's a

Lay quickly figured out that deregulation would turn the good-ol'-boy world of gas on its head—so he snapped up former energy regulators who didn't wear the blinders of the old era

matter that I've gone through life and a lot of good things happened to me."

These days, Lay recharges by running two or three miles a day, exploiting the solitude of jogging "to get the creative juices flowing." He and his second wife, Linda, kick back in a beach house on Galveston Island, Tex., where he gets away from it all on his 21-foot Boston Whaler. The Lays, who between them have five adult children, also have a winter home in Aspen, Colo., where they hit the slopes at least three times a year.

RISKY TURF

Politics delayed the completion of Enron's power plant in Dabhol, India, and slowed down Lay's global push

Since his Washington days, Lay has kept strong ties to players in GOP and Democratic circles. In energy, "we can't ignore our public officials even if we want to," he says. So he's an active visitor in Washing-

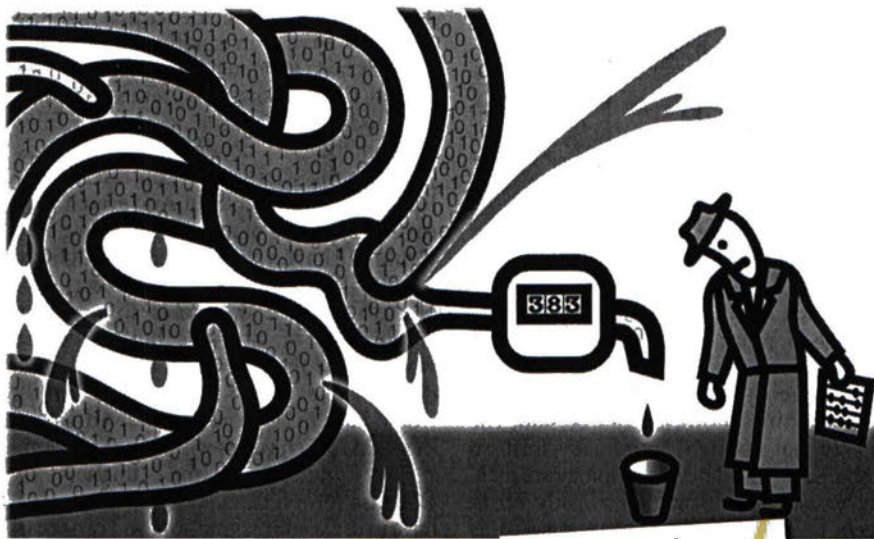
ton—and an active fund-raiser at home. Among Enron's directors are former Commodity Futures Trading Commissioner Wendy L. Gramm (Phil Gramm's wife) and former Deputy Treasury Secretary Charles E. Walker. Among Democrats, Lay counts Nebraska Senator Bob Kerrey and former Treasury Secretary Lloyd Bentsen as friends.

RELENTLESS. But politics is incidental to the larger field Lay increasingly wants to play on. Electricity could dramatically enlarge the scale of what Enron has been doing. The wholesale natural-gas market Lay helped spawn is now worth \$46 billion. Adding retail gas and electricity creates a market more than five times that—the reason why Lay's deregulation campaign is so relentless. For the pivotal California debate, Enron recruited technology giants Lucent Technologies, Hewlett-Packard, and Schlumberger to lobby for suppliers' right to install their own electric meters. Utilities had fought to retain existing meters as a cost savings. But Enron and its allies argued that unless new suppliers could install meters, services such as off-peak pricing or remote reading would be severely limited. They won.

That's the kind of success Lay needs to keep things on track. "We believe in markets," he says. "Sometimes there's an aberration. But over time, markets figure out value." This is one free-market advocate who can't afford to let America's last big monopoly go unchallenged.

By Gary McWilliams in Houston

DISAPPEARING TAXES



The tap runs dry

copied
Spelling
COS

The forces of globalisation and new technology threaten to weaken the power of governments to tax their citizens. Can governments plug the leak?

TWENTY-SIX tax collectors were killed in Russia last year and 74 were injured in the course of their work; six were kidnapped, 41 had their homes burnt down. Elsewhere in the world, being a taxman is merely an unpopular, rather than a dangerous, profession. But everywhere, people are finding it easier to escape paying taxes. They will be helped by two big changes: the gradual integration of economies and the growth of electronic commerce.

The first is more important at the moment. As the world becomes more integrated, and as capital and labour can move more freely from high-tax countries to low-tax ones, a nation's room to set tax rates higher than elsewhere is being constrained. At the same time, the expansion of business conducted over the Internet will make it harder to track and hence tax transactions.

In early May, for example, several large Swedish companies, including Ericsson, a telecommunications giant, said that they were considering moving out of the country because of high taxes. They were not complaining about high rates of corporation tax, which Sweden was forced to trim long ago. This time, companies were complaining about high personal income taxes, which make it difficult to recruit highly

skilled employees. Including local taxes, Sweden's top marginal rate of income tax is almost 60%, and (worse still) becomes payable at an income of SKr209,200 (\$28,000). In contrast, America's top federal tax rate of 40% does not bite until over \$260,000. No wonder many talented scientists and engineers have been leaving Sweden.

This is just one example of how individuals and firms have greater choice today about where to work, where to locate production, where to shop and where to save and invest. This article analyses the various pressures upon governments' capacity to raise revenue, considers how serious those pressures might become, and ends by looking at how governments could respond.

Local taxes, global capital

Modern tax systems were developed after the second world war when cross-border movements in goods, capital and labour were relatively small. Now, firms and people are more mobile—and can exploit tax differences between countries. This is the heart of the problem that governments face.

Globalisation is a tax problem for three reasons. First, firms have more freedom over where to locate. Activities that require only a screen, a telephone and a modem

can be located anywhere. This will make it harder for a country to tax businesses much more heavily than its competitors. Corporate tax rates still vary widely (see chart 1).

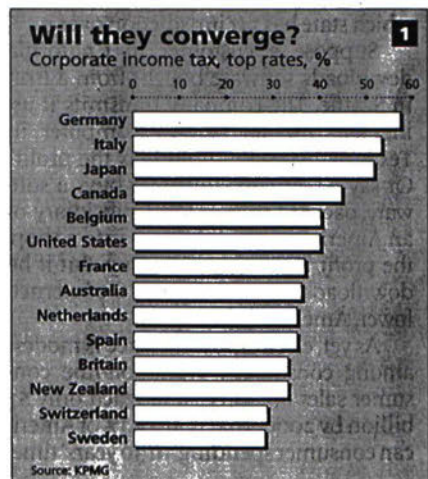
Of course, such differences persist because not all firms can decamp to a low-tax country—and even those that can might hesitate to leave because tax is just one element in a firm's calculation about where to locate. German firms face some of the highest rates of tax in the world but most of them stay put, rather than fleeing *en masse* to, say, Sudan.

Nevertheless, at the margin, it is clear that capital is becoming more mobile, and some economists fear that as countries offer lower taxes to lure foreign firms, there will be a "race to the bottom". Taxes on company profits might even disappear.

Second, globalisation makes it hard to decide where a company should pay tax, regardless of where it is based. Multinational firms design their product in one country, manufacture in another, and sell in a third. This gives them plenty of scope to reduce tax bills by shifting operations around or by crafty transfer-pricing. By paying inflated prices for components imported from a subsidiary in a low-tax country, a firm can move its taxable profits to that country and so reduce its tax bill. Foreign subsidiaries of American companies report higher profit margins in low-tax countries than in high-tax ones. What a coincidence.

So globalisation hampers the taxman's ability to check the accuracy of profits reported by firms. Of course, this is far from new, but the scale of the problem is growing. In 1970 a typical large American company earned 10-20% of its income from abroad. Now many earn at least half their profits outside the United States.

The third reason why globalisation is a

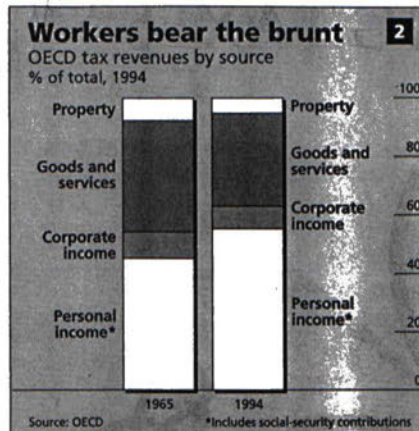


DISAPPEARING TAXES

problem is that, as Swedish firms discovered, it nibbles away at the edges of taxes on individuals. It is harder to tax personal income because skilled professional workers are more mobile than they were two decades ago. Even if they do not become tax exiles, many earn a growing slice of their income from overseas, for consultancy work, for instance. Such income is relatively easy to hide from the taxman. Taxing personal savings also becomes harder when these can be zapped from one side of the globe to the other: cross-border sales of equities and bonds have surged from 3% of America's GDP in 1970 to 136% in 1995.

Lost in cyberspace

In the future, therefore, globalisation—and, eventually, the Internet (see box)—may drain governments' tax revenues either by making evasion easier or by encouraging economic activity to shift to lower-tax countries. The economic principles at work are fairly clear. What is less clear, however, is their practical impact. Anecdotal evidence shows that changes are taking place. But quantifying those changes is hard. No one has yet been able to measure exactly



how much revenue governments have forgone as a result of companies avoiding taxes, individuals becoming tax exiles or people buying goods over the Internet.

Two things, however, can be said. The first is that tax nets are already torn, so globalisation and new technology are making worse a problem that already exists. Even in America, where tax evasion is thought to be smaller than in Europe, a guessed-at 15% of total personal taxable in-

come is concealed from the taxman.

A cynic might argue that there is little evidence that governments are finding it hard to raise revenue. Total tax revenues in OECD countries climbed to a record 38% of GDP in 1996, up from 34% of GDP in 1980. And there is no clear evidence that high-tax countries have seen smaller increases in their tax burdens in recent years.

But it is important to remember that globalisation has begun to develop fully only in the past decade; the Internet is younger still. Their impact on taxes is unlikely to be measurable yet. And even if they eat away just 10% of revenues one day, that would still have a huge impact in a high-tax country. France, for example, collects 50% of GDP in taxes. If it loses 10% of that amount—5% of GDP—the budget deficit would more than double. Or, to keep the deficit stable, public spending on health would have to be more than halved. Imagine what French voters would make of that.

To understand the impact of globalisation on taxes, though, you do not have to use your imagination. You can see it in the way governments have been forced to change the structure of taxation. Before

Taxes slip through the Net

A FAMOUS cartoon had two dogs sitting in front of a computer. "On the Internet," ran the caption, "nobody knows you're a dog." Such anonymity poses problems for taxmen. The Internet eliminates not just national borders but also the identity of firms and individuals doing business. As a result, the Net will open up opportunities both to exploit tax differences and—which makes it even more of a headache than globalisation—to dodge taxes altogether.

In theory, on-line retailers are subject to the same tax laws as other businesses. But how these apply to electronic commerce is a grey area. Because the Internet has no single location, it is hard to say which state has tax jurisdiction over it.

Suppose a customer in California downloads software bought from a firm in Seattle. The company transmits it using the Internet from a computer in Texas. Which state should tax the profit? Or say a German consumer buys a software package from a local subsidiary of an American firm. If he goes into a shop, the profit is taxed in Germany. But if he downloads the software over the Internet, lower, American rates apply.

As yet, electronic commerce is modest among consumers. World on-line consumer sales are forecast to reach only \$7 billion by 2000. That is just 0.1% of American consumer spending. In 30 years' time,

however, 30% of consumer activity could be taking place on-line, says John Neilson of Microsoft's interactive services division. If so, and if the juridical problems remain unsolved, then the Net would make a big dent in sales taxes.

All this gives rise to slightly different concerns in America and Europe. Under a quirk of American law, mail-order firms are usually exempt from state sales taxes if the buyer is in a different state. If a New Yorker buys a case of wine from a Californian firm, then no tax is payable. The Internet will boost such business.

Europe's problem is how to charge VAT on electronic commerce. In the Netherlands, for instance, many people buy CDs over the Internet from small foreign firms. Since the firms do not charge VAT, the CDs are cheaper. Last December, the Dutch government clamped down on this wheeze by ordering the post office to open all suspicious packages. But customs officers can hardly start opening all the post entering a country as sales over the Net expand.

Goods delivered by mail pose problems enough. Policing products downloaded electronically—music and videos—will be even trickier. Small companies cannot be expected to collect VAT from customers and then remit the revenues to all the relevant tax authorities in every country in the world. And if, as in

Canada, customers are supposed to make their own assessment of VAT payable on anything purchased over the Internet, there will be big leaks.

Two particular features of products delivered over telecommunication networks will make it hard for the taxman to catch tax dodgers. The first is that the marginal cost of such products is close to zero. It requires no additional inputs to provide an extra viewer with satellite television. This removes the standard cross-check on a firm's tax return by comparing purchases of inputs with claimed output. If a firm sells software on floppy disks then the number of blank disks purchased can be used to verify sales. But if the software is sold electronically, there is no corroborating evidence.

The Internet may also reduce the role of traditional intermediaries, such as bankers and brokers, who report transactions to tax authorities. These intermediaries help tax inspectors compare interest income declared by the individual with that paid out by banks. By cutting out the middleman, the Internet removes this source of cross-checking.

Lastly, electronic money is likely to make tax evasion easier. At present, tax inspectors can check reported income and spending against bank accounts or credit-card statements. But electronic cash, like paper cash, can be anonymous, untraceable—and a good deal more convenient for money launderers than lugging a suitcase stuffed with notes around the world.

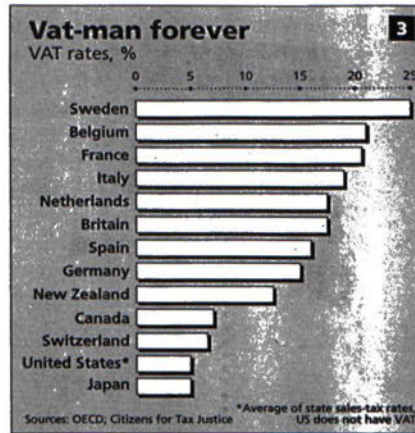
the second world war, America's federal corporation tax yielded one-third of total federal tax revenues, more than personal income tax. Now, corporation tax accounts for only 12% of the total and barely a quarter as much as personal tax. In the European Union the average rate of tax on income from capital and self-employed labour fell from almost 50% in 1981 to 35% in 1994; the average tax rate on wages rose from 35% to 41%. Everywhere there has been a shift from taxing capital towards taxing less mobile factors of production, such as workers. Personal income taxes are by far the most important source of government revenue in all rich economies (see chart 2 on previous page).

Will international competition cause tax regimes to change further and converge? The answer will depend on the sort of tax. For corporate taxes, the answer is likely to be yes. Convergence is already happening here. There are also limits on governments' freedom to set widely-different consumption taxes. The large numbers of Britons popping over to France to buy beer and spirits have forced the British government to cap the excise duty on booze, because of the loss of tax revenue. Attempts in Canada to raise sharply the tax on cigarettes to discourage smoking had to be reversed in 1994 because of massive smuggling across the United States border.

But such "sin taxes" tend to be the exception. By and large, the scope for increased cross-border shopping via, say, mail-order, or over the Internet is mainly limited to low-volume, high-value products. Higher rates on luxury goods, such as cameras and watches, may have to be abandoned. In contrast, the opportunities for tax arbitrage on low-value, high-volume products, such as food, are limited. For these taxes, the answer to the question "Will taxes converge?" is likely to be no. Differences will remain between countries' general sales taxes, which now range from around 5% in the United States and Japan to 25% in Sweden (see chart 3).

The answer may also be no for standard rates of income tax. There are still big social and economic obstacles to the movement of individuals across borders, so significant income-tax differentials are likely to persist. Language, culture, visas and qualifications prevent over-taxed Europeans flooding into America, for instance.

In short, economic integration does not necessarily make tax rates uniform. But it does tend to encourage some of them to converge. America illustrates the point. Though capital and labour are highly mobile, tax differences are still tolerated. State



sales taxes vary from zero in Alaska to 7% in Mississippi; personal income-tax rates from zero in Alaska to 12% in Massachusetts; corporate tax rates from zero in Texas to 12% in Pennsylvania. However, these differences are smaller than tax differences between countries. The top personal income-tax rate ranges from 33% in New Zealand to 65% in Japan. That suggests that competition in America has encouraged some convergence of tax rates there. Indeed, the differences in effective tax rates between American states are smaller than the crude figures suggest because state income tax is deductible from the federal income-tax bill.

Read my lips

How might governments react to the pressure that globalisation and electronic commerce puts on tax regimes? One possible response would be to adjust the tax base to reflect changes in the economy at large—something that governments have done throughout history. In this case, the adjustment might mean taxing all electronic flows of information. That is the proposal of Luc Soete, an economist at the University of Limburg in Maastricht and the chairman of an independent committee appointed by the European Commission. In April the committee submitted a report recommending a so-called "bit tax" (ie, a tax on the "bits" of information zooming around computer networks).

Many European politicians support

such a tax, partly because Europe (with high rates of VAT) stands to lose the most from untaxed electronic sales. In America, which does not have a federal sales tax, the idea has been ridiculed. True, some states, including Texas, are trying to tax Internet service-providers and transactions. But the Clinton administration rejects the idea of any new taxes on the Net. Last November America's Treasury published a discussion paper on the tax implications of electronic commerce. It opposed any new taxes on Internet transactions but said existing tax rules should be applied to Internet business exactly like other forms of commerce. Fine. But how on earth can that be done?

The basic problem with a bit tax is that it is indiscriminate: it taxes not just on-line transactions but all digital communications. Hence it would stunt the growth of that industry. Moreover, on-line transactions would simply take place in a state or country where there is no such tax.

So what else might government do? The unpalatable fact is that, in coming years, they will probably be forced to shift further their tax base from footloose factors of production, such as profits and savings, towards consumption and labour. And even here, it may become harder to tax the income from, and the consumption of, goods and services sold over the Internet.

A disturbing consequence therefore is that in a world of mobile capital, labour is likely to bear a growing share of the tax burden—especially unskilled workers who are least mobile. This will tend to exacerbate unemployment and blue-collar resentment. Add in the fact that the Internet will affect sales of basic necessities less than sales of luxury goods—and the result will be a more regressive tax system.

One solution would be to tax more heavily spending with an unavoidable physical presence, namely property. In days gone by, kings used to collect most of their revenue from land taxes. As recently as 1913, 60% of American taxes came from property, against around 10% now. How ironic it would be if the computer age required the post-industrial world to go back to a pre-industrial tax system.



This article is indebted to "Globalization, Tax Competition and the Future of Tax Systems" by Vito Tanzi (IMF Working Paper, 96/141); and "Tax Systems in the 21st Century" by Mervyn King (International Fiscal Association, Geneva, September 1996).

To Gen's Fy -

Bc

IT OVERSTATES INFLATION! DOES NOT! DOES SO!

Fueled by the issue of quality changes, the consumer price index debate rolls on

Are new apartments bigger than old ones? Does better heart surgery compensate for the end of the house call? And is life better because of cellular phones, Windows 95, and Apple Cinnamon Cheerios? Questions like these aren't just fodder for idle conversation. Figuring out changes in quality is critical to settling a trillion-dollar debate: the controversy over whether the federal government is exaggerating consumer-price inflation.

To date, the shrillness of the inflation debate has been directly proportional to the scantiness of data. Last December, a blue-ribbon panel of economists headed by Stanford University's Michael J. Boskin told Congress that the consumer price index overstates inflation by something like 1.1% a year. It said the mismeasure, if not corrected, would add \$1 trillion to the national debt by 2008. The two costs: excess payments for inflation-indexed programs such as Social Security, and excessive shielding of taxpayers from the effect of inflationary "bracket creep."

ON TARGET. Now two researchers from the Bureau of Labor Statistics, keeper of the CPI, are firing back. In a document released this May, Brent R. Moulton and Karin E. Smedley tear holes in some of the commission's calculations. But they balk at producing their own estimates of the overstatement (or understatement) of inflation, and say the bureau is improving the CPI as quickly as possible. "We're in the business of collecting data using standard, verifiable techniques and not in the business of speculating," says Moul-

ton, who is chief of the bureau's price and index-number research division.

On balance, the Boskin commission's estimate of mismeasurement in the CPI may be roughly right. A poll of 320 academic economists by *The Wall Street Journal* found that 79% thought that there was some degree of overstatement: 21% thought it was 1% or more, while another 35% thought it was 0.6% to 1%. Boskin himself now says his panel's estimate might have been one- or two-tenths low. But the only way to know for sure is to

their purchasing patterns in response to changes in prices. They may substitute a cheaper brand of pickle, buy chicken instead of beef, or shop at Home Depot instead of the local hardware store. In April, the BLS introduced an experimental alternative CPI that allows for substitution within narrow categories such as pickles. This adjustment alone would have reduced measured inflation by 0.3% for the past year.

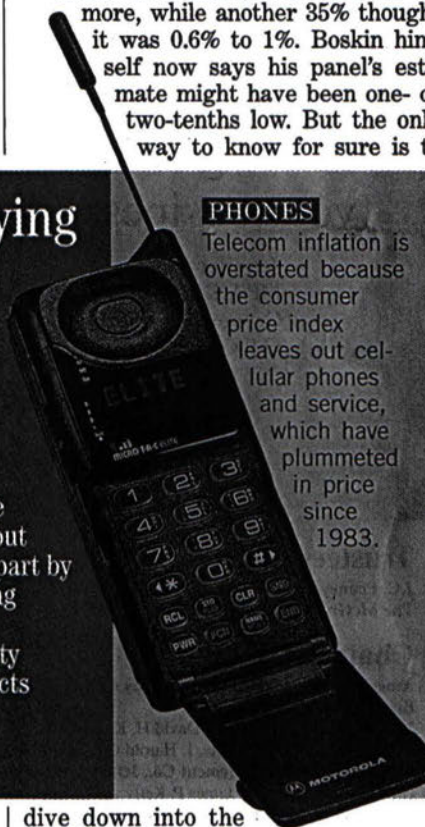
But correcting the so-called substitution bias in the CPI is simple compared to measuring quality. The Boskin commission attributed the remaining

Quantifying Quality

The blue-ribbon Boskin Commission says the government overstates consumer-price inflation by about 1.1% a year, in part by underestimating benefits from improved quality and new products

PHONES

Telecom inflation is overstated because the consumer price index leaves out cellular phones and service, which have plummeted in price since 1983.



SHELTER

The Boskin commission argued that bigger apartments compensated for higher rents. But the government disputes the panel's figures.

dive down into the details of everyday life—and answer questions like the ones posed above. BLS Commissioner Katherine G. Abraham calls it "the house-to-house combat of constructing price-change measures."

To be sure, quality questions aren't the only issues in the inflation debate. The Boskin commission calculates that half a percentage point of the overstatement by the BLS comes from failure to recognize how consumers change

0.6% of the inflation error to undercounting the benefits to society from improved quality and the introduction of new goods. Counting those benefits is a mind-boggling task.

Consider apartments. The Boskin commission argued that inflation in shelter was overstated because the BLS did not give adequate weight to growth in the size of apartments, which helped offset higher rents. It said that the size of the average apartment grew 20% from 1976 to 1993. But Moulton and

Smedley demonstrated that the actual size increase was only about 6%. If anything, they say, the CPI might have understated inflation in rents. Likewise, in women's apparel, the Boskin panel said old Sears, Roebuck & Co. catalogs show prices rose more slowly than the government says. The BLS responds that the Boskin panel focused on items that were discounted because they had gone out of style.

For most products today, the BLS uses a crude method for estimating quality change. Say a TV set disappears from the shelves, replaced by a new model with a better picture costing 5% more. If the inflation rate of other TVs was 2%, then the BLS assumes that the rest of the increase, 3%, can be attributed to higher quality—namely, the better picture. But the true test of quality is how the new set sells. For instance, if it gains market share, the quality must have risen more than the BLS's 3%. Says Yale University economist William D. Nordhaus: "We actually don't know how much quality change exists in the BLS numbers."

FOOT-DRAGGING. Not that other quality-measurement techniques they use are much better. With cars, for example, the BLS sometimes calculates the value

its quality measures. Yale's Nordhaus is sympathetic: "It's a gargantuan problem that they're tackling. They collect almost a million price quotations a year." Yet, Jerry A. Hausman of Massachusetts Institute of Technology has stated publicly that the entire bureau should be shipped off to Guam. "They're dragging their feet," Hausman says. "They're hurting the economy."

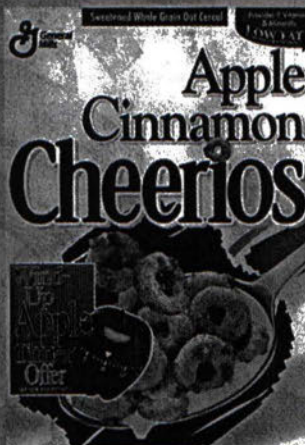
Hausman has invented an ingenious way to measure the consumer benefit from the introduction of new goods. Not only is the BLS slow to include new products with rapidly falling prices in the index—cellular phones still aren't in—but it neglects to measure the extra value of new goods vs. what was available before. In a 1994 paper, Hausman calculated that the introduction of Apple Cinnamon Cheerios by General Mills Inc. in 1989 improved the overall welfare of the American public by an average of

A Boskin panel member says that he gets better data by thumbing through old *Consumer Reports*

step in the right direction: People value the outcome of a hospital stay, not how many injections and operations they got there. The bureau is also moving to speed up the introduction of all kinds of new products into the index. **NO. 1 DEFECT.** But the BLS remains hamstrung by a data-collection methodology that makes it difficult to compare the quality and price of products over long periods. For one thing, the set of priced products differs from city to city, so there's no way to

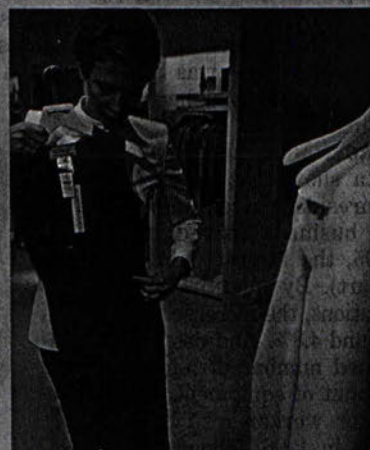
come up with a national price for, say, a particular model of microwave oven. Boskin panel member Robert Gordon, a Northwestern University economist, says he finds better data by going through old copies of *Consumer Reports* magazine, which list detailed prices and specifications of various products. "*Consumer Reports* is doing what the BLS should do," says Gordon. Hausman, among others, says that the BLS should

MEDICINE Patients care about the outcome of medical care, not the number of injections or operations.



FOOD Did Apple Cinnamon Cheerios create a "consumer surplus" of 27¢ a year per person in the U.S.?

APPAREL The government defends its price index for apparel. It says the Boskin panel focused too much on discounted items.



of a new feature by asking the manufacturer how much it cost to add—at best, a rough approximation of its value to the consumer. The BLS uses a different method for some other items, including computers and apparel, basing the change in quality on the improvement in quantifiable features—such as the processor speed of a PC. But a computer that's twice as fast might not be twice as valuable to the buyer.

Economists differ on whether the BLS is moving quickly enough to improve

27¢ per person per year. As for cell phones and service, he calculates that leaving them out means that the telecommunications portion of the CPI is overstated by about 2.3 percentage points per year. Hausman argues that the Boskin commission's estimate is, if anything, "probably on the low side."

The BLS is taking some steps toward improvement. This year, it started measuring medical-care costs by pricing bundles of services instead of discrete items such as pints of blood. That's a

make far more use of bar-code scanning data from supermarkets and other stores.

The BLS has been getting an earful from economists since 1961, when a panel headed by the late Nobel laureate George J. Stigler stated that underestimation of quality was "the most important defect" of the CPI. The sooner it gets fixed, the better. After all, a trillion here, a trillion there, and pretty soon you're talking real money.

By Peter Coy in New York

Copied
Lovell
COS

THE PRESIDENT HAS SEEN

4-5-97

Seminar on the Political Implications of The Approach and Passage of the Year 2000

Presented by the Center for Millennial Studies
Richard Landes, Director
January 13, 1997

To Ellen Lovell
Fyfe
Bo

Most people in the cultural elite, when they hear about 2000, or millennialism, tend to consider it marginal and aberrant behavior, applicable neither to them nor to the public at large. We think of paranoid militias, Chicken Littles and raving pseudo-prophets. What, other than the ridiculously tragic spectacle of a Waco or an Oklahoma City, could this have to do with mainstream life in the modern world?

Quite a bit. Few beliefs are more protean than the apocalyptic belief in an imminent and radical upheaval; they take on a wide spectrum of secular and religious forms. One errs both in conceiving of the phenomenon as restricted to "Waco wackos" and in imagining that only a tiny minority could find the beliefs of a David Koresh appealing. On the contrary, even the seemingly mad ravings of a Koresh have a compelling logic which less extravagant forms of apocalyptic rhetoric exercise on a far wider audience. The very beliefs in science, pluralism, skepticism, which, for the cultural elite (academics, policy makers, government officials), have rendered overt apocalypticism an absurdity, can have the opposite effect on a wide range of people. Not only does modernity itself trigger apocalyptic reactions among those who come up on the short end of social upheaval and change, but the patterns of apocalyptic belief, rhetoric, and behavior that such conditions generate take on forms that a secular culture does not readily recognize even in their most extreme forms. The fact that currently we consistently group some extremely powerful forms of apocalyptic belief under the rubric *fundamentalism* illustrates the problem.

The problem has deep roots. Western culture is at once particularly susceptible to *millennial moments* (i.e., when apocalyptic expectation becomes widespread), and particularly adept at forgetting them when the moment passes. The origins of Christianity lie in the first well-documented case of a millennial generation in history (first century C.E. Roman Palestine), and with one of the most millennial veins of Christianity becoming the official version of the Latin West, the urgent sense of apocalyptic transformation has become a part of the "deep structure" of European mentalities. Some of the most powerful of millennial moments result from date-based prophecies which have had several generations or even centuries to spread and build conviction; and among these, the most powerful dates have been those at the "end of the current millennium." At times like this, an apocalyptic wave can well up from the depths of a culture, exercise great if ephemeral dominance over public discourse, and, even after its ignominious "passing", exercise incalculable effects on social, political and economic developments. One can identify some half a dozen such "millennial cusps" in European history when either the end of a millennium since creation (sixth or seventh) or the end of a millennium since Christ has triggered widespread religious and social ferment and led to a fundamental reorientation of European culture (C.E. 500, 800, 1000/1033, 1100, 1500/1533, 1800).

Every apocalyptic moment pits roosters against owls: roosters crow that the dawn of redemption is imminent and try desperately to wake the barnyard to action; owls hoot for the roosters to fall silent, that the night is still young, the fox about, the master asleep, and that rousing the sleeping animals will only lead to disaster. Because roosters -- whether they predict catastrophe or millennial paradise -- have *always* proven wrong, sometimes with tragic consequences, there is a built-in tendency by those who survive (owls and roosters who have become owls) to disparage the words and deeds of the roosters and to retrospectively rewrite past narratives that either marginalize their eschatological foes (dangerous roosters become soup, innocuous ones, "chicken littles") or expunge the record to save prominent figures from any taint of so erroneous a belief (Charlemagne, Newton). Similarly, we historians, who come still later, tend to favor the owls' discourse which we know was accurate, thus behaving

like bats whose radar only picks up one range of data. (Charlemagne was the founder of Europe; Newton, of science.)

But before their failure, apocalyptic prophecies can exercise immense power over people, even non-believers; at times when roosters crow successfully, the hooting of owls is impotent -- like liberals after the Nazi takeover. Like tickets to the Superbowl, before the game the rooster's prophecies have immense power, even to those who have no desire to participate; after the game is played, they have at best souvenir value, at worst, they can be dangerous. After the Restoration, no one wanted to be found with his *tricolor*. Apocalyptic moments come and go with a doppler effect, reaching terrifying intensities and fading with all the speed and intensity of a dream or nightmare from which one has awakened. And yet, at the same time as the explicitly apocalyptic dimension of these movements has this ephemeral intensity, the social dimension, the kinds of community dynamics that these beliefs set in motion, may have far longer and more compelling consequences. In gauging the long-range legacy of apocalypticism, the first rule is: wrong has nothing to do with effective.

Thus, apocalyptic moments tend, by their very nature, to be masked from posterity, and some of the most interesting results of the kinds of social and religious ferment they engender -- the social creativity, the incorporation of technology into new and protean communities, the egalitarian principles -- have often been masked by the nature of the documentation. As bat-historians, we tend to keep our eyes on the functioning satellites and ignore the apocalyptic booster rockets that launched them. Thus a bat with refined radar might write a book about how modernity has resulted from unintended consequences of failed but powerful apocalyptic expectations, with millennial moments at which these expectations reach very high levels playing a key role. The ensuing marriage of utopian dreams with scientific technology, then, has created a kind of Frankenstein's millennial kingdom, at once immensely powerful and impressive, but fatally, even monstrously flawed.

At the approach of the next millennial cusp -- 2000/2033 -- we find ourselves in a peculiar situation. On the one hand, we have generated a culture which has, at its highest levels of discourse at least, completely expunged belief in an apocalyptic God (i.e. one who will intervene in history); on the other, because so much of our technology and social engineering stems from secularized millennial drives (Nazism, Marxism, Positivism), we have a built-in apocalyptic dynamic about which we are scarcely conscious. At the same time as this secularized apocalyptic dynamic works at the higher cultural levels, we tend to ignore and belittle religious beliefs which are widespread at "lower" levels of the culture. Thus we use the word "fundamentalism" to refer to an uncritical, literal-mindedness about both religion and politics, neither realizing to what extent apocalyptic beliefs animate this attitude and give it its punch, nor appreciating how intellectually coherent and psychologically appealing it can be to large numbers of people. As a result, while the indices abound of both causes and manifestations of an apocalyptic *Zeitgeist* -- economic and cultural dislocation world-wide, anxiety about the future, successful use of apocalyptic rhetoric in a wide variety of forms, presence of sects and movements animated by apocalyptic beliefs, new forms of communication (e.g. the web) which foster the spread of a wide range of apocalyptic communication -- most sane observers fail to note the apocalyptic as anything more than a marginal phenomenon.

The Center for Millennial Studies is dedicated to both collecting an archive of these "superbowl" prophecies, and to interpreting the significance of these apocalyptic reactions to the approach of the millennial year 2000 in the context of an overheated and ambivalent modernity. We offer the following list of topics for treatment from our perspective, for those who need to be "brought up to speed" on a major, if still little visible aspect of our and the global culture's dynamics.

Proposal to Deal with Problems Implementing Solutions to the Y2K Time Bomb

The Problem

technical: identifying and changing all the two-digit dates to four-digit; identification of the billions of lines of code that pervade much main-frame software, is especially difficult since many of the earliest layers in ancient computer languages, and programmed by people who are no longer working for the companies in question. This is a massive problem, akin not to finding a needle in a haystack, but to finding a million needles somewhere in the Midwest, when tens of thousands of them are not of metal. The possibilities that changing these lines of will create bugs in the programs, means that finding and changing are only part of the task. Until now, this technical sense is the primary, if not sole, dimension in which the problem has been stated and assessed. As such it is deemed a massive and all pervasive effort: last year's figure favored by experts was \$300-600 billion, exclusive of legal costs which may skyrocket.

economic: to solve the technical problem without bankrupting the company; to survive the effects of other companies whose services are needed to provide customers with product.

social: to maintain the confidence of both other companies, the client public, and regulatory officials.

Quake analysis: Let us use a double metaphor as a way to view the coming Y2K problem: for the corporation it is a time-bomb one must diffuse, and for the larger economic and social culture an earthquake of unknown magnitude. At present, with none of the time-bombs defused, and a corporate and social structure completely dependent on computers, one would might say that we are looking at a quake of a magnitude of between 7 and 10 on the Richter scale, with an infrastructure the quality of San Francisco, 1906. There are two major approaches to handling it: 1) reduce the intensity of the quake by defusing as many bombs as possible; and 2) reduce the impact of the quake, whatever its force, by preparing the infrastructure.

The Solutions

technical: right now it is long, hard, dirty work, something like emptying a flooded basement with a sponge. there is already and will be a learning curve, with software designed to identify and change as many lines as possible, but there is also a complexity curve, as more and more bugs emerge from the changing of lines of code. Waiting for the "silver bullet", some equivalent to the *Independence Day* virus diskette, is the equivalent of waiting for the messiah. On the other hand, already computer schools are training people to take on this job. One can imagine the individual company as trying to defuse a time bomb with an extremely complicated mechanism.

economic: massive amounts need to be spent, much of them on salaries for technical experts and managers (not to mention lawyers). Even if solutions are possible, it is equally likely that unknown numbers of companies will not be able to sustain the cost and will fail. These economic failures need to be factored in to any prognostic, since key corporations can bring others down with them. The ways in which these expenses are borne may have significant impact on viability of many companies, and the government will eventually be forced, as with the S&L crisis, to step in. One can imagine here that our corporate explosive experts are working with increasing anxiety at the approach of the date, while other bombs go off around them and their own people have gathered anxiously around to "see." The possibility of multiple explosions at the millennial cusp portends a serious quake with multiple aftershocks.

social: an unprecedented degree of communication will be necessary to maintain public confidence; corporations can anticipate setting up information offices to field questions, and public relations offices to inform the public of their activities in this area. Indeed the current atmosphere of competition and hostility between corporations, and ubiquitous distrust and suspicion (especially in the public sector vis-à-vis corporate and governmental sectors), suggests an uphill battle. If the public mistrusts the corporation, one can imagine situations in which even a millennium-compliant company could lose accounts and support for lack of public trust.

Complexities of Implementing a Solution

late start: work should have begun on this five years ago; because of widespread denial and procrastination, many corporations and government agencies have yet to begin work.

interdependency: solving this is not an individual problem, the interdependency of both software and services means that unless the issues are collectively solved -- intra and inter-corporationally -- even small failures in one sector can have powerful impacts.

denial: multiple aspects of corporate culture have militated against even identifying the problem, from the reluctance to spend vast sums "to fix the plumbing", to the tendency to treat computer technicians like mushrooms, to the hierarchical structures of feedback, with managers in a position to block threatening information.

triage: given the massiveness of the problem and the difficulty in estimating how quickly it can be solved, it is necessary of any large corporation to do a triage of its programs into some half-dozen categories of priorities. It is unclear where the deadline will fall in terms of this triage. Similarly, companies may also undergo a natural triage effected by the economic and technical forces at work. It is clear to those who have paid close attention to these issues, that there are already walking dead among the current crop of corporations whose operations may now seem perfectly healthy.

awareness of dangers: it is impossible to gauge the potential impact of the problem, partly because it will to some unknown extent be solved (i.e. we cannot know how many of the time-bombs will be diffused and, hence, of the magnitude of the quake), partly because there are still vast areas of the interdependency factor that have yet to be explored, including economic failures, the larger cultural problem of public and community opinion, and actions by political and governmental agencies (i.e. we have no idea of how the infrastructure will hold up).

denial has powerful inertial impact

The overcoming of denial about this problem is not as simple as it may seem. Even after the leaders of the corporation have decided to tackle the problem and committed large budgets, that does not mean that: a) they do not continue to harbor doubts about the necessity to spend all this money; and b) that the rest of the corporate personnel who need to participate in the effort are as convinced about its necessity. There are no small number of firms who have -- consciously or unconsciously -- assigned the Y2K Compliance work to people who neither have the clout nor the resources to make it work. And below the level of CEOs, the first message that makes it past the resistance of most systems managers is not explanation of the task, but the unwelcome news that several million dollars of their operating budget will be commandeered to render their soft and hardware millennium compliant.

corporate structure and interdepartmental cooperation

This inertial denial even after budget-apportionment is not merely impartial or even financial skepticism -- although those are, in themselves valid responses; it also relates to resistance to the kinds of cooperation and access to personalized software that many of the managerial structures and the general culture of corporations fosters. Overcoming this resistance -- indeed turning it into willing cooperation -- is a major priority of any Y2K Compliance project; if the solution proceeds by pulling teeth, it is almost bound to fail.

Difficulties in implementing a solution over the next three years

late starts: the later any given corporation starts, the more exponentially difficult the task. The asymptote has begun to rise in earnest now, and we will be now seeing a rush of corporations starting their own compliance task forces. The later they come, the more desperate they will be, and hence the more likely to engage in drastic, often panicked action -- trying to buy good managerial and technical teams away from the places they are working, driving up the costs of labor.

divisiveness: the only serious chance for a successful solution to the Y2K problem is one that

mobilizes intense commitment and cooperation at all levels and in all sectors of corporate culture and between corporations, government, and the public at large. Given the lack of these factors everywhere, the prognosis is currently rather dim. Ironically, only the rapid sense of impending doom -- a classic apocalyptic threat -- is likely to trigger an appropriate response. On the other hand, however, such rhetoric is dangerous in public, forcing millennium compliance managers into contradictory rhetorical stances in different audiences -- reassuring to the public, urgent within the corporation.

future trends in the larger market

Starting in the first quarter of this year, the number of companies with seriously dedicated teams will rise exponentially. This will transform the market in dramatic ways, pushing demand for specialists through the roof. As the rush of new companies come to realization, panic responses will lead to undermining rather than building on the previous work of "competitors". Just as there is internal triage in which certain programs will have to be left to fail, there will be triage in the larger corporate world, with companies unable to absorb the financial drain of dealing with the problem, especially those who have started late.

Prognoses

This is hard to say yet. In purely technical terms, barring unforeseen major complications, a bank with a reasonably early start like Bank of Boston should successfully debug all of its vital and most of its important programs; a preponderance of ancillary programs should also be accomplished with a comfortable buffer of time to address issues which arise consequently. The interdependence of programs and services, however, makes a really informed prognosis still difficult, since what is now deemed an ancillary program may have as yet unforeseen repercussions in other sectors which would render its failure critical.

At the same time, the problem of the larger community has yet to be addressed. Neither the public, nor various governmental agencies have begun to deal with this problem at any coherent level. All of this will change, and the level of cooperation among governmental, corporate, and community organizations will play a crucial role in determining the impact of the problems. While the technical teams must work to lessen the intensity of the coming quake, others must look to the strengthening of those structures that must withstand the quake, whatever its (by anyone's scenario not-inconsequential) force.

Much depends on speed, cooperation, determination. The only optimistic scenarios voiced by experts are those who foresee a strong learning curve; pessimistic reports project linear or limited learning curves in which the plane cannot pull up in time to avoid the mountain; foolishly optimistic ones anticipate the magical intervention -- Independence-Day-like -- of a brilliant last-minute software solution. Serious possibilities, however, lie where the will to solve the problem has galvanized collective action.

Moreover, just as firms finally begin to take concerted action, the public will begin to find out about the problem and the degree of corporate negligence in tackling it. Problems of where the blame and financial burden fall will be the fodder of both political and community deliberations. There are even realistic possibilities that serious loss of confidence in financial and governmental institutions may affect performance regardless of how successfully compliant the software may be. The possibility genuinely exists that, at the approach of 2000, the compliance teams will be trying to defuse their time bombs while about them, panicked superiors and running crowds jostle him. How, how soon, and how often the BoB communicates with its customers, government officials, and the public will be extremely important in a smooth and concerted approach to the problem.

Topics:

1) the basic approach of the center:

- a) rooster, owls, and bats: on the invisibility of past millennial moments
- b) what's at stake: the surfacing of hidden transcripts
- c) past millennial moments: social creativity, popular violence, elite repression
- d) pre-millennial projects": modernity and post-modernity as part of a punctuated continuum
- e) rapid transformation of apocalyptic behavior at the approach of a date: agendas that have been articulated but ignored by the "sane" outsiders come to the fore with great speed and aggression
- f) 2000 is only the beginning: post-millennial disappointment leads to a wide range of mutations, many of them highly effective and functional organizations

2) 2000 as a millennial moment

- a) religious (Christian and non-Christian -- Jewish, Muslim, Hindu, native American, Buddhist)
- b) secular (new age, Gaia and other "pagan" cults, Mayan calendar, millennial stew, UFO's)
- c) technological millennium or apocalypse: eco-dangers, atomic threat, Y2K, revived technological utopianism
- d) political/financial problems in the mix
 - 1) global fundamentalism and violence
 - 2) financial dependency
 - 3) anti-western attitudes
 - 4) internet as a player: as the printing press to "Protestantism" so the internet to the next major apocalyptic wave
 - 5) Y2K problem considered in this perspective (see below)
- e) planning (barely) ahead of the curve
 - 1) elasticity of time: headed for dense time
 - 2) importance of anticipating the events
 - 3) value as well as dangers of millennialism
- g) post-millennial response: real dangers and potential arise in the aftermath of millennial dates

3) Right-wing and left-wing millennial challenges

Militias are only the first product of previous trends (posse comitatus, etc.) linked to the web. They are classic expressions of apocalyptic groups that are at once intensely anti-modern, fully equipped with the latest technology of communications and aggression, and steeped in conspiracy theory. They are predicated upon an imminent climax of forces secretly at work, and are accordingly at once intensely dedicated and profoundly unbalanced. They, themselves, must come to a climax where all their (still) contained energy will spill out.

- a) keeping track of activity, connections, mutations in ideology
- b) watch for inroads into mainstream culture
 - conspiracy doctrines
 - Farrakhan, Robertson
 - neocons and theocons
- c) watch for new and unexpected alliances (including right and left extremes)
- d) challenge to human rights: proliferation of sects and cults and increasing appeal will pose serious threats to principles of religious freedom and tolerance (e.g. Waco).
- e) spread of ideas to mainstream: despite the profound dualism of most of these groups, they can and will find an unusual degree of sympathy among the larger population despite the unwillingness of this larger public to "join" the radical core.

4) Y2K Computer Time-Bomb:

The full impact of this has yet to be assessed: the common \$300-600 billion estimate is a year old, and considered high and low by different experts. Thinking about worst-case scenarios has so far been largely undertaken by roosters; little systematic thought has addressed the wide-ranging interdependency of so much of both the computer systems themselves and of the societies which, in the past two decades, have become so computer-dependent. Solving the problem will, at the very least, be an immense financial drain (minimally as big as the S&L problem: huge expenses, lots of accountability to avoid, scandals galore). The aftershocks -- businesses crippled or bankrupted by computer failures, dragging others with them -- will make all of the year 2000 and subsequent years a period during which the full impact of the problem will make itself felt economically and culturally. Finally, this problem "plays" into the apocalyptic scenarios of disaster-mongers both secular and religious in ways that have yet to develop. As the details of both the problem's magnitude and potential for damage become more widely known, and the ways in which both government and corporation executives have denied and procrastinated, perhaps fatally, in addressing it, the Y2K will be grist for the apocalyptic mill. Given the widespread suspicion of both government and corporations among the public, conspiracy theorists will have a field day. Finally, scam artists will prepare a host of schemes for taking advantage of the breakdown.

role for government:

Governmental Information Offices (to dispense information for local businesses who have decided to tackle the problem, for public wanting to know more about problem and its implications for their own money)

Federal commission

- a) to keep track of effort,
- b) to prepare the kinds of loans and assistance necessary to keep businesses afloat and reassure the public
- c) to study how the weight of the cost will be borne by various sectors,
- d) to give certificates of *millennium compliance* first to those who are genuinely trying to solve the problem and, eventually, to those firms who have prepared their systems
- e) to help create 2000-safe havens for people who fear for their money in its current places

5) International problems of millennial nature

Foreign policy-makers need to be aware of the minefield of sacred time into which we are entering. In 1400 AH (an apocalyptic date in Islamic eschatology), Khoumeini overthrew Iran: no Western agency responsible for foreign policy saw it coming. (When the last such an Islamic millennial date -- 1300 AH -- occurred, Gordon lost Khartoum and his life to the *Mahdi* in 1885. We ignore sacred time at our peril.

- a) fundamentalism = apocalypticism, especially in Middle East
- b) Jerusalem as eschatological center of all three major religions; not just Christians but Jews and Muslims are in the grip of apocalyptic beliefs (see separate analysis)
- c) other forms of ethnic strife responding to this *Zeitgeist*
- d) rooster-doves (e.g. Millennium Institute) and plans for world-wide, bottom up cooperation
- e) international pretensions (France, Russia, China)
- f) movements that sweep through a range of nations (e.g. 1848, 1989)
- g) technologically disadvantaged countries using the temporary problems/paralysis of the advanced countries to launch military attacks early in 2000 (e.g. against Israel)

6) impact of eschatological thinking on money

- a) debt and investment activities: Jubilees are times of debt forgiveness, people somehow feel entitled, especially when they see CEOs getting away with murder, apocalyptic time encourages irresponsible economic behavior (e.g. farmers who don't grow crops)
- b) reaction to news about Y2K: paranoia, aggressivity (scams)
- c) strikes and public demonstrations are expressions of millennial *Zeitgeist*
- d) implications of a world-wide depression in this atmosphere ✓

7) Presidential campaign 2000: in the shadow of the millennium

- a) Gore may face a Christian "fundamentalist" opponent with the ability to spark responses far more widespread than the brush fires Buchanan was able to light in 1996
- b) attack on secular modernity will be at its most intense
- c) on Gore's watch that Y2K happened: his prescience a key element in his credibility
- d) international scene may be filled with crises (especially the Middle East focussed on Jerusalem)

Proposals:

1) Concentric Scenario Workshops: Starting within the corporation, moving then to inter-corporation, and finally to community involvement, assembling some 20 key figures with a clear sense of the various issues at play, having them work out beforehand a list of the various problems in their sphere, and evaluating the consequences of failure, cost and likelihood of success in solving. By gathering these groups in 1-2 day conferences the interconnectedness of these initially individualized scenarios can be explored as each participant points out to the group the ways in which failure of a system in sector x will effect performance in y.

Budget: \$50,000 for first meeting with BoB systems managers and CEOs; \$10,000 to begin setting up subsequent meetings with a) corporate clients, and b) the larger community.

Benefits:

- 1) realistic sense of potential dangers (no scenario is realistic without this process; "apocalyptic" fears will emerge not from rhetoric but from sober assessment)
- 2) collective sense of interdependence, open channels of communication (no one will emerge from these meetings thinking about the problem in the same way as when he or she went in)
- 3) galvanize determination of entire corporation, generate the will to solve (determination will, appropriately, be a response to careful assessment, and match the urgency of the task)

2) Time-Lapse Archive of Public Opinion: After identifying a representative sample of some two dozen individuals, we will interview them at intervals of three months (initially) about their awareness of the problem. At this point (Jan 10, 1997), awareness is still low, vague, bemused, and largely skeptical or, even if informed, largely subject to the natural tendencies of the individual to like either dramatic or reassuring scenarios. As time passes, at an asymptotic rate, people's awareness of the problem and concerns will rise; increased publicity will lead to a wide variety of voices addressing the issue, many far less inclined to reassure the public than those of the corporations. Indeed, when considered from the optic of a conspiracy-minded militant or an apocalyptically minded talk-show host (e.g. the religious Jack Van Impe, or the secular Art Bell), this problem fits so neatly and wondrously into their world-views, that one of the most coherent discourses on the subject will be an explicitly apocalyptic disaster scenario. More than AIDS, this problem and its potential destructive impact, can be presented, by right and left alike, as a (divine) punishment for technological hubris. The time-lapse interviews would allow us to track the emergence of public awareness and the crystalization of various responses to the news about Y2K.

In proceeding, we suggest that the interviews about the Y2K problem be folded into a larger body of questions concerning the millennium, and thus, by not arousing special interest in the issue, we neither skew the responses, nor advertise an issue whose presence in public discourse we want to track and record.

Benefits:

- 1) allows corporation to track public concerns, helping them both time and shape their own communications to address the public intelligently.
- 2) offers a superb case study in the workings of secular apocalyptic time which condenses at asymptotic rates, quickening and intensifying responses and activity.
- 3) permits us to gauge the power of apocalyptic rhetoric and conspiracy theories stemming from marginal groups.

Timing:

In both of these projects, time is of the essence. The sooner we begin, the more valuable the archive of public opinion is, since we will be able to gauge people's reaction *as they become aware*. The sooner we begin with the inter-corporation meetings, the sooner the sense of purpose and task will crystallize.

Future Trends and Suggestions:

Public Relations and Information Offices (trained personnel with an ability to explain the situation and a sense of the anxieties of their public)

Liason Offices with other Corporations and Government (people with the training to perceive a genuine response, and the clout to respond appropriately)

Governmental Information Offices (to dispense information for local businesses who have decided to tackle the problem, for public wanting to know more about problem)

Silver lining, not silver bullet

There is a silver lining to this cloud: by starting early, the Bank not only has a chance of solving most of the problems in time, but it also establishes itself as a leader in finding a solution, a position of immense prestigious and financial advantage. By becoming not only a center of solutions, but an anticipator of communications trends and fostering forms of cooperation and understanding that will yield critical benefits at the approach of the MC, the Bank takes on the role of community as well as corporate leader. The ability to take advantage of this opportunity is now, where time is of the essence: just as every day of delay escalates the difficulty of reaching a solution, so does it lessen the chances of taking a leadership role here. Rather than a bitter pill, to be taken at the last second, this immense difficulty offers immense opportunity to those who swallow it early and look clearly at the consequences.

Center for Millennial Studies: *The Jews and the Year 2000 Question*
Richard Landes (617-566-9631; www.mille.org; rlandes@bu.edu)

Prospects for the Impact of Christian Apocalyptic Expectation on Israeli Politics and Society

Position Paper of the
Center for Millennial Studies
Boston MA
www.mille.org

Background: On Apocalyptic Time and its Denizens

The advent of the second Christian millennium has already occasioned a substantial amount of apocalyptic activity. While the core of this apocalyptic *Zeitgeist* derives from Christian expectations of the year 2000, there is evidence of a "contact high" phenomenon, in which some Jews, Hindus, New Age "pagans", Muslims, and even purely secular "scientists" have fixated on 2000 or thereabout as a key apocalyptic date, a turning point in human history.¹ The core, however, remains Christian, and the primary focus of Christian apocalyptic faith is now, and has always been, Jerusalem. Not only did the Christian Church begin there (variously dated to the Crucifixion/Resurrection or to the Pentecost), but it will reach its full completion there with Jesus' return at the Second Coming (*Parousia*) on the Mount of Olives. This tradition, as old as the religion itself, has repeatedly manifested itself at times of intense apocalyptic expectation within Christianity, leading to massive, one-way pilgrimages and even Crusades. This longstanding apocalyptic hope is now linked to Jewish messianic expectations, forging a significant alliance over the status of the Temple Mount. The current belief that the network of tunnels under Har HaBayit will lead either to the Ark, or the ashes of the Red Heiffer -- both triggers to the rebuilding of the Third Temple -- suggest a wide range of disastrous scenarios, and may explain some of the heated passion surrounding the opening the tunnel a few months ago.²

The approach of the year 2000 should not be considered an exception to the rule: just because the cultural elites in modern and "post-modern" culture are themselves largely secular, and if religious, not of the apocalyptic type, does not mean that large numbers of people, educated and not, are not susceptible to apocalyptic enthusiasms. The best-selling living author is not Stephen King, but Hal Lindsey, author of *The Late Great Planet Earth*, a book which applies the symbolism of the *Book of Revelation* to current political and social events, and predicts a series of apocalyptic events for the world, and particularly for Israel starting with the "Rapture" in 2000 and climaxing with the *Parousia* in 2007. Apocalyptic believers must not be ignored just because their beliefs seem so ridiculous and superstitious. Right or wrong, people

¹ . In a particularly striking example of how apocalyptic ideas about "the other" I recently heard from an ultra-orthodox rabbi that he thought "big things will happen in 2000" because of a verse in Psalms which may mean that Edom (= Christianity) will have dominion over the Jews for 2000 years. Neither the historical implications (dominion should be dated from 312 and Constantine) nor the theological (by starting with 1, he gives the doctrine Incarnation cosmic status) slowed him down; indeed, he then cited Nostradamus, whose 40% accuracy rate in prophecies was "very good, very rare", as another authority for 2000. There are at least two outstanding elements here: first, the power of an apocalyptic date, regardless of its source, and the penetration of "prophecies" into various circles where one would least expect them; and second, the way in which the same date means polar opposites to different religions. This reproduces almost exactly the situation in 365/398, when Christians expected the *Parousia* of Christ at the end of the *annus magnus* of 365 years, while pagans and Jews expected the end of Christianity.

² . To argue that the tunnel did not go under the Temple is to miss the point: to the apocalyptic believer, nothing is what it seems, nothing merely what the public record shows.

who believe that the end is near, especially a divinely wrought end in which they will triumph over all their foes, are powerful actors -- uninhibited, totally committed, capable of super-human feats of self-sacrifice and destruction. And what applies to most apocalyptic believers applies all the more sharply to those who believe in a date.

Apocalyptic time is not normal time. The attitudes towards "unbelievers" that characterize people who believe that God's Day of Wrath is at hand differ notably from what one might call their "normal" co-religionists. Indeed, apocalyptic time tends to trigger polar, powerful and interrelated responses: on the one hand, irenic expansiveness (aimed often at conversion), on the other, violent intolerance (aimed at eliminating *the enemy*). The former response can turn into the latter (far less often vice-versa) as disappointment mingles with impatience and missionizing turns from enthusiasm to coercion. In other words, the urgency of apocalyptic expectation places immense pressure on what one might call "moral eschatology" (saved by how one acts) to become "credal eschatology" (saved by belonging to the right group, whose victory justifies any action).

Everything that can be said generally about apocalyptic believers and their relationship to outsiders applies tenfold to Christian views of Jews. In almost every known case of Christian apocalyptic thought, Jews play a central role: they are both the final converts and the followers of Antichrist, and the advent of apocalyptic time for Christians signals dramatic changes in their perception and treatment of the Jews. In apocalyptic time, none of the "normal" rules (of either tolerance or contempt) apply; and in a paradox that is typical of apocalyptic beliefs, some of the most warmly tolerant and most violently paranoid attitudes of Christians towards Jews spring up in this vortex.

Jews have no choice in these matters: whatever they may think they are doing -- from abandoning/secularizing their messianic hopes, to following a messianic prophet -- they appear on the Christian apocalyptic screen in radically different forms. The great secular messianic project of modern Judaism -- Zionism -- has done more than any single event to trigger the Christian apocalyptic imagination. Both the *Protocols of the Elders of Zion* and the current wave of Zionist fundamentalist Christian support for Israel stem from this strange symbiosis. The former reaction stems from the fact that one of the prevailing Christian myths of Antichrist presents him as a Jewish false messiah, and the end of Jewish exile as the awakening of the Antichrist.

Such beliefs have had a long and profoundly insidious effects on Jewish-Christian relations. Precisely at moments where dialogue begins to offer genuine alternatives in the relationship between the two enemies, it has a tendency to triggering messianic hopes which inevitably call into play the traditional Antichrist activity.

Jerusalem and the Year 2000

Christian apocalyptic expectation focused on the year 2000 poses a serious challenge to Israeli society.

Millions of Pilgrims: These should emphatically not be considered tourists. They are pilgrims of a special sort, and have a long lineage in Western Christian history.

*At this time [i.e., the millennium of the Passion] an innumerable multitude of people from the whole world, greater than any man before could have hoped to see began to travel to the holy sepulcher of the Savior in Jerusalem. Many did not want to return at all, and prayed on the Mount of Olives for Christ to take them up. First the order of the inferior plebs then those of middling estate, and after these, the great men, that is kings, counts, marchlords and bishops, and eventually, and this was unheard of before, many women, noble and poor, undertook the journey. Many wished to die there before they returned to their own lands... (Rodulfus Glaber [d. 1045], *Five Books of Histories*, 4.6.18)*

If at the last millennium, when the population was small, and the way long, arduous, and rarely travelled, "innumerable" pilgrims went, then in this age of easy travel and a billion Christians world-wide, one can expect a great deal more. Moreover, as at the previous millennium, a substantial number of these pilgrims will be coming with no intention of returning since they believe that Jesus will return and rule over his millennial kingdom from Jerusalem. Already some guided tours suggest that the pilgrims may be in the Holy Land when the Second Coming happens. One can predict with a fair degree of confidence that there will be large numbers camped out around the Mount of Olives, waiting for this *Parousia*. At the very least, one can expect not merely a greater number of cases of "Jerusalem syndrome" but collective examples of it; it will most likely spill out from the hospital wards into the streets and pilgrim camps, where many of those who are convinced they are Elijah, or Jesus, or the Lord's vessels for humanity's redemption, will find like spirits and audiences on an unprecedented scale.

Missionizing Impulse

One of the most fundamental and enduring of Christian eschatological beliefs is that at the end of time the Jews will convert to Christianity. This will be the climax of a process of conversion of all peoples which will occur at the end. The intensity of Christian missions, explicitly targetted to 2000, has been clearly evident throughout this decade (according to the Episcopalians, "the decade of mission"), and in 1996 the Southern Baptists have named the Jews as the prime target for conversion. The recent mass mailing of missionary material to individual Israelis warns of things to come and speaks volumes about the financial support behind such a process. In some of the more violent of the Christian apocalyptic scenarios currently circulating (e.g. Jack Van Impe), the group of Jews who convert play an absolutely crucial role in both bringing violent persecution on the Jews, and defeating Gog and Magog (Russia and allies). One can expect the apocalyptic pilgrims of 2000 to engage -- intentionally or not -- in missionizing activity. For most them to do anything less would be an act of cowardice and weakness in their faith. Only those rare Christian groups who are, to take a term from the Y2K crisis, *millennium compliant*, and who believe that Jews and other non-Christians can be saved as Jews and non-Christians, can embrace this apocalyptic fervor without striving for conversions.

Success of Christian Missions:

A surprising number of Jewish (and Muslim) Israelis may be more vulnerable to these Christian efforts at conversion than we imagine. Modern day Israel, with its split between religious and secular culture, with its rapid social and cultural changes, with its long tradition of messianic hope, is fertile ground for the appeal of apocalyptic rhetoric, even Christian rhetoric. Christian apocalyptic appeals have been developing language that is acceptable and attractive to Jews for over a generation now, not without success, especially among secular Jews. In general, the latest stages of modernity have effects on whole populations that closely correspond to the kind of conditions that cults seek to create artificially -- sleep deprivation, information overload, sensory enervation -- in order to break down people's resistance. Given the tensions and crises that beset Israeli society on a regular basis, one cannot anticipate every sector of the culture resisting what, in apocalyptic times, can be most compelling rhetoric and group dynamics. This does not mean mass conversions to Christianity, but enough, especially at the level of teenagers, to create huge uproars within the Jewish community. At the same time, however unacceptable these successes to the Jewish community, the Christians will find them insufficient, and feel deeply disappointed -- once again -- that the Jews did not convert.

Deep-seated Hostility to Jews and Zionism: These pilgrims have, by and large, a deep seated ambivalence to Jews and to Zion. In their view Zionism, especially secular Zionism, represents at best a momentary element in God's plan, legitimate only insofar as it participates in gathering Israel together and thereby bringing on God's kingdom to earth. But from their perspective, secular Zionism is part of a Godless modernity and Judaism a religion superseded by Christianity; ultimately, therefore, Jews should convert and Zionism should yield to the millennial rule of Jesus. Judaism is, in almost all Christian eschatology, a vehicle to an end which will, by disappearing, lead to that End. As profound and sincere as Christian apocalyptic support for Israel may be now, at another stage of their hopes, the continuance of a secular Zionism and a non-Christian Judaism will register in exactly the opposite way -- an obstacle to God's plan.

Disappointment and Anger

When, inevitably, these fervent believers begin to realize the failure of their expectations, they will respond by both intensified efforts to convert the Jews (in order to advance the millennial process) and intensified hostility to Jews (for, by refusing to convert, having caused the failure). The conflicts that this double-edged, deeply resentful behavior will trigger could easily break out into localized, but widespread violence. And, as we know from Jewish history, apocalyptic Zealots are capable of immense and ruthless violence, as well as an unhesitating willingness to commit suicide for the cause.

Alliances with other Religious Movements:

These disturbances may even go beyond the merely Christian. There are strong millennial and apocalyptic currents in Islam today, and it is likely that at least some of the disappointed Christian groups will find a welcome (if temporary) home for their bitterness and hostility among Muslims. It is characteristic of apocalyptic thought that at key moments radical reversals occur: the ally is revealed as the enemy, the enemy as the ally. Such reversals almost always stem from a quickening of the pace, the outbreak of hostilities and violence, the "coming out" of the apocalyptic group onto the public stage.

International Repercussions:

Nor is this merely a municipal problem, however, extensive. If these Christian pilgrims become difficult to manage, if violence breaks out, if Israeli counter-measures backfire, then one can easily imagine a large number of players on the international scene who are just waiting for an opportunity to insist that Israelis cannot handle so complex a religious and social phenomenon as Jerusalem. Obviously Palestinians will have every reason to accentuate the problems; and Christian nations, especially the European ones, who now feel marginalized by the negotiations between Arabs and Israelis, will see this as an opportunity to take their place at the table. Israel will need a great deal of help in 2000: better they should line it up now, rather than need to go to governments and religious groups who do not wish them well, in time of desperation.

Initial Recommendations:

1) Monitor closely the activity of Christian apocalyptic groups; subscribe to their mailings, keep track of their finances, know the key players, be familiar with:

- the various scenarios (discovering the ashes, war of Gog and Magog, appearance of Elijah, etc.),
- the sacred dates (Easter, Pentecost, Advent, 2000, 2001, 2003/4, 2007, 2033. etc.)
- the sacred locations (Temple mount and tunnels, Holy Sepulcher, Mount of Olives, Megiddo, etc.).

Planning and response must be informed about the nature and content of these beliefs.

2) Plan a (large and expandable) shelter near the Mount of Olives and be on the alert for squatters.

3) Make links with non-apocalyptic Christian groups (with genuinely friendly ties to Israel) and encourage the preparation of pastoral counsellors who can deal with pre-apocalyptic enervation and post-apocalyptic depression among these pilgrims.

4) Prepare police and other agents of public order to deal with these kinds of problems, including possibly the inclusion of Christian counsellors on patrols to hot-spots.

5) Establish before-hand, and quite explicitly, the rules of the game for pilgrimage to Israel, including causes for and methods of expulsion. Have all pilgrims sign a pre-landing agreement.

6) Prepare a public relations offensive, warning of the anticipated problems, getting the press as much on your side as possible, so that once the problems break out, you will have made clear how many precautions you have taken.

7) Establish some kind of Jewish-Christian(-Muslim?) committee to deal with the frictions created by proselytizing.

Millennial Cusps and Social Transformation

Millennialism is a phenomenon so rare and little-known in historical memory that those who study it have had to invent the term, shaving this particular variant off of a collection of terms (millenarianism, chiliasm) used by social scientists and ecclesiastics alike to designate a popular eschatological variant -- the belief that the institutions of this world are in for a radical transformation (the meek shall inherit the earth, there will be an end to death and taxes). Millennialism refers to those times when this chiliastic popular excitement gains impetus from the approach of a millennium's end according to the prevailing calendar (annus mundi, anno Domini) giving a wide-spread apocalyptic (imminent) sense to these chiliastic hopes. Given the rarity of such an event -- literally once in a thousand -- what impact such millennialism has had on our culture has not, obviously, been the object of many comparative studies. But, it turns out, the phenomenon is not so rare; varying calendars offer multiple "fin de millénaires", and the West has actually gone through at least four previous millennial cusps. The dates C.E. tell even the least-practiced historian of their transformative power: 500, 800, 1000, (1100), 1500, (1800). We are now, by all apparent indices, approaching yet another such millennial cusp, although its strength has been veiled from our intellectual elite by, among other filters of information, our insistence on the purely secular.

This means that in the next four years we can expect to see the emergence of popular movements which may even, in some cases define basic elements of the coming centuries. (One can certainly make the case that the generation around 1000 set the agenda right up to our own end of a millennium -- civil society's fundamental challenge to aristocratic dominance was first posed in the Peace of God movement -- 990s, 1020-33. The Renaissance and Protestant Reformation around 1500 have had even more specific an impact on the last 500 years). That challenge has obviously, if slowly and imperfectly, penetrated certain aristocracies; but the problem of a larger common culture remains elusive, even within a country like the US. Obviously Western countries have a better relationship to their commoners than most other "nations". The challenge remains: peripheral societies still massacre their uppity commoners the way the Franks of the ninth and tenth centuries did, even if they can be made to feel that this was somehow bad; and even within the most developed nations, relations between commoners and elites remain strained and, increasingly, tinged with violence. Millennial moments characteristically bring all these issues of power relations between elites and commoners to the fore, and by endowing the populace with an apocalyptic microphone with which to find their voice, the dramatically, if temporarily, alter the balance of public influence.

Apocalyptic language challenges reason in unexpected and powerful ways. It operates at levels where rational discourse has little weight; it rouses audiences with its excitement, its livening touch, its semiotic promiscuity, its spectacular promises of power and, in the interim, proleptic rewards of intimacy and purpose. Apocalyptic believers are capable of the most extraordinary activities, of ultimate sacrifices of love and hatred. In periods where apocalyptic language becomes a form of public discourse, (e.g., millennial cusps), wide ranging popular voices come to the fore. While some of the voices reach for new levels of human understanding, others use paranoia to provoke violence; and often the two voices coexist in the same actor. In any case, the effects of this language can, in apocalyptic times, be so dramatic that the voices of reason invoking futures generations to whom we must account, become weak counsel, straw in the wind, like liberals when Nazi rallies gathered hundreds of thousands, tears of joy streaming down their cheeks. Apocalyptic rhetoric in an apocalyptic time is like the crowing of a rooster at dawn: hushing it will not prevent it from awakening the barnyard, nor return those awakened back to sleep.

Thus, we can expect, in the coming years, to have an emotionally aroused and semiotically motile population, responding readily to arguments that, under normal circumstances (as still, now), would be greeted with ridicule. The extensive belief among Americans in flying saucers

(including one behind Haley-Bopp), and in UN-US Federal conspiracies to commit genocide on the white race (the black helicopters), heralds a larger wave of conspiracy thinking, signposts along a road travelling from the periphery to the center of American discourse). The ease with which, through various media -- TV, radio, the web -- such voices can speak to unknown audiences, makes the current moment in history especially susceptible to the crowing of the roosters, who now need not invoke religious prophecy at all in order to stir people with a sense of cosmic destiny. At no moment in the history of mankind (since Babel?) has the entire globe been in contact, nor felt the exhilarating and disturbing transformations brought on by this contact. Nor are the dreams and nightmares of this time merely ridiculous; what would normally seem jejune and naively idealistic can take on far more powerful collective forms. The imaginative sparks fly in every direction, and the creative mind both good and evil, becomes socially fecund.

The Y2K bug is the ultimate metaphor: it is an irony to die for. Here we have, over the past millennium, taken over for God, substituted our knowing power over nature -- our wondrous technology -- for the incomplete deeds of a God who always tarries, creating this modern world, a miraculous yet deeply flawed society, a Frankenstein's millennium of tremendous delight and immense misery. Having mastered the measurement of time over the last millennium and reaped its technologies with increasing momentum in the last three centuries, we have, in the last two decades, become a computer-dependent society. And now, with a reasonable shortcut about dating in computers taken by programmers a generation ago, uncorrected as a result of a mass, collective act of denial on the part of corporation heads and government officials, we have set a bomb to go off in our own houses, precisely at the end of the current millennium.

It is a time bomb in more senses than one. The consequences of a technical failure in the current social and cultural atmosphere nationally and globally, will be far greater than the mere and considerable technological failure itself. Currently, most discussion has focussed on the technical dimensions, less on the problems facing the larger culture, although one can easily imagine dire consequences -- mass bankruptcies, panics, financial disasters spreading at unknown velocities. In a sense our ability to think clearly about the problem stems from a reluctance to think in such terms. Any sane manager would obviously hope that his intuition's customers could be kept in a collective state of mild reassurance through the crisis. But no such reluctance inhibits the apocalyptic rooster from crowing at the very time that the computer crisis reaches its own climax (1999). On the contrary, this is the stuff they dream of -- a genuine, material phenomenon upon which a massive disaster scenario can be built. The sane position is to find responses to the rooster's crow, not to plan on silence holding.

In the meantime, the crisis offers immense opportunities: the bomb or the quake, however one imagines it, is controllable in its intensity and impact depending upon our preparations. This is a task that calls for cooperation at levels our culture rarely even imagines -- intra- and inter-corporate, federal, national levels, and between elites in all these agencies and the larger public of commoners. Solving it well will necessitate new forms of interaction whose long-range consequences may have an inestimable impact on the "tenor" of the coming age. The opportunity presents itself; are we looking?

We are essentially dealing with a series of prognostications and prophecies. Predictions are generally advanced by people who have considered and studied the situation and who proffer educated guesses. Prophecies are by people who have intuited the situation, often identifying as the source of insight, some divine figure or messenger. The former tend to be more modest in their projections, partly because of the staid intellectual culture that produces it, partly because the projections are based largely on the extension of already existent and known factors. The latter tends to be more radical and dramatic, partly because the culture of the practitioners who represent those on the outside, with less stake in maintaining the current system,

partly because, with their intuition, they look at more fundamental factors, and see changes at work beneath the surface of what attracts the attention of the prognosticators. Both techniques have their strengths and weaknesses: prognosticators tend to be shallow, but sober; prophets profound, but susceptible to megalomania. Both are subject to their proclivities -- in terms of what they notice, and how they weight the factors.¹ Where the former errs, mistakes are circumscribed, quickly forgotten;² where the latter errs, mistakes are flagrant, easily ridiculed.

Our generation is now faced with a particularly dramatic and difficult task. We must listen to the voice of both the prognosticators and the prophets, and take them both seriously. We cannot afford either to under- or overestimate the problem. And for all its peril, the situation is immensely promising. While we must take everything seriously, and at the same time as we seek to avert disasters, we should look for the opportunity in the crisis. Millennial moments produce a great deal of emotional motility: large movements permit a level of social and institutional creativity that societies rarely achieve. They are also notoriously volatile, capable of swinging from pacific to violent and (hopefully) back with great speed. These movements need to be watched, monitored, fostered and discouraged where appropriate. Like it or not, the voice of the rooster arises in the land; and it behooves us to listen carefully.

1. Columbus, one of the greatest prognosticator prophets, based his first expedition around the world on his calculations of the globe's circumference: he grossly underestimated it *in order to make the journey seem possible*, and only the presence of an unknown continent there where he thought to reach China did his mission have success.
2. Think of how many people in the job of prognosticating have abysmal records and continue to be listened to because they are so articulate.

the center for millennial studies



February 7, 1997

Albert Gore
Vice-President
United States of America
Washington, DC

12 Abbottsford Rd
Brookline, MA 02146
617 353 2558
fax 617 566 2781
cms@mlle.org
http://www.mille.org

Dear Vice-President Gore:

This may be a first: a medieval historian writes the Vice-President to suggest policy considerations based on what happened a millennium ago. But then, given how rare it is to come to a millennium's end, one has to go quite far back to get historical perspective on the kinds of things that happen at such times. The study of both the history of chronology and of the social and political implications of apocalypticism suggests that Western culture is unusually rich in such "turns of the millennium," or millennial cusps, each of which coincides with some of the major turning points in our history — 500, 800, 1000/1100, 1500, 1800. And despite the determinedly secular nature of our own times, a wide range of indices suggests that similar effects are at work right now, with this millennial cusp accompanying a set global of developments that, in their own right, encourage apocalyptic thinking (global village/ghetto, World Wide Web, ecological and other techno-generated crises, socio-economic transformations, etc.). Indeed, this is the first millennial cusp that will occur on a global scale.

The social phenomena at play during a millennial cusp is something that tends to develop under the normal cultural radar of the elites (clerical or secular), who tend to view the inordinate interest of the masses in such matters as irrational and ridiculous. (The New York Times never reviewed the book that topped its best-seller list for the 1970s -- Hal Lindsay's *The Late Great Planet Earth*. They didn't even know whether it should be listed in fiction, non-fiction, or self-help.) But it is precisely the function of a millennial moment to bring popular agendas welling up into public discourse in ways that cannot happen during "normal time", producing a wide array of collective actions and movements. At such times, the potential for irredentism and violence is substantial, as is the likelihood of larger mass demonstrations of popular will. In this sense Waco, Oklahoma City, and Montana on the one hand, the million-man march, Korean strikes and Bosnian street rallies on the other, should be seen as pre-quake tremors. How the government handles the proliferation of such phenomena will have a significant effect on the tone of the millennial moment.

With the great dangers, however, come great opportunities. Above all, preparation can make difference. Apocalyptic time is periodic and follows a fairly set pattern running from crescendo of elation, to disorientation, to disappointment. The responses of believers also follow patterns ranging from creative mutations enhancing, to suicidal violence attacking civil society. By taking measures (relatively) early on a wide range of issues (from the Y2K computer problem to the Jerusalem pilgrimage), government can show precisely a kind of leadership that, as even Republicans will agree, is an appropriate function. The basic lessons of history concerning these moments are ambivalent: while a millennium obviously

Board of Directors

Richard Landes
Boston University
Stephen O'Leary
University of Southern California
Caroline Bynum
Columbia University
Michael Barkun
Syracuse University
Albert Baumgarten
Bar-Ilan University
Paula Fredriksen
Boston University
David Gordis
Hebrew University

Board of Advisors

Chip Berlet
Political Research Associates
Ted Daniels
Millennial Watch Institute
Moshe Idel
Hebrew University
Robert Jay Lifton
John Jay College
Bruce Lincoln
University of Chicago
Bernard McGinn
University of Chicago
Hillel Schwartz
Millennium Institute
Charles Strozler
John Jay College

Staff

Beth Forrest
Aaron Katz
Rick Massel
Jennifer Snow
Kristin Solias
David Van Meter

has not brought about the End (at least till now), it does bring about *an* end, with the socio-cultural world that emerges from it looking very different from the previous one. One might argue that millennial cusps tend to bring new cultural paradigms. 2000, in this sense, should be understood not as a terminal date, but as the launching pad for a wave of social movements — not all of them violent by any means — whose protean moment will last decades. Traditionally, for reasons of Christian chronology as well as natural and astronomical rhythms, these millennial moments have lasted a generation (1000-1033, 1500-1533).

All of this, of course, places immense pressure on you. You are at once in a position to take policy initiatives in the years approaching the millennium; and how you use the coming years will have a significant impact on how people perceive your claim to their votes in the millennial year 2000, as it will your ability to rebuff a challenge from a candidate who may well use a wide range of Christian apocalyptic rhetoric in his attack on secular government. Perhaps no single person is more centrally placed than you to have an influence on how this particular millennial cusp plays out in the long run; and none stands to lose more by not anticipating and preparing for some of the manifestations of the millennial Zeitgeist.

I hope the enclosed is of interest, and look forward to being able to present some of the material in greater detail.

Sincerely,



Richard Landes
Director

P.S.: On March 5, 1997 from 10:00-13:00 the Bank of Boston is hosting the first major meeting of the Boston Millennium Association, an organization dedicated to coordinating efforts at solving the Y2K problem. This is an especially welcome initiative that recognizes the interdependence of corporations in this matter and the need for cooperation rather than competition. They would obviously be delighted if you were to come and address the group, but with less than a month's warning, that's obviously a long shot. On the other hand, if you can send a representative, it would bolster their efforts considerably. The Y2K problem, as I'm sure you are already aware, is one of the millennial issues most in need of federal guidance.

enclosed:

brief essay on Millennial Moments
outline of a seminar on the socio-political impact of 2000
background on the Center for Millennial Studies
CMS position paper on the Y2K computer problem
CMS position paper on the Jerusalem pilgrims of 2000
invitation to the Boston Millennium Association Meeting



SUNDAY, MAY 26, 1997 PRESIDENT WAS SEEN

Copied
McGinty
COS

The Washington Post

OUTLOOK

Commentary and Opinion

Hot Air, Cold Truth

Why Do We Pay Attention
To Greenhouse Skeptics?

By Ross Gelbspan

In January 1995, a vast section of ice the size of Rhode Island broke off the Larsen ice shelf in Antarctica. Although it received scant coverage in the press, it was one of the most spectacular and nightmarish manifestations yet of the ominous changes occurring on the planet. Two months later, a second shelf collapsed, leaving only a plume of fragments in the Weddell Sea as evidence of its 20,000-year existence.

Scientists had predicted as early as the 1970s that the melting of Antarctica's ice shelves would signal the accelerating heating of the planet. They were not wrong. Rodolfo del Valle, an Argentine scientist who witnessed the disintegration of the ice shelves, had little doubt about the implications, including rising sea levels, when he recalled the events to a reporter from Reuter. "We thought the flooding would occur over the course of several centuries, but the whole process has been much quicker than we anticipated."

The Antarctic ice thaw may be the most dramatic evidence of global warming, but other symptoms have been emerging around the world for several years. While the experts supposedly debate whether global warming has been "proved," the weather record of the past two decades has been marked by more intense rainfalls and severe snowstorms; stronger hurricanes; unseasonal and prolonged droughts, resulting in crop failures and devastating forest fires from Texas to Mongolia; killer heat waves from India to Chicago; and record flooding from Yemen to Nepal. All of these escalating extremes share a common source, according to the overwhelming consensus of scientific thought: They are nature's early reaction to the heating of the atmosphere.

"There is no debate among any statured scientists of what is happening," says Harvard University earth scientist James McCarthy. "The only debate is the rate at which it's happening."

Even as global warming intensifies, the evidence is being denied with a ferocious disinformation campaign. Largely funded by oil and coal interests, it is being carried

Ross Gelbspan is a Boston-based journalist who specializes in environmental issues. This article is adapted from his book, "The Heat is On," published this month by Addison-Wesley Longman.



out on many fronts: behind closed doors, where the affairs of state and industry are conducted; in the media, where public opinion is formed; in the halls of Congress, where laws are made; and in international climate negotiations. In their most important accomplishment, global warming critics have successfully created the general perception that scientists are sharply divided over whether it is taking place at all.

Key to this success has been the effective use of a tiny band of scientists—principally Patrick Michaels and Robert Balling, together with Sherwood Idso, S. Fred Singer, Richard S. Lindzen and a few others—who have proven extraordinarily adept at draining the issue of all sense of crisis. Deep-pocketed industry public relations specialists have promoted their opinions through every

The Case Against Global Warming Is Full of Hot Air

WARMING, From C1

channel of communication they can reach. They have demanded access to the press for these scientists' views, as a right of journalistic fairness. Unfortunately, most editors are too uninformed about climate science to resist. They would not accord to tobacco company scientists who dismiss the dangers of smoking the same weight that they accord to world-class lung specialists.

But in the area of climate research, few major news stories fail to feature prominently one of these handful of industry-sponsored scientific "greenhouse skeptics."

If the public has been lulled into a state of disinterest, the effect on decision makers has been even more effective. Testimony by industry-sponsored skeptics contributed to the defeat of proposals in California and Colorado to increase electricity rates to reduce the amount of greenhouse gases produced by oil and coal-burning power plants. Congressional conservatives have used the skeptics to justify cutting the climate research budgets and to discredit the scientific findings of the U.N.'s Intergovernmental Panel of Climate Change (IPCC), which represents the consensus of 2,500 scientists. Internationally, the skeptics' work has been used to frustrate diplomatic attempts to address the crisis.

Remarkably enough, the rise to prominence of most of these greenhouse skeptics is spelled out in several annual reports of the Western Fuels Association, a nonprofit organization that purchases coal for electric utilities. In its 1994 annual report, Western Fuels declared that "there has been a close to universal impulse in the [fossil fuel] trade association community here in Washington to concede the scientific premise of global warming. . . . We have disagreed, and do disagree, with this strategy."

To counter it, the group said it would support the work of those who challenged the premise. Western Fuels wrote, "Scientists were found who are skeptical about much of what seemed generally accepted about the potential for climate change." Among them: Michaels, associate professor of climatology at the University of Virginia; Singer, also of U.Va.; and Balling, director of the climatology program at Arizona State University.

In their defense, each of these individuals says that they have long held their positions on global warming and that those stands have been unaffected by support from any group.

How closely these individuals are tied to the fossil fuel industry was made public in a May 1995 hearing before Judge Allan Klein, who sits on the Minnesota Public Utilities Commission and was charged with the responsibility of determining the environmental costs of the burning of coal by Minnesota power plants. Among the witnesses were Michaels, who told Klein that despite the buildup of greenhouse gases, he foresees no increase in the rate of sea level rise. Balling concurred that any potential warming is barely worth consideration. "I would anticipate no more than a small rise in temperature, maybe a degree," he testified. Balling has labeled concerns about climate change "pure media hype."

As part of his testimony, Michaels revealed under oath that he had received more than \$165,000 in industry and private funding over the previous five years. Not only did Western

HEATING UP

The planet is warming at a faster rate than at any time in the past 10,000 years. Since 1980, we have had the 10 warmest years in recorded history. The five warmest consecutive years on record began in 1991. The warmest year ever recorded was 1995.

In November 1995, 2,500 leading climate scientists announced that Earth is warming in large part because emissions from coal and oil burning are trapping more of the sun's heat. Even if the average temperature increase is not yet conclusive, they warned, the change is already generating extremes in the weather. This new period of less-stable climate, the scientists wrote, "is likely to cause widespread economic, social and environmental dislocation."

And it's not just the scientists who've come to this conclusion. For the past few years, the ravages of the changing climate have been sending shock waves through the executive suites of international insurance companies. In the 1980s, the industry paid out an average of less than \$2 billion a year for weather-related property damage. But in just the five years between 1990 and 1995, hurricanes, cyclones and floods across the globe have cost more than \$30 billion a year.

—Rosa Gelspan

But we wouldn't ignore scientific evidence just because it happens to be something we don't want to hear. Noooo...



Fuels fund two journals that he edited, but it provided a \$63,000 grant for his research. Another \$49,000 came to Michaels from the German Coal Mining Association and \$15,000 from the Edison Electric Institute. Michaels also listed a grant of \$40,000 from the western mining company Cyprus Minerals, the largest single sponsor of the anti-environmentalist Wise Use movement.

Michaels calls his publications serious journals of climate science. However, they often seem quite political in content, such as these passages by Michaels in the fall 1994 issue of *World Climate Review*: "The fact is that the artifice of climate-change-apocalypse is crumbling faster than Cuba. . . . There is genuine fear in the environmental community about this one, for the decline and fall of such a prominent issue is sure to horribly maim the credibility of the green movement that espoused it so cheerily."

In the winter 1993 issue, he wrote of mainstream scientists in words that would be devastating if they were applied to his own career and its sponsors: "The fact is that virtually every successful academic scientist is a ward of the federal government. One cannot do the research necessary to publish enough to be awarded tenure without appealing to one or another agency for considerable financial support. . . . Yet these and other agencies have their own political agendas."

Apart from never explaining why the federal government would want to promote such a crisis, Michaels also ignores the fact that all

research sponsored by the federal government is subjected to the exacting requirements of scientific proof through a system of review by other experts. By contrast, industry-funded research is frequently published in industry journals without undergoing this kind of rigorous scientific scrutiny.

Nonetheless, Michaels has appeared as a star witness at several congressional hearings, most notably before the House Science Committee. There, Michaels's testimony has been accorded more credibility than experts at the government's own climate research facilities and has resulted in funding cuts for programs to study the global climate.

The case of Balling is equally intriguing. A geographer by training, much of Balling's research prior to 1990 focused on hydrology, precipitation, water runoff and other Southwestern water- and soil-related issues. Since 1991, however, the year he was solicited by Western Fuels, Balling has emerged as one of the most visible and prolific of the climate-change skeptics.

Balling has received, either alone or with colleagues, nearly \$300,000 from coal and oil interests in research funding, which he also disclosed for the first time at the Minnesota hearing. In his collaborations with Idaho, Balling has received about \$50,000 from Cyprus, \$80,000 from German Coal and \$75,000 from British Coal Corp. Two Kuwaiti government foundations have given him a \$48,000 grant and unspecified consulting fees and have published his 1992 book, *"The Heated Debate,"* in

Arabic. The book was originally published by a conservative think tank, the Pacific Research Institute, one of whose goals is the repeal of environmental regulations.

Among the skeptics, Singer stands out for being consistently forthcoming about his funding by large oil interests and conservative groups. During a 1994 appearance on ABC's "Nightline," Singer did not deny having received funding from the Rev. Sun Myung Moon (to whose newspaper, the *Washington Times*, he is a regular contributor and whose organization has published three of his books). Nor has he apologized for his funding from Exxon, Shell, ARCO, Unocal and Sun Oil. Singer's defense is that his scientific position on global atmospheric issues predates that funding and has not changed because of it.

And it is true that Singer held firm to a similar position on another environmental controversy—despite overwhelming evidence against his position. Singer once warned the oil companies that they face the same threat as the chemical firms that produced chlorofluorocarbons (CFCs), a class of chemicals that was found to be depleting the earth's protective ozone layer. "It took only five years to go from . . . mandating a simple freeze of production [of CFCs] at 1985 levels, to the 1992 decision of a complete production phase-out—all on the basis of quite insubstantial science," Singer wrote.

Contrary to his assertion virtually all relevant researchers say the link between CFCs and ozone depletion rests on unassailable

scientific evidence. As if to underscore the point, the three scientists who discovered the CFC-ozone link were awarded the Nobel Prize for chemistry. But that did not faze Singer, who proceeded to attack the Nobel committee in the *Washington Times*.

Singer's tantrum against the Nobel committee would be laughable—except that his views are influential, especially with conservative politicians. Based in part on Singer's work, House Majority Whip Tom DeLay (Tex.) and Rep. John Doolittle (R-Calif.) are making an effort to withdraw U.S. participation in the Montreal Protocol, the international compact that mandates an end to production of the chemicals that destroy the ozone layer. Despite the remarkable international consensus on the Montreal Protocol, DeLay uses Singer's pronouncements to attribute it merely to "a media scare."

The power of the apparent certainty expressed by the greenhouse skeptics should not be underestimated. "The public press is anxious to seize on scientific controversies, and rightly so," said Bert Bolin, a Swedish scientist who had chaired the IPCC. "But an accurate account is seldom given of how well various differing views are founded in the scientific expert community. An increasing polarization of the public debate that has been developing in some countries is not a reflection of a similar change among experts at work on these issues."

If the fossil fuel industry were honestly concerned about getting at the truth of climate change, it would contribute to a blind-trust pool of private research funds that the federal government would allocate to researchers, with guidance from bodies like the National Science Foundation, the National Academy of Science and the National Research Council. At a congressional hearing last November, one of the most distinguished American climate researchers, Jerry Mahlman, Princeton University, said: "Because I speak with credentials as a physical scientist, I do offer personal opinions on what society should do about these predicted climate change. Societal actions in response to greenhouse warming involve value judgments that beyond the realm of climate science. I do not encourage your skepticism when you hear a climate scientist's prediction accompanied by a policy opinion."

This attitude—not the political diatribe Michaels or the ideological pronouncements of the others—reflects the scientific consensus. But that same restraint puts genuine science at a serious disadvantage in the arena of public debate.

"Scientists, by nature, are very conservative," explains Harvard's McCarthy. "I don't want to overstate things. In this debate the skeptics are atypical of the general scientific community. The irony is that when you see scientists who are adamant on any side, it looks very curious within the scientific community. But to the general public, they come across as the most knowledgeable and authoritative of all."

THE PRESIDENT HAS SEEN
6-5-97

197 MAY 22 11:05

Copied
Spertling
COS

THE WHITE HOUSE
WASHINGTON

May 22, 1997

THE PRESIDENT HAS SEEN
Spertling's briefing
memo for
Friday 5/23 9:15
budget meeting
Bob Rubin Green

MEMORANDUM TO THE PRESIDENT

FROM: GENE SPERLING
SUBJECT: Tax Cut Proposals for Budget

Your economic team is meeting with you in the morning to go over options for going forward on the tax package. There are several processes, strategic and substantive issues we need to discuss with you in order for us to move forward.

1. Developing a Package: All of your advisors agree that we need to develop our sense of an overall \$135 billion gross tax package. One reason for developing our tax package is that it allows us to work with Democrats to increase a commitment for our education tax package, by showing them that we can put together a package that could include their priorities. Currently, Republicans are telling Democrats that they could support other Democratic education tax cuts -- if they are paid for **within** our \$35 billion tax cut. By putting together a package, we can show people like Breaux and Rangel that if they are committed to your higher education tax cuts, we could fit their priorities -- e.g., Kidsave, Rangel's initiatives, -- outside of the \$35 billion.

2. Working with Democrats and Republicans: While part of the goal is putting together a set of ideas to get "buy-in" from the Democrats that unifies them, both Bob Rubin and John Hilley believe that the best way to proceed is to shop a \$135 billion package with both Democrats and Republicans so that we are continuing to work in a bipartisan process. Therefore, while we would seek to unify Democrats with our \$135 billion package, we would shop it and get input from all sides, as opposed to having a "Democratic package" that at this moment might alienate Republicans from working with us. As John states, this would be similar to our posture in March when we took the same one page budget summary and sought input and comments from both Democrats and Republicans.

Bob Rubin and his staff are already been involved in serious consultations. On Wednesday, Bob spoke with Archer for 30 minutes and met with Roth for over 45 minutes, while also speaking with Moynihan and Rangel and other House Ways and Means Democrats. Archer and Roth agreed with Bob to have their staffs meet with Treasury staff next so that they could review our \$135 billion set of ideas for discussion.

3. Two Votes Strategy: Erskine cautions that all decisions should be considered against the backdrop of what best ensures that we preserve our two vote strategy.

4. Education Package: One of the main issues we need to decide is what alterations we need to make in our education proposals in order to garner adequate support from Democrats and the education community. Everyone agrees that we need to make the Hope Scholarship more progressive and in some way drop the B- requirement. Yet, in order to afford these changes, we need to decide whether and how to shave the Hope Scholarship or the \$10,000 deduction. Attached is a decision memo that goes through the pros and cons of such choices.

5. New Education Ideas: Another decision is what additional ideas we may wish to consider, particularly from Charlie Rangel outside of the \$35 billion.

6. Child Tax Credit/Kidsave: A major issue is whether to amend our child tax credit, to a "Kidsave" proposal, and whether we want to add refundability, or change the age or income limits. The current Treasury set of ideas does include a refundable Kidsave proposal.

7. Capital Gains Design: We must decide what capital gains proposal we want to present. This clearly involves not only where we want to end up on capital gains, but strategic questions of where we should start. Currently, the Treasury set of ideas includes a 50% exclusion, a Bumpers expansion, your home capital gains, and the Daschle estate tax cut. One of the ideas you had mentioned was to include provisions with strong appeal to the small business and high technology community.

8. AMT Reform: Treasury believes there is strong policy rationale for AMT reform. In the current proposal, this is started in 2003. This allows more middle income tax relief to be included in the first five years, yet it fills the last five years with a sensible tax reform instead of an exploding capital gains tax cut. Is this something you are interested in proposing?

9. Additional Ideas: At your request, Treasury has also included a short description of a modified home office deduction and an increased health care deduction for the self-employed.

Attached are the following:

- **One Page Treasury Chart:** Following a meeting in Erskine's office, we agreed on a preliminary package to present you. The chart shows Treasury's estimates of what costs of the different proposals would be.
- **Treasury Background Paper:** Memo from Don Lubick that explains several of the provisions in the chart.
- **Education Tax Cut Pro/Con Memo:** This is a pro/con memo on the different options for reforming our tax proposals using ideas presented from both Secretary Riley, Treasury Department and other members of your economic team.

Illustrative Baseline Tax Package: Very Preliminary Treasury Estimates (except where noted)

Dollar amounts in millions, May 23, 1997

	<u>1997</u>	<u>1998</u>	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>1998-02</u>	<u>1998-07</u>
Education package								
HOPE scholarship, \$1,200; Tuition Deduction, \$10,000 ¹¹	-78	-4,242	-6,561	-8,461	-9,371	-10,198	-38,833	-94,560
Rangel K-12 school finance tax provision (not scored)								
Make Section 127 Permanent	-82	-645	-670	-730	-796	-833	-3,674	-8,443
Middle-Class Tax Relief and Saving Provisions								
Refundable Kidsave Credit ¹²	-568	-10,612	-10,930	-14,338	-17,889	-17,960	-71,729	-161,423
Individual AMT reform, start in 2003 ¹³	0	0	0	0	0	0	0	-37,472
Capital Gains and Estate Tax Relief								
50% CapGn Exclusion and 20% AMT	-702	-1,470	1,493	-1,643	-1,621	-1,549	-4,790	-11,009
Super-Bumpers Plug Number ¹⁴	0	-50	-150	-300	-400	-500	-1,400	-5,500
President's Home Sales Provisions ¹⁴	-60	-239	-222	-205	-187	-168	-1,021	-1,600
Daschle Estate Tax Proposals (JCT)	0	-440	-540	-640	-740	-840	-3,200	-10,200
Urban Initiatives								
Distressed Areas Initiatives (JCT) ¹⁵	-25	-172	-370	-464	-483	-487	-1,976	-4,063
Welfare-to-Work (JCT)	0	-41	-75	-95	-77	-41	-329	-353
Other Tax Incentives (JCT) ¹⁶	0	-57	-156	-285	-344	-420	-1,262	-9,422
One-year Extensions of Expiring Provisions (JCT)	-405	-958	-682	-398	-259	-127	-2,424	-2,459
Gross Tax Cut	-1,920	-18,926	-18,863	-27,559	-32,167	-33,123	-130,638	-346,504
Revenue Offsets	883	7,747	9,067	10,225	10,668	10,955	48,662	103,945
Total Net Cut	-1,037	-11,179	-9,796	-17,334	-21,499	-22,168	-81,976	-242,559
(Not including Rangel school construction program, expected to cost \$3 billion through 2002 and \$7 billion through 2007)								

¹¹ The proposal drops the B- rule and Pell offset to HOPE.

¹² A refundable child credit for children under 13 with an optional \$500 nondeductible IRA for education or retirement for each child credit allowed. The credit is \$150 in 1997, \$300 in 1998 and 1999, \$500 in 2000 and indexed thereafter.

¹³ Assumes the enactment of the Administration's child credit proposal. Among other things, it eliminates several inappropriate AMT preference items (most importantly, personal exemptions and the standard deduction), allows personal credits to offset AMT liability, and indexes the A

¹⁴ Stacked after the 50% exclusion.

¹⁵ Expand Empowerment Zones and Enterprise Communities, Brownfields, and CDFI.

¹⁶ Equitable tolling, Puerto Rico Tax Credit, FSC software, and DC incentives.



DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

May 22, 1997

MEMORANDUM FOR SECRETARY ROBERT E. RUBIN
DEPUTY SECRETARY SUMMERS

FROM: DONALD C. LUBICK *DCC*
ACTING ASSISTANT SECRETARY (TAX POLICY)

SUBJECT: Possible Tax Package

The attached table presents an illustrative budget package that fits within the recent budget agreement under very preliminary Treasury scoring. The package includes a number of features that will appeal to Congressional Democrats and some Republicans and reflects our current judgment about the outlines of a sound and politically popular package.

This memo highlights decisions that need to be considered if tax package recommendations are to be made publicly. The memo concludes with brief descriptions of several tax ideas appealing to small business that the President has asked about.

Education

- o The current education package contains a \$1,200 HOPE credit, a \$10,000 tuition deduction, drops the B- grade requirement and no longer offsets the HOPE credit by Pell grants and other federal aid that a student receives. This package costs \$3.8 billion more than the \$35 billion for education that is allocated within the budget agreement.

Alternatives

- o The Education Department has suggested an alternative with a \$1,500 HOPE credit, with no B- and no Pell grant offset with a \$10,000 tuition deduction that is either capped at \$1,500 of tax reduction (so, for example, a family in the 28 percent bracket could deduct no more than \$5,357) or converted into a credit equaling 15 percent of all higher education expenses, up to \$10,000. In addition, the second year of the HOPE credit could only be received by students who have completed their full freshman year of school. We believe this package will cost roughly the same amount as the first package.
- o Either the amount of the tuition deduction, HOPE credit or both must be scaled back to meet the \$35 billion revenue target, particularly under JCT scoring. In addition, many potential allies strongly urge us to alter or drop the B- requirement and eliminate the Pell grant offset.

Additional features of the education package

- o With money outside the \$35 billion, we propose to make permanent the exclusion of employer-provided educational assistance from taxable income (Section 127). This is a cause that has been championed by Senator Moynihan and others in the House and the Senate.

Additional Education Proposals that Could be Considered to Attract Support of Key Members of Congress

- o School Construction: We have designed a tax proposal to aid school construction (and other activities) in poor neighborhoods, as urged by Congressman Rangel among others. The States and the District of Columbia would be permitted to allocate a fixed annual amount of tax credits (based on population), much as they do currently with low-income housing tax credits. The States could allocate the credits for projects in public schools located in empowerment zones, enterprise communities or that have a high percentage of low-income students. The schools could use the credits to help pay for construction and renovation projects by giving them as partial payment to developers who perform the construction work or by selling them. Each school would be allocated credits equal to a specified portion of construction costs with the balance to be covered by the State or the school districts.
- o Expansion of the Work Opportunity Tax Credit: In addition to extending the credit for at least one year, it would be expanded so that employers hiring graduates of schools that have a high percentage of low-income students within one year of their graduation would be eligible to receive the work opportunity tax credit.
- o Exemption for Withdrawals from State Prepaid Tuition Plans: Families that invest in plans that allow them to prepay college tuition not only would receive tax deferral on the annual increase in value of their investment as provided under current law but also an exemption from tax when the funds are applied to the child's tuition. The exemption would apply to plans like Florida's and Virginia's that allow parents to pay in full in advance for tuition, but not to some other states' plans that operate like mutual funds.
- o Position on Deductibility of Student Loan Interest: We prefer our tuition credit and tuition deduction, which do not favor borrowing over saving to pay for college, to a student loan interest deduction, which does favor borrowing. A student loan interest deduction would provide relief, however, to many middle-income students and is administrable. Such a proposal is popular with certain Senators (e.g., Moseley-Braun) and thus may be included in a Congressional budget package.

Middle Class Tax Relief and Saving Provisions

- o The baseline package contains a refundable "Kidsave" credit based on the child credit in your FY98 Budget. Kidsave proposals combine a child tax credit with a tax-preferred saving vehicle that can be used for the child's education and for retirement (of the taxpayer). Kidsave is popular with many moderate Senators, particularly Breaux and Kerry. The particular version shown in the baseline package is refundable, which would help draw a striking contrast between the distributional effect of likely Congressional taxes packages and ours.

Alternatives

- o An alternative would drop refundability and instead extend the child credit in your FY98 budget to children under 18 (the Budget proposal gives a credit for children under 13).
- o Kidsave proposals cleverly combine an education saving mechanism with the child credit (our version would make contributions to the education saving account optional). An alternative would be to have separate child credit and IRA proposals, as was done in the FY98 Budget. IRAs, particularly backloaded IRAs, are very costly in years beyond 2002. Adding our IRA Budget proposals would cost about \$15 billion through 2002 under JCT scoring.

Additional features of the Middle-Class tax relief package

- o The large tax cuts agreed to in the second five years of the package provide an excellent opportunity to reform the individual Alternative Minimum Tax in a sound tax policy way and better distributed to the middle class. Currently only 600,000 taxpayers are affected by the AMT. By 2007, however, as many as 9 million taxpayers may be affected by the AMT, many of whom will be ordinary taxpayers since even the personal exemptions, standard deduction and state and local taxes are treated as preference items. The AMT will also start to claw back HOPE credits and the child credit. Fixing the AMT is important for the long-run health of the income tax, but is very expensive since the costs of doing so increase sharply beyond 2002. We propose to tackle this problem when the AMT problem becomes important, namely after 2002.

Small Business and Capital Gains Tax Relief

- o The baseline package contains a 50 percent exclusion for long-term capital gains (so the maximum tax rate is 20 percent); a small business/venture capital proposal for capital gains relief, supported particularly by the biotech and computer industry; and the home sales provision in your FY98 budget. Note that Treasury and JCT scoring of capital gains has differed substantially in the past.

More Detail on Special Rules for Small Businesses and Small Business Investment Companies

- o Individuals' long-term capital gains would be taxed at one half of the statutory rate applicable to ordinary income -- the maximum rate would be reduced from 28 to 19.8 percent. Correspondingly, the maximum rate on the sale of small business stock held for more than five years would be reduced from approximately 14 percent to 9.9 percent (from 21 percent to 15 percent for taxpayers subject to the alternative minimum tax).
 - The size of companies eligible for these special rules would be increased from \$50 million of gross assets to \$100 million of gross assets and the limitation on the amount of gain that could be excluded (currently \$10 million) would be eliminated.
 - This proposal would also adopt some of the changes to the 1993 small business stock provision previously suggested by Senators Daschle, Lieberman and Hatch and by Congressman Matsui (among others). This proposal is particularly favored by venture capital and biotechnology firms.
- o Under a separate proposal, a specialized small business investment company (SBIC) would be allowed under special rules to qualify for an exemption from entity-level corporate tax to the extent it distributed its income currently. Alternatively, during a specified period, any SBIC would be permitted to convert tax-free to a partnership. In addition, the rules that provide for exclusion of gain on securities when there is a roll-over to a SBIC would be liberalized for individuals, and would be extended to corporations. These rules would increase the exclusion for capital gains on SBIC stock from 50 to 60 percent, extend the preference for corporate taxpayers, and liberalize certain other rules.
 - These changes have been proposed by Congressman Jefferson who has advocated them as a means of improving capital access for minority-owned businesses.
- o This package should receive wide political support, yet is designed to not unduly favor very high-income taxpayers and cause the net tax cut to explode in years beyond 2002.

Estate Tax Relief for Family Farms and Closely-Held Small Businesses

- o The baseline package includes the estate tax proposals for special relief to farms and small businesses sponsored by Senator Daschle. They would create an estate tax exemption for the first \$900,000 of value in a "qualified family-owned business interest" (in addition to the \$600,000 unified credit). The proposal would also increase the amount of estates eligible for the special 4 percent interest rate on deferred payments, as in your FY98 Budget.

Urban initiatives and other Budget items

- o The baseline package contains a complete set of FY98 Budget initiatives, including the expansion of EZs and ECs, Brownfields, CDFI and the welfare-to-work tax credit and tax incentives for FSC software, D.C., and Puerto Rico, and the equitable tolling provision. It extends expiring provisions that we do not make permanent, including the R&E tax credit, deduction for contributions of appreciated stock to private foundations, the work opportunity tax credit and the orphan drug tax credit.

Increase Deduction for Self-Employed Health Insurance

- o You have asked us to think about increasing the deduction for the purchase of health insurance for the self-employed. The Small Business Job Protection Act of 1996 gradually increases the deduction for self-employed health insurance costs from 30 percent in 1996 to 80 percent in 2006 and thereafter. It has been proposed that the deduction should be increased to 100 percent. The proponents argue that the proposal would provide parity with the employer-provided health insurance deduction, which is 100 percent. However, most employers do not cover 100 percent of their employees' insurance costs. Thus, current law is closer to parity so the proposal to increase the deduction for self-employed health insurance is overly generous. It should also be noted that no tax subsidy is presently provided to encourage employees without employer-provided insurance to purchase their own health insurance. There are approximately nine million employees who purchase their own insurance, as compared to three million self-employed individuals who claim the self-employed health insurance deduction.

Modification to the Home Office Deduction

- o You also asked us to think about modifications to the home office deduction. A home office business expense deduction could be allowed where substantial and essential administrative or management activities of the taxpayer's business are conducted on a regular basis in the taxpayer's home, provided the taxpayer has no other location for performing these activities. The current-law limitation that the deduction is available only with respect to that portion of the home that is used exclusively for business purposes, and is so used on a regular basis, would also continue to apply. This proposal has been estimated to cost roughly \$650 million through 2002, assuming a January 1, 1997, effective date.

THE WHITE HOUSE
WASHINGTON

May 22, 1997

MEMORANDUM TO THE PRESIDENT

FROM: GENE SPERLING

SUBJECT: Education Tax Package

This memo describes two basic approaches to changing the HOPE Scholarship and \$10,000 tuition tax deduction proposals in order to (1) fit within the \$35 billion allocation over 5 years, (2) address, to varying degrees, the concerns about possible grade inflation and tuition inflation raised by pundits, and (3) address issues of progressivity raised by key Democrats and education groups. The memo also describes other education tax items that could be included in an Administration tax package *outside* of the \$35 billion that was reserved for your credit and deduction

Inside the \$35 billion: HOPE and the Deduction

Treasury's estimate of the revenue loss from your two higher education tax proposals is \$36.2 billion, with roughly half the cost associated with each proposal (the credit costs \$18.6 billion and the deduction cost \$17.6 billion).¹

Both options 3 and 4 below are attempts to regain costs that would be the result of changes to the grade requirement and Pell offset, as described in 1 and 2.

1. Grade Requirement

The reasons for changing the grade requirement include: (1) administrative concerns raised by colleges, (2) "grade inflation" arguments from pundits, and (3) concerns that the requirement would not be applied equally across families, because middle income families at traditional colleges could still get as valuable a tax benefit through the tuition deduction (which has no grade requirement) even if ineligible for the credit. There are two possible alternatives:

¹Joint Tax estimates have been higher -- a total of \$40.6 billion, with \$28.9 attributable to the credit, and \$11.6 attributable to the deduction. The cooperative efforts between Joint Tax and Treasury, agreed to in the budget deal, may reduce this disparity.

1a. Satisfactory Academic Progress. Federal student aid programs currently require that, in order to continue receiving aid, the students must maintain “satisfactory academic progress.” This roughly equates to “passing,” and is defined and policed by the schools. This option is roughly equivalent to eliminating the grade requirement.

Pro: This is the measure that the colleges prefer, since it is already in use.

Con: This is not a rigorous requirement. We would not be able to argue that we are encouraging students to excel.

1b. Achieving Sophomore status. Under this approach, a student could not receive a second HOPE Scholarship until she had successfully completed one full academic year. (This would incorporate satisfactory academic progress as well).

Pro: A full-time start in college is strongly associated with retention and attaining a degree. This would encourage students to do more than take a few classes, or to continue with their studies beyond a semester or two. It provides an argument that we are not completely backing away from an accountability component within HOPE.

Con: This could be confusing to students and taxpayers who, based on information provided by the school, would have to switch from the credit to the deduction until they fully completed one year, then would switch back to the credit.

Eliminating the grade requirement (option 1a) costs \$2.2 billion (assuming no other changes). Option 1b would probably cost slightly less, but has not been estimated.

2. Offset of Federal Grants (“Pell Offset”)

In order to stretch the \$1,500 credit further into the middle class, your HOPE Scholarship proposal currently makes Pell Grant recipients (and other Federal grant aid recipients) ineligible for the HOPE Scholarship if they receive \$1,500 or more in Federal grants. Higher education organizations and Democrats in Congress have argued that this unfairly excludes low-income families from HOPE, leading to a more regressive proposal.²

There are two alternatives for the Pell Grant offset:

² Ignoring the full \$3,000 that the lowest income students can receive in Pell Grants, they argue that your Budget provides only \$300 for the poor students (the Pell Grant *increase*), but \$1,500 (HOPE) or even \$2,800 (maximum \$10,000 deduction at 28% bracket) for higher-income families.

2a. Eliminate offset entirely. A student with a \$3,000 Pell Grant could also receive a \$1,500 HOPE Scholarship, if the taxpayer paid enough tuition and fees and had tax liability to which to apply the credit. This option costs \$3 billion when considered alone.

Pro: Makes the credit more progressive, addressing concerns of key Members of Congress and constituency groups (who have been reluctant to fight for the details of our proposal as currently drafted). Reduces the amount of data that the taxpayer and IRS will need to compute the credit.

Con: Cost which must be absorbed through other changes to the proposals.

2b. Offset grants by 50%. With this approach, a student's eligibility for the HOPE Scholarship would be reduced by half of the Federal grants received. This approach costs \$0.9 billion when considered alone.

Pro: Costs less than eliminating the offset entirely.

Con: Excludes the *poorest* students from HOPE (those with maximum Pell Grants). Will not completely satisfy key Democrats and constituency groups. Would still require a "Federal grants" data element to be reported by colleges, and used by taxpayers and the IRS in computing the credit eligibility.

3. Education's approach: \$1,500 Credit, Deduction capped at \$1,500

The maximum HOPE Scholarship would remain at \$1,500. The tax deduction would still apply to up to \$5,000 of tuition and fees through 1998 and up to \$10,000 thereafter. However, the value of the deduction would be reduced by either capping it at \$1,500 or turning it into a 15% credit. With either approach, in the first two years of college, the HOPE Scholarship would never be less valuable than the deduction.

Education argues that this approach would (1) equalize the benefits between the credit and the deduction, addressing a criticism from some Democrats and higher education groups, and (2) maintains the commitment to provide access to the average community college.

The two approaches for achieving these objectives are:

I. Cap value at \$1,500. The value of the deduction (tax bracket times applicable tuition and fees) could not exceed \$1,500. A family in the 28% tax bracket would reach the cap at tuition and fees of \$5,357. For tuition and fees up to that level, the deduction would continue to be more valuable for higher income families than for lower income families, because of their different tax brackets.

Pro: Middle class families in the 28% bracket, with a child at a public university or lower-cost private institution, would continue to get the full benefit of the deduction.

Con: Students at higher-cost private colleges would not benefit as much as under the current proposal.

ii. Set value of deduction at 15% of tuition and fees. The deduction would essentially be turned into a credit valued at 15% of the tuition and fees charged. The value of the deduction would not vary according to the family's tax bracket (except to the extent that a low-income family lacks tax liability to reduce).

Pro: More likely to be embraced by key Democrats and the education groups.

Con: Less helpful to middle-income families at moderate-cost colleges.

Neither of the approaches above would save enough to fully offset the elimination of the grade requirement and the Pell offset. One or both of them might offset a partial elimination of the grade requirement and Pell offset, as described in 1b and 2b.

4. Treasury's approach: \$1,200 credit, \$10,000 deduction.

The tax deduction would be unchanged: it would apply to up to \$5,000 of tuition and fees through 1998 and up to \$10,000 thereafter. The HOPE Scholarship would be reduced to a maximum of \$1,200.

Pro: One benefit of reducing the HOPE credit is that it reduces any potential tuition inflation at community colleges, because fewer community colleges would have tuition and fees below that level.

Con: Increases the disparity between the value of the credit (\$1,200) and the value of the deduction for a higher-income family (\$2,800). The credit would not cover average community college tuition (now at \$1,500).

This approach also would not save enough to fully offset the elimination of the grade requirement and the Pell offset. One or both of them might offset a partial elimination of the grade requirement and Pell offset, as described in 1b and 2b.

5. Reduce both the deduction and the credit

If you decide to completely eliminate both the grade requirement and the Pell offset (1a and 2a), it may be necessary to explore options that would reduce both the deduction and the credit in order to offset those costs. For example, a \$1,200 HOPE Scholarship, and an \$8,000 deduction, capped at a value of \$1,200 or 15%, might yield the necessary savings.

Education tax items outside the \$35 billion

The Administration's tax package could include several education-related tax items outside of the \$35 billion allocation. While Chairman Archer's staff clearly want to use some of these other items in place of your HOPE Scholarship and tuition tax deduction, I strongly feel that we must hold firm to our strict interpretation of the letter, which reserves the roughly \$35 billion for "postsecondary education, including a deduction and a credit. . . consistent with the objectives put forward in the HOPE scholarship and tuition tax proposals contained in the Administration's FY 1998 budget to assist middle-class parents." If we open up the \$35 billion to other items this early in the process, we risk losing the HOPE Scholarship and tuition deduction.

The larger tax package could include:

- **A Rangel elementary-secondary provision.** Rep. Rangel has been helpful on HOPE Scholarships and the tax deduction, and very much wants to see some of his ideas incorporated into the Administration's tax package. Some possible directions are described below. Cost: perhaps \$3-5 billion.
- **Student loan interest deduction.** Different proposals have been put forward by Senate Republicans, Senate Democrats, and House Democrats. Strongly supported by the higher education community. Cost ranges from less than \$1 billion to \$3 billion, depending on design (caps, income ranges, new versus old loans, and whether parents or just students are eligible).
- **Extending Section 127** (tax deduction for employer-paid education assistance). Senate Republicans have proposed making it permanent, while your 1998 Budget extended it through the year 2000. Sen. Moynihan is a strong supporter of this provision.
- **Education savings incentives**, loosely based on the Lieberman-Breaux "KidSave" proposal.
- **Community Service/Income Contingent Loan Forgiveness.** Exclusion from income of loans forgiven by a non-profit entity for community service, or loans forgiven under the Direct Loan Program's income-contingent repayment provisions. Part of your 1998 Budget, costs only \$15 million.
- **Work-Study income exclusion.** Senate Republicans have proposed excluding income from the Federal Work-Study program from taxation. This costs \$0.4 billion.
- **Pre-paid tuition plans.** Exempt withdrawals from taxation. This costs \$0.6 billion.

Rangel's Education Empowerment Zones

Rep. Rangel recently introduced legislation that includes his version of the HOPE Scholarship (refundable), as well as his own proposal aimed at helping public elementary and secondary schools in poor areas. Rangel's legislation includes (1) a tax credit to subsidize bonds for construction, renovation, teacher training, and curriculum development for "academies" based on school-business partnerships in empowerment zones and empowerment communities or high-poverty schools in other areas, and (2) an expansion of the Work Opportunity Tax Credit to benefit employers who hire graduates within six months of leaving an academy.

There are a number of problems with the design of these proposals. However, we do feel that there are some useful concepts in the legislation, and that we can work with Mr. Rangel on one or more of the following approaches:

School Construction in EZ/ECs: A tax benefit to help reduce the cost of borrowing or other financing of school construction or renovation in high-poverty areas. This could include some of Rep. Rangel's conditions for business contributions and involvement, though that would be an awkward design.

Charter School Construction in EZ/ECs: A tax benefit to help reduce the cost of borrowing or other financing for the construction or renovation of public charter schools in high-poverty areas.

School-Business Partnerships in EZ/ECs: A tax benefit for contributions of money, equipment, or time associated with a partnership between a business and a school in a high-poverty area.

WOTC expansion to EZ/EC graduates: Like Mr. Rangel's proposal, expand the Work Opportunity Tax Credit to graduates of schools in EZ/ECs, or to schools that meet certain criteria (such as the Rangel "academies").

WOTC expansion for high school apprenticeships: expand the Work Opportunity Tax Credit to businesses that hire participants in school-business partnerships *while they are in school*.

Illustrative Baseline Tax Package: Very Preliminary Treasury Estimates (except where noted)

Dollar amounts in millions, May 23, 1997

	<u>1997</u>	<u>1998</u>	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>1998-02</u>	<u>1998-07</u>
Education package								
HOPE scholarship, \$1,200; Tuition Deduction, \$10,000 ¹¹	-78	-4,242	-6,561	-8,461	-9,371	-10,198	-38,833	-94,560
Rangel K-12 school finance tax provision (not scored)								
Make Section 127 Permanent	-82	-645	-670	-730	-796	-833	-3,674	-8,443
Middle-Class Tax Relief and Saving Provisions								
Refundable Kidsave Credit ¹²	-568	-10,612	-10,930	-14,338	-17,889	-17,960	-71,729	-161,423
Individual AMT reform, start in 2003 ¹³	0	0	0	0	0	0	0	-37,472
Capital Gains and Estate Tax Relief								
50% CapGn Exclusion and 20% AMT	-702	-1,470	1,493	-1,643	-1,621	-1,549	-4,790	-11,009
Super-Bumpers Plug Number ¹⁴	0	-50	-150	-300	-400	-500	-1,400	-5,500
President's Home Sales Provisions ¹⁴	-60	-239	-222	-205	-187	-168	-1,021	-1,600
Daschle Estate Tax Proposals (JCT)	0	-440	-540	-640	-740	-840	-3,200	-10,200
Urban Initiatives								
Distressed Areas Initiatives (JCT) ¹⁵	-25	-172	-370	-464	-483	-487	-1,976	-4,063
Welfare-to-Work (JCT)	0	-41	-75	-95	-77	-41	-329	-353
Other Tax Incentives (JCT) ¹⁶	0	-57	-156	-285	-344	-420	-1,262	-9,422
One-year Extensions of Expiring Provisions (JCT)	-405	-958	-682	-398	-259	-127	-2,424	-2,459
Gross Tax Cut	-1,920	-18,926	-18,863	-27,559	-32,167	-33,123	-130,638	-346,504
Revenue Offsets	883	7,747	9,067	10,225	10,668	10,955	48,662	103,945
Total Net Cut	-1,037	-11,179	-9,796	-17,334	-21,499	-22,168	-81,976	-242,559
(Not including Rangel school construction program, expected to cost \$3 billion through 2002 and \$7 billion through 2007)								

¹¹ The proposal drops the B- rule and Pell offset to HOPE.

¹² A refundable child credit for children under 13 with an optional \$500 nondeductible IRA for education or retirement for each child credit allowed. The credit is \$150 in 1997, \$300 in 1998 and 1999, \$500 in 2000 and indexed thereafter.

¹³ Assumes the enactment of the Administration's child credit proposal. Among other things, it eliminates several inappropriate AMT preference items (most importantly, personal exemptions and the standard deduction), allows personal credits to offset AMT liability, and indexes the A

¹⁴ Stacked after the 50% exclusion.

¹⁵ Expand Empowerment Zones and Enterprise Communities, Brownfields, and CDFI.

¹⁶ Equitable tolling, Puerto Rico Tax Credit, FSC software, and DC incentives.

THE PRESIDENT HAS BEEN
6-5-97

'97 JUN 4 PM5:37

THE WHITE HOUSE
WASHINGTON

June 4, 1997

MEMORANDUM FOR THE PRESIDENT

FROM: Ellen McCulloch Lovell

CC: Michael Waldman

SUBJECT: Meeting with Chancellor Kohl - Expo 2000 in Hanover, Germany

You asked me why the U.S. is one of the few countries *not* participating in the Hanover, Germany Expo 2000, which is one of Germany's main millennium projects and will be organized around the themes of culture and the end of the Cold War. In 1992, the United States Information Agency closed its International Expositions office and decided not to participate in world's fairs unless through a private sponsor, or unless Congress appropriated funds for a specific fair. USIA still retains the responsibility for the U.S. presence at world's fairs; the Director names a "Commissioner General" for the U.S. who then must raise private resources to mount the exhibition or build the pavilion. Both USIA and the Department of State are parties to the Bureau of International Expositions, an international treaty in which forty countries cooperate.

Terry McAuliffe was the Commissioner of the Taejon, Korea expo in 1993; the Amway Corporation was the major private sponsor (as they were also in Genoa in 1992.) Presently Tony Coelho is trying to mount support for a U.S. presence at the Lisbon '98 fair.

I understand that the State Department has recommended we accept Germany's invitation to participate in Expo 2000. Unless funds are appropriated for this purpose, however, the U.S. would depend on private sponsors to fund or supply our presentation there.

Copied
Bowles
Lovell

Handwritten note:
EIB
Can send the President
a letter saying that the US
is not participating in the
Expo 2000 in Hanover, Germany
because of the cost of the
Expo 2000 in Hanover, Germany

THE WHITE HOUSE
WASHINGTON

May 25, 1997

MR. PRESIDENT:

Gene wanted you to see this
memo tonight--it is a follow-up
from your Friday morning
tax cut meeting.

Phil Caplan

copied
Spelling
COS

THE PRESIDENT HAS SEEN
6-5-97

THE WHITE HOUSE
WASHINGTON

1997 MAY 25 PM 6:19

May 25, 1997

Spertling memo
re: Tax Package
12/16/97
Riley

MEMORANDUM TO THE PRESIDENT

FROM: GENE SPERLING

SUBJECT: Tax Package

At the close of the meeting on tax issues Friday morning, we said we would provide you with memos on the form of the capital gains tax cut and the education package. Those memos are attached, along with a memo that Secretary Riley sent to me.

Capital Gains

On capital gains, most of your advisors, including me, believe that the best approach may be to lead with a 40% exclusion of capital gains, as well as an expansion of the Bumpers capital gains relief for the sale of small business stock. Some Democrats will not be satisfied with this approach because it does not have a populist component. But its advantage, as Summers notes, is that it allows you to start with a broad-based capital gains cut that still gives us room to bargain. Bob Rubin, Larry Summers, Ron Klain, John Hilley, Frank Raines and myself all concur that it is best to start with a broad-based cut that leaves you some room to bargain. A 40% exclusion is one, but not the only approach, that would meet that standard.

You will note on the capital gains memo that there are two options listed that actually raise revenues over both the five and ten-year period. These options set specific rate schedules -- as opposed to broad rate exemptions -- which lead to less generous capital gains tax cuts to those in the 31% and 28% brackets. For example, while a 50% exclusion would mean someone in the 31% bracket pays 15.5% and someone in the 28% bracket pays 14%, under the specific rate schedule listed here, both would pay the higher rate of 20%.

Capital gains tax cuts that have significant tax relief for people in the highest marginal rates and only smaller tax rate reduction for those in 28% and 31% brackets tend to raise revenues for the following reasons:

When there is a significant capital gains tax reduction, there is a scoring assumption that upper income taxpayers will realize significant capital gains that they would not have otherwise realized within a five or ten-year window. Therefore, even though tax rates are being reduced, revenues increase because of the increased amount of capital gains realizations occurring within the five and ten-year period. Hence, over a five to ten-year window, significant capital gains tax cuts on those at the 39.6% bracket will tend to raise revenue.

On the other hand, there is a scoring assumption that capital gains tax cuts on those in the 31% and 28% brackets reduce rates on many realizations that would have happened anyway during the five to ten year budget window. Therefore, significant reductions on capital gains rates on those in the 31% and 28% brackets tend to cost revenues. Consequently, options that have significant rate cuts for those in the 39.6% bracket while only smaller tax cuts for those in 31% and 28% brackets can have the cumulative impact of raising revenues within the budget cycle.

My personal view, and one that is shared by many of your economic advisors, is that a capital gains cut that raised revenues would be very poorly received particularly among Democrats and commentators.

Education

On education, the choices are to reduce the credit, reduce the value of the deduction, or to phase both of them in slowly. The cost estimates are preliminary, so any option you choose may need to be adjusted somewhat in order to not exceed the \$35 billion allocation. As you will see from Riley's memo, he feels strongly that the credit should be maintained at \$1500 (he presents an option similar to Treasury's third option).

While I think there is significant substantive merit to Secretary Riley's option, in light of the criteria you have expressed for laying out an education tax package, myself, Frank Raines, John Hilley, and Ron Klain would all support a proposal that would keep both your \$10,000 deduction and \$1,500 credit and save costs by simply phasing them in. The Treasury option that meets that standard is option four which phases in both the HOPE Scholarship and \$10,000 deduction so that they are at their full amount, \$1500 and \$10,000, by the fourth year of your budget plan -- Fiscal Year 2001.



DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

May 23, 1997

MEMORANDUM FOR THE PRESIDENT

FROM: LAWRENCE SUMMERS
DEPUTY TREASURY SECRETARY

SUBJECT: Capital Gains Relief Package

This memo provides several options for broad-based capital gains tax relief. Our recommended option is a 40 percent exclusion for capital gains (with the AMT rate on capital gains reduced to 20 percent). This leaves room for negotiating a slightly higher exclusion, but holding firm against capital gains indexing. We would also recommend that a capital gains relief package include expansion of the Bumpers targeted capital gains relief presently provided to holdings of small business stock (as described more fully below), and our budget proposal to exclude up to \$500,000 of capital gains from the sale of principal residences for married couples filing jointly (\$250,000 for other taxpayers). We intend to provide you next week with a memo regarding capital gains indexing, which will detail the problems that would result from allowing indexing.

Broad-based capital gains tax relief

The following table provides the cost estimates for various broad-based capital gains options that we have considered:

Preliminary Treasury Estimates, (Dollar amounts in billions)¹		
	1998-2002	1998-2007
40% capital gains exclusion (w/ 20% AMT rate)	-\$2.7	-\$15.2
40% capital gains exclusion (w/o AMT preference)	-\$10.6	-\$34.0
50% capital gains exclusion (w/o AMT preference)	-\$18.3	-\$55.3
50% capital gains exclusion, plus indexing starting 1/1/97	-\$32.3	-\$96.9
Separate rate schedule: 10.5% for 15% bracket taxpayers, 20% for other taxpayers; 20% AMT rate	+\$13.4	+\$15.3
Separate rate schedule: 7.5% for 15% bracket taxpayers, 20% for other taxpayers; 20% AMT rate	+\$8.2	+\$3.7

¹ All of the estimates shown include the cost of the proposed exclusion for sales of principal residences, which costs \$1.4 billion through 2002 and \$2.3 billion through 2007. However, they do not include the proposed expansion of the Bumpers targeted capital gains provision.

o **Replace the current maximum rate on capital gains with a percentage exclusion.** This provides the same proportional reduction in the rate on capital gains for taxpayers in all tax rate brackets. Thus, in contrast to current law (which provides a maximum capital gains rate of 28 percent benefitting only higher income taxpayers), the proposal would provide capital gains relief for low and middle income taxpayers. A 50 percent exclusion would lower the top rate on capital gains from 28 percent to 19.8 percent. Several current Republican bills include a 50 percent exclusion for capital gains. For AMT purposes, capital gains would be subject to a special 20 percent rate, rather than the regular AMT rates of 26 or 28 percent. This ensures that the top capital gains rate is 20 percent for both regular tax and AMT purposes.

o **Separate rate schedule applicable to capital gains.** An alternative means of providing rate relief would be to tax capital gains under a separate rate schedule. For example, a special rate schedule could be established with a rate of 7.5 percent for taxpayers in the 15 percent bracket and a rate of 20 percent for taxpayers in higher tax brackets. A special AMT rate of 20 percent would apply.

Thus, in contrast to a percentage exclusion, taxpayers in tax brackets ranging from 28 percent to 39.6 percent would be subject to the same special capital gains rate. This causes a separate rate schedule of this type to be much less expensive than a percentage exclusion because the greatest benefits are given to high bracket taxpayers who are more likely to have induced realizations from the proposal. Conversely, less revenue is spent on lower bracket taxpayers who are less likely to change their realization pattern as a result of the proposal. Obviously, this type of separate rate schedule is more regressive than an across-the-board exclusion.

Expand Bumpers targeted capital gains relief for the sale of small business stock.

In 1993, targeted capital gains relief was added under section 1202, largely at the behest of Senator Bumpers, for sales of small business stock. Section 1202 presently provides a 50 percent exclusion for capital gains from the sale of qualified small business stock held for more than 5 years. If additional targeted capital gains relief is desired, Section 1202 could be expanded by: (1) eliminating the \$10 million limitation on eligible gain, and (2) increasing the size of qualified businesses from \$50 million of gross assets to \$100 million of gross assets. Also, if a broad-based capital gains exclusion were adopted, we would recommend that the exclusion under section 1202 be increased correspondingly to 75 percent, i.e., the maximum rate under section 1202 would be reduced to 9.9 percent (15 percent for taxpayers subject to the AMT). Certain technical changes would also be made.

These changes are similar to proposed changes to section 1202 made by Senators Daschle, Lieberman and Hatch and by Congressman Matsui (among others).



DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

May 25, 1997

MEMORANDUM FOR THE PRESIDENT

FROM: LAWRENCE SUMMERS
DEPUTY TREASURY SECRETARY

SUBJECT: Education Packages

This memo presents Treasury estimates of several possible combinations of the HOPE scholarship and tuition deduction as well as several other education proposals. The packages illustrate the tradeoffs necessary to fit the HOPE scholarship and tuition deduction into the \$35 billion agreement. These tradeoffs are necessary in order to offset the increased costs of the package that would result from dropping the B- requirement (as requested by the education lobby) and the Pell grant offset (as requested by Congressional Democrats). Dropping these two items is estimated to cost approximately \$5.3 billion through 2002.

Each of the options set forth below would eliminate the Pell grant offset and the B-restriction. Each option would fully phase in the complete education package by 2003, so the tuition deduction would be \$10,000 and the HOPE Scholarship would be \$1,500. The effective date of the options has been moved back to January 1, 1998, which saves roughly \$2.5 billion. Please note that the Joint Tax Committee may score these proposals as being more expensive than shown in the table.

Education Packages: Preliminary Treasury Estimates, (Dollar amounts in billions)

	1998-2002	1998-2007
HOPE Scholarship, \$1,200; Tuition Deduction, \$10,000 ¹	35.2	92.8
HOPE Scholarship, \$1,000; Tuition Deduction, \$10,000 ²	34.1	91.7
HOPE Scholarship, \$1,500; Tuition Deduction @15% credit ³	34.9	92.5
Phased in HOPE Scholarship; Phased in Tuition Deduction ⁴	35.0	92.6

¹The tuition deduction starts at \$5,000 through 1999, and increases to \$10,000 thereafter.

²The tuition deduction starts at \$10,000 in 1998.

³This variation converts the tuition deduction into a 15 percent credit on expenses up to \$10,000 (\$5,000 in 1998).

⁴The tuition deduction starts at \$5,000 through 2000, and increases to \$10,000 thereafter. The HOPE credit starts at \$1,200 through 2000, and increases to \$1,500 thereafter.

- o The crucial design choice that needs your guidance is whether the HOPE scholarship, the tuition deduction, or both should be trimmed to fit the education into the \$35 billion agreement.

____ Trim the HOPE credit ____ Trim the deduction ____ Phase in both
(As in package #1 above) (as in package #3 above) (as in package #4 above)

- There are additional possible variations of the packages. Elimination of the Pell offset could be phased in, though this would not save a lot since completely eliminating the Pell offset costs roughly \$3 billion through 2002. The income phaseout ranges could also be altered (the credit and deduction phase out for joint filers with incomes between \$80,000 and \$100,000 and single filers with income between \$50,000 and \$70,000).

Additional Features of the Education Packages

- o With money outside the \$35 billion, we propose to make permanent the exclusion of employer-provided educational assistance from taxable income (Section 127). This is a cause that has been championed by Senator Moynihan and others in the House and the Senate. Doing so will cost roughly \$3.7 billion through 2002.
- o A student loan interest deduction would provide relief to many middle-income students and is politically popular. Adopting the student loan interest deduction in the Republican Leadership education bill (S.1) would cost \$1.8 billion under Treasury scoring (and \$0.7 billion under Joint Tax scoring).
 - The proposal to deduct student loan interest would provide a \$2,500 above-the-line deduction, phased out at \$45,000 to \$65,000 for single filers and \$65,000 to \$85,000 for joint filers.
- o We are developing proposals to aid school construction (and other activities) in poor neighborhoods, as urged by Congressman Rangel and others.



UNITED STATES DEPARTMENT OF EDUCATION

THE SECRETARY

May 23, 1997

MEMORANDUM FOR GENE SPERLING

FROM: SECRETARY RICHARD RILEY ^{MS}

RE: Recommended compromise higher education tax package

I describe below a compromise \$35 billion higher education tax package that would eliminate the B- requirement and eliminate entirely the HOPE offset for Pell and other federal grants while keeping the maximum HOPE tax credit at \$1,500 -- the average community college tuition. It pays for these changes by making the tax credit and tuition deduction effective January 1, 1998 rather than June 1, 1997, and by capping the value of the tax deduction at 15% of tuition, up to a maximum of \$1,500. I strongly favor this approach over one that would reduce the size of the HOPE tax credit for the following reasons:

The compromise package described below which maintains the \$1,500 tax credit would:

- Make the average community college free.
- Still provide significant benefits to families in the 28% tax bracket (over \$60,000 AGI) because families with more than one child could take the tax credit for each child in their first or second year of college at the same time that they take the tax deduction for their other children or for themselves (i.e. the credit is per person while the \$10,000 tuition deduction is per family). In addition, we would help families in the 28% bracket by reinstating the student loan interest deduction, paid for outside the \$35 billion.
- Make the package more progressive, ensuring that the balanced budget plan is more progressive, and even more so when viewed in combination with the 1993 Economic Plan.
- Simplify the proposal by equalizing the maximum value of the credit and the deduction.

Reducing the HOPE tax credit to \$1,200 and maintaining the tuition deduction as is would:

- Make it very difficult to say that the tax credit would make the average community college free because the average community college tuition is \$1,500. *Over half the States* now have estimated average community college tuitions above \$1,200.
- Make it difficult to argue with others against lowering the credit further because the level would no longer be tied to the average community college tuition.
- Leave us highly vulnerable to Congress amending our proposal to cap the deduction at \$1,500 and using the savings for a different Congressional proposal. Congressional Minority, the higher education community, and pundits have criticized our deduction as regressive. *Thus, we could very well end up with a tax credit below \$1,500 and a reduced tuition deduction.* And once we propose lowering the tax credit, it is very unlikely that we could raise it back up to \$1,500.

600 INDEPENDENCE AVE., S.W. WASHINGTON, D.C. 20202-0100

Recommended Compromise Package:**5-year cost: \$35 billion****1. HOPE Tax Credit: Require satisfactory progress rather than at least a B-**

This package would eliminate the B- requirement for eligibility for a second HOPE tax credit, but would continue to require responsibility by applying the "satisfactory progress" requirements now used for eligibility for student aid programs. These rules require that students maintain at least a C average or meet other standards set by the institution. This change would increase costs by \$2.2 billion over 5 years.

2. HOPE Tax Credit: Eliminate the offset for Pell and other federal grants

Our FY98 Budget proposal deducts the value of any Pell or other federal grant from the value of the HOPE tax credit. To provide more assistance to lower income students, this compromise package would eliminate the offset completely, as both Rep. Rangel's bill and the Senate Minority bill propose. This costs an additional \$3 billion over 5 years.

3. Tax Deduction: Cap the benefit at \$1,500

To offset the cost of the above changes, this package would reduce the maximum benefit of our proposed tax deduction from \$2,800 to \$1,500 by limiting the value of the deduction to 15% of tuition and fees, up to a maximum of \$1,500. This would respond to criticism that the deduction is regressive while maintaining its sensitivity to tuition amounts. The higher education community and Hill Democrats would strongly supported this change, and it would save \$4.0 billion over 5 years. To provide additional assistance to families in the 28% bracket who would benefit less than under our original proposal, I recommend reinstating tax deductibility of interest on student or parent higher education loans, paid for outside the \$35 billion reserved for the tax credit and tuition deduction.

4. Make the tax credit and deduction effective for studies begun after January 1, 1998 instead of after June 1, 1997

Our FY98 Budget proposed making the tax credit and tuition deduction effective for studies begun after June 1, 1997. However, at this point, it would be very difficult, if not impossible, for the IRS, Education Department, and higher education institutions to implement the change for tax year 1997. Therefore, this package would make these changes effective for studies begun after January 1, 1998 (tax year 1998), which preliminary Education Department analysis suggests might save \$2.3 billion over 5 years.

This package would also commit to reinstating the deductibility of interest on any student or parent higher education loan (Senate Minority version which has the higher phased out range benefiting those in the 28% bracket), extending Section 127, establishing a 10% tax credit for small businesses that provide education and training, and allowing tax-free forgiveness of student loans for those engaged in community service, but would pay for these proposals outside the \$35 billion reserved for the HOPE tax credit and \$10,000 tax deduction.

Compromise Higher Education Tax Package

	5-year cost (\$ billions)
Proposal in FY98 Budget:	\$36.1
Possible Compromise Package:	
1. Substitute satisfactory progress requirement for the B- requirement	+\$2.2
2. Eliminate HOPE offset for Pell and other federal grants	+\$3.0
3. Cap the value of the tax deduction at 15% of tuition, up to \$1,500	-\$4.0
4. Make the tax credit and tuition deduction available for studies begun after January 1, 1998	est. -\$2.3 (Treasury estimate not yet available)
Net change:	-\$1.1
Total Cost:	\$35 billion
Outside of the \$35 billion reserved for the HOPE tax credit and tuition deduction, this compromise package would reinstate the student loan interest deduction (Senate Minority version which has the higher phase-out range benefiting those in the 28% bracket), extend Section 127, establish a small business tax credit for education and training, and allow tax-free loan forgiveness for people engaged in community service.	

THE PRESIDENT HAS SEEN
6-5-97

2627

NEW DIRECTIONS FOR U.S.-CHINA RELATIONS

*Sandy
This is quite good
PS*

by
Alexander M. Haig, Jr.
and
Harvey Sicherman

*Copied
Bergen
COS*



Foreign Policy Research Institute
1528 Walnut Street, Suite 610
Philadelphia, PA 19102-3684
(215) 732-3774

INTRODUCTION

On October 28-29, 1996, the Foreign Policy Research Institute convened a conference at the Union League in Philadelphia on U.S. policy toward China. The participants, including scholars and former officials, were united by their conviction that new directions were needed. Important changes, including the end of the Cold War, the explosive economic growth of the PRC, political transition in Beijing, the appearance of democracy in Taiwan, and growing uncertainty about the U.S. role in Asia, had all combined to undermine confidence in the future. The Strait crisis of 1995-96 culminated several years of deteriorating U.S.-PRC relations and threw into sharp relief the potential for disaster.

Our analysis suggests that in the wake of that episode, an opportunity exists to put both Sino-American and Cross-Strait relations on a more constructive basis. The death of Deng Xiaoping on February 19, 1997 gives further urgency to this quest. The United States and the PRC are already engaged in a series of visits and exchanges intended to mend relations. But this is only a start. More fundamental changes will be needed for improvements to endure. And those changes, in our view, must be rooted in both the realities of the region and a more assertive American leadership, not only in the capitals of Asia but in Washington itself.

"New Directions For U.S.-China Relations" draws upon the discussions at the Conference but represents the views of the authors alone. We put it forward in the hope that it will stimulate debate not only among Americans but among the Chinese themselves, who have the greatest stake in a peaceful, prosperous, and democratic outcome to their historic endeavors.

We also wish to thank Halpern Associates and the Trustees of the FPRI, chaired by John Gilray Christy, for making the Conference possible.

Hon. Alexander M. Haig, Jr.
Conference Chairman

Dr. Harvey Sicherman
Program Director

CONFERENCE ATTENDEES

Conference Chairman

Hon. Alexander M. Haig, Jr., Chairman, Worldwide Associates, Inc.; Secretary of State (1981-82); SACEUR (1974-79); White House Chief of Staff (1973-74).

Program Director

Dr. Harvey Sicherman, President, Foreign Policy Research Institute; Special Assistant to the Secretary of State (1981-82); Consultant to the Secretary of State (1988-90); Member of the Policy Planning Staff of the Department of State (1990-91).

Participants

Mr. Peter F. Geithner, Consultant; Director of the Ford Foundation's Asia Programs (1990-96).

Dr. Gerrit W. Gong, Director of Asian Studies Program, Center for Strategic and International Studies; Special Assistant to Ambassadors Winston Lord and James R. Lilley in the U.S. Embassy in Beijing; Special Assistant to Under Secretary of State for Political Affairs Michael H. Armacost.

Mr. Charles Hill, Diplomat-in-Residence, Yale University; Special Assistant to the Secretary General, United Nations (1994-96); Executive Secretary, Department of State (1985-88).

Hon. James R. Lilley, Director of Asian Studies, American Enterprise Institute; U.S. Ambassador to the People's Republic of China (1989-91); Director, American Institute in Taiwan (1982-84).

Mr. Ross H. Munro, former Director of Asia Program, Foreign Policy Research Institute; a former *Time* Magazine Bureau Chief in Bangkok, New Delhi, and Hong Kong.

Hon. Richard H. Solomon, President, United States Institute for Peace; Assistant Secretary of State for East Asian and Pacific Affairs (1989-92); Director of the Policy Planning Staff of the Department of State (1986-89); Senior Staff Member for Asian Affairs on the National Security Council (1971-76).

Hon. Helmut Sonnenfeldt, Guest Scholar, The Brookings Institution; Counselor of the Department of State (1974-77); Senior Staff Member on the National Security Council (1969-74).

Dr. Alfred D. Wilhelm, Jr., Executive Vice President, The Atlantic Council of the United States; U.S. Army attache to the People's Republic of China (1986-88).

FOREIGN POLICY RESEARCH INSTITUTE

Founded in 1955, the Foreign Policy Research Institute is an independent, nonprofit organization devoted to advanced research and public education on international affairs. FPRI works in three areas: **research**, **publication**, and **education**.

Research. FPRI brings the insights of scholarship to bear on the development of policies that advance U.S. national interests abroad. We add perspective to events by fitting them into longer-range patterns. And we develop alternative policies to deal with pressing U.S. international problems. Current programs include:

America's Defenses, an examination of new developments in mission, procurement, and defense industrial base that could significantly diminish America's military capability in the years ahead.

Russia and Its Partners: New Directions in Business and Security, a collaborative project with Russia's Institute of the USA and Canada that considers security and economic issues in Europe.

South Asia: Energy and Environment, a historic project bringing together leading officials and experts from India and Pakistan to consider potential areas of cooperation.

History Academy, a project designed to help shape the teaching of history in the schools, focusing on such themes as the history of U.S. foreign policy, the idea of the West, and the use and abuse of history.

Emerging Markets, a program offering political risk analysis to corporations as well as policy relevant studies on issues relating politics to the international economy.

Middle East Council, focusing on Gulf security, the Arab-Israeli peace process, arms proliferation, and water issues.

Asia Program, focusing on strategic issues in U.S.-China relations, Taiwan's role in the world community, and the fate of Hong Kong.

Education. In 1990, FPRI established the Marvin Wachman Fund for International Education to help teachers, students, and the general public learn more about America's role in world affairs. The Fund's programs include: **Global Classroom** and **Weekend Academy**, lectures and workshops for secondary school teachers, and four named lectures -- **Cynthia P. Robinson Memorial Lectures in World Affairs**; **Templeton Lecture in Religion and World Affairs**; **Bobby Hall Luxenberg Memorial Lecture on Japan**; and the **Sheila T. Benjamin Memorial Lecture**.

Publication. In 1957, FPRI launched **Orbis**, a quarterly journal of world affairs that offers the latest in foreign policy research and debate to a broad audience of policymakers, scholars, and the interested public. *Orbis* is edited by Pulitzer Prize-winning historian Walter A. McDougall. FPRI also publishes research bulletins such as the **FPRI Wire**, **Peacefacts**, and **CubaWatch**.

The views expressed in this report are those of the authors. As a tax-exempt (501)(c)(3) organization, the Institute does not take positions on public issues.

New Directions for U.S.-China Relations

by

Hon. Alexander M. Haig, Jr. and Dr. Harvey Sicherman

The emergence of China as a major world power is surely one of the transforming events of the late 20th century. Over the past twenty-five years the Chinese people have achieved unprecedented economic progress in the context of regional peace and prosperity that also promises the spread of democracy. Yet the events of the past several years, culminating in the Strait crisis of 1995-96, have raised fears for the future. This challenges not only vital American interests but our international leadership because our engagement with China and our policies in Asia helped to set "the rules of the road" that made much of this progress possible.

Most recently, the United States has attempted to put its relationship with the PRC on a sounder footing. Visits and exchanges among high officials are surely a welcome alternative to threats but do not guarantee success. Instead, a more searching examination of the roots of discord and the potential for cooperation is necessary. Both Sino-American and Cross-Strait relations have been buffeted by substantial change that call for new directions in American foreign policy.

1. Sino-American Relations

U.S.-PRC relations were formed amidst the travails of the Cold War when both Beijing and Washington saw their respective interests threatened by an aggressive Moscow. Fear of the Soviet Union enabled both sides to develop what might be called a "theology" of their relationship, a set of precepts that allowed them to cooperate without reconciling very large differences on such key issues as democracy, Taiwan, and the U.S. military presence in Asia. The foundation of this theology is the One China principle which in the U.S. view recognizes the PRC as the legal government of China; acknowledges the reality that both sides of the Taiwan Strait agree that there is only one China; and declares that the conflict between the PRC and Taiwan should be resolved peacefully. The three U.S.-PRC Communiques and the Taiwan Relations Act have all elaborated on these points without fundamentally changing them.

Major developments since the early 1970s, however, have called the theology and the subsequent rules of the road into question.

- The Tiananmen Square affair suddenly raised human rights issues to the top of the Sino-American relationship.
- Beijing, presiding over a booming economy, began a political transition from the Deng era with the inevitable questions about the new leadership's durability and direction.
- Taipei, after achieving its own economic miracle, became a democracy seeking a new international identity even as Taiwanese businessmen became major investors on the mainland.
- In 1993, Washington experimented with a new agenda attempting first to force political change while achieving arms control and trading goals in the PRC through economic leverage, then in 1995-96 abandoning that approach in the name of economic primacy.

The end of the Cold War and the demise of the USSR suggested to many Americans that, apart from growing trade, the U.S. and the PRC had few common interests and several growing conflicts.

The earlier policy towards China thus seemed to lose much of its strategic footing. This has inspired two dangerous myths that should be dispelled. The first is to view a rising China, in the absence of a Soviet threat, as a strategic danger to U.S. interests. The second is to allow U.S. interests to be defined by events rather than by a strategic view of the American role, not only in dealing with China but in Asia as a whole.

The Reality. The PRC is not a strategic threat to the United States today. It does not offer international ideological competition and by its own admission is well behind American military technology, despite the size of its armed forces. Even its most obvious strength--its fast growing economy--must feed, clothe, house, and employ 22% of the world's population on 6% of the arable land, with 12 million new mouths added each year. The country is undergoing severe stresses of modernization that will sorely tax the capacity of any central government to survive without avoiding upheaval.

The PRC regime and indeed traditional Chinese statecraft, however, put considerable emphasis on military power, whether nuclear or conventional weapons. Economic growth enables Beijing to invest in technological modernization and increased "power projection" capability. This military is at the service of what might be called a geopolitical agenda: the recovery of lost lands (for example, Hong Kong to the British, Macao to the Portuguese, Taiwan to the Japanese). Beijing's authoritarian government also sees Chinese nationalism as a substitute for the discredited communist ideology. Recent frictions with the United States have stimulated a "China that can say no" school that views Washington's policies an attempt to deny China its rightful place as a great world power or, for others, its dignity and respect.

These views must be squared with an acute sense of realism in Beijing about China's true status. Great powerdom cannot be attained without a growing degree of international economic interdependence and an overall climate of political stability. These in turn demand a workable relationship with the United States and indeed with China's neighbors, especially Japan.

Beijing thus exhibits today a mix of the historic "middle kingdom" ambitions mitigated by pragmatic considerations that provide ample puzzlement for analysts and diplomats alike. In previous periods a strong leader, whether Mao or Deng, could establish a consistent balance between the two tendencies that governed Chinese behavior. Recently this consistency has been a casualty of the transition but has also been aggravated by inconsistencies and confusion in Washington.

A Strategic American View. The American relationship with this sometimes schizophrenic China requires both strategic and historic perspectives to be successful. Our China policy was not only the product of a Cold War; it reflected long-standing U.S. support for an independent, prosperous China. The U.S. entered knowingly into this "gamble with history," that we could create a constructive relationship with a potentially great power and in doing so, encourage China to accept our gifts--our free market economy with its emphasis on individual institutions; our freely chosen political system with its emphasis on individual rights; and our conviction that sovereign nations can and should settle their disputes peacefully. It is surely not our business to impose our ideals on China and Americans should not presume to teach an ancient civilization how to develop its culture. Yet it is surely our right to espouse American values.

Today, China is important to us because it is crucial to a secure, free, and prosperous Asia, because it will affect the future of the planet's environment and its agricultural resources and it has a vital role to play on such global issues as nuclear proliferation. China is in increasing measure a regional "peer" of the United States. But it is not the only regional peer.

The American role in Asia, to be successful, must draw upon broader and deeper roots than China alone. Much of Asia's recent success--including China's--derives from a stable set of relationships throughout the region. These have depended upon Washington's continued adherence to a policy established after 1945: the U.S., in alliance with Japan and other countries, would construct a cooperative security arrangement with other major countries in the area that precluded the dangerous rivalries--especially between China and Japan--that led to regional conflict in the 1930s and world war thereafter.

Seen in the cold light of geopolitical reality, our continued alliance with Japan sustained by a forward American military position and a constructive relationship with China are the key elements in preventing a repetition of a history disastrous for all of Asia. It is therefore vital for the U.S. to persuade China that, for example, the recent strengthening of the U.S.-Japanese security relationship is not part of a larger American scheme to contain China or create a condominium with Japan at China's expense. We are and will remain an Asian power out of strategic conviction not only commercial convenience, although presence and economic interest are closely related. But it is equally vital for the PRC to understand that its actions can also raise doubts about its intention toward its neighbors and that our presence, especially in Japan, serve China's long-term interests.

2. Cross-Strait Relations

The most critical flash-point in U.S.-China relations remains Taiwan. Last year's military tensions were especially damaging because until quite recently both Beijing and Taipei had made surprising accommodations to changing times. Despite adverse political conditions including de-recognition by most states, the government on Taiwan developed a highly successful economy, and amassed a large foreign exchange reserve. Island businessmen also became second to Hong Kong as the largest investors in mainland industry. Taiwan's government also made a smooth transition from a martial law regime to a democracy.

As the economic connections grew between island and mainland, a new rule of the road also developed: "work around politics." Thus, both sides strictly maintained their vision of the One China theology: Beijing, that Taiwan was a province in One China with two systems; Taipei that One China was a country with two governments, much like the Koreas or the Germanies. A unique formula to work around politics was created through the Cross Strait Commissions that brought "unofficial" official contacts on common problems such as fisheries, piracy, trade, transportation, and communications.

These arrangements came apart when the United States granted a visa to President Lee Teng-hui to visit his alma mater at Cornell after the PRC had been given assurances to the contrary. For Beijing this seems to have confirmed a suspicion that the U.S., after undermining its legitimacy through a human rights campaign was encouraging Taiwanese independence as a final blow. The PRC's campaign of intimidation, however, went too far, probably boosting Lee's vote totals and forcing the U.S. into a not entirely convincing demonstration of naval power in the Taiwan Strait.

The various miscalculations that produced the crisis originated in domestic pressures that backed all three parties into each other. In Taiwan, Lee and the KMT en route to democracy sought to outflank the opposition DPP party, which was appealing to islander resentment of mainlander dominance. In the PRC, the Government's search for legitimacy fastened on nationalism and the historic wrong that put Taiwan under Japanese control in 1895. Finally, domestic pressures in the U.S. occasioned the surprise sale of F-16's to Taiwan during the 1992 election, the fixation with human-rights in 1993-95, and the visa crisis of 1995.

The outcome of the crisis clearly alarmed all of the parties and each, in its way, lost ground. Beijing did not stop Lee, did not stop the election, worried its neighbors, brought U.S. warships in its vicinity and, most alarming for the long term, shook Japanese confidence in Chinese intentions. The Taiwanese suffered a serious, if temporary economic dislocation and the loss of carefully nurtured cross-strait contacts. The United States found the Taiwan issue a potential cause for war with the PRC, a prospect that twenty years of American policy had successfully avoided without compromising the island's security.

Both the island and the mainland are operating on different theories about the outcome of their relationship. Economically they are closer today than ever before yet these ties have not yielded commensurate political influence for either side. Beijing has been relying on the "long-term sponge" effect, expecting that the economic interchange will absorb the island's independence sooner or later.

Meanwhile the PRC holds out for Taipei an expanded version of the promise for Hong Kong: a separate "system" that leaves the island with its own military.

Taipei, for its part, seeks a "modus vivendi," a de facto independence that preserves a profitable economic connection with the mainland but allows the island to cultivate its own political system and a separate international political personality. In the meantime, it counts on the international community--especially the United States--to keep it free of overwhelming military pressure for the foreseeable future or until the communist regime passes into history.

Neither of these theories has given their adherents much comfort lately. Beijing's functional ties with Taipei did not prevent the growth of an independence movement on the island or increase the political pressure for more rapid reunification. The "sponge" was absorbing the PRC's tolerance but not Taiwan's sense of independence. Neither did Taipei see a palpable weakening of the communist government's opposition to its quest for some international status or, for that matter, a relaxation of authoritarian tendencies, only a visible improvement in Beijing's military power and international economic leverage. Thus, both the island and mainland emerged from the Strait crisis less secure about the future of their relationship and more anxious about finding new rules for their road. Neither can achieve their maximum goals: Beijing cannot seize Taipei in the face of American opposition; Taipei cannot go it alone without American protection. Each in its own way looks to Washington to set the "red lines."

3. New Directions: Resetting the Track

Five years after the end of the Cold War, the United States faces a critical juncture in its relations with the PRC and indeed the major states of Asia. Some compare the rise of China at the end of this century to the rise of Germany in the last and find in Asia the same symptoms that led to World War I: an ambitious regime at once assertive and insecure pressing against a defective security system. It follows under this logic, that the United States, should be organizing a coalition to contain China, especially encouraging Tokyo to "offset" Beijing.

This depiction is both inaccurate and likely to be a self-fulfilling formula for new and dangerous tension. There is and has been a well-functioning security system for some time now; it consists of the United States, its allies, and associated powers. This coalition relies on American leadership to rally the region against conflict, for increasingly open trade and a political evolution toward greater freedom. The problem we face today is not the rise of the power of an authoritarian China *per se* but rather the rise of that power in the context of uncertainty about American intentions. Are we going to continue to operate the current security framework expanded to include a cooperative China or are we going to become more a commercial interest with a diminishing security presence? Does the Asian future hold a return to the earlier era of national competition with the United States part of the problem rather than part of the solution?

The beginning of wisdom for American policy toward China therefore is to see that policy in the context of a continuing American presence that rests on these principles:

- Our security and economic interests in Asia require an active U.S. role on all fronts and a forward military presence to back our diplomacy.
- Our security relationship with Japan remains a foundation stone for the peace and security of the region. It makes unnecessary unilateral Japanese armament or a free-lance Japanese security policy. It makes possible multilateral cooperation in such issues as Korean tensions. U.S.-Japan security arrangements should be transparent and contribute to a sense of regional confidence. Japan is not a "card" to be played against China or any other power nor should its security responsibilities be expanded unmindful of China and other regional powers.

- We have a leading role in organizing coalitions that can deal with major multilateral issues. Leadership is different from "hegemony;" we do not dictate the outcome or demand subservience but rather try to define and shape the common interest in solving problems, whether Korean tensions, weapons proliferation or other issues that broadly affect regional security and prosperity.
- The U.S. should not and cannot assume the exclusive right or bear the entire burden of creating the solutions.

It is essential that these points be articulated and understood both in the region and in the United States. Based on these principles, the following suggestions are offered for U.S. policy toward China.

Cross Strait Relations: Peaceful Change. The Taiwan issue remains the most neuralgic of all those dividing the U.S. and PRC and the one that most likely to lead to a military clash.

It would be a serious mistake to tamper with the One China theology and its commentaries; like all diplomatic devices, these serve to offer constructive ambiguities and will not pose insurmountable obstacles if the parties wish to transact business. Nonetheless, three points need to be clearly and strongly reaffirmed by the U.S.:

- 1) We will oppose any attempt by the PRC to force reunification. Part of this is continuing arms sales to Taiwan that offer it a capacity for self-defense. The August 1982 U.S.-PRC communique, approved by President Ronald Reagan, anticipates reduced arms sales based on a peaceful approach by Beijing to reunification. In any event, it should be clear that Taiwan's security rests ultimately on the United States.
- 2) We will not defend a unilateral formal declaration of independence by Taiwan. The United States should not apologize for its dealings with the island but should also make clear to those on Taiwan seeking independence that they cannot assume American support.
- 3) Through our contacts with each side the U.S. should continue to encourage necessary dialogue between mainland and island, but not set the details of that dialogue.

The paradox of Cross-Strait relations remains the extent to which the economic dialogue prospers and the political dialogue is constrained. We may very well see the following sequence: an improvement in the U.S.-PRC track; a slow motion exchange of proposals for high level Mainland-Island meetings that establishes the criteria for success; action pitched to a major event, either a commercial change, or entry into an international organization (such as the WTO). The United States, by staying true to the guidelines and "out of the details" can facilitate a "third way" that encourages both parties to find the space and the time to accommodate each other. The rules of accommodation must truly be "made in China" by Chinese on both sides of the Strait.

The Great Multilaterals. The U.S. and the PRC have many issues that affect a broader range of states. These include: the regional disputes over the Spratly Islands and other areas; the continuing tensions on the Korean peninsula; weapons proliferation. In line with our regional role, we should be arguing for the peaceful resolution of these disputes in multilateral circumstances. We should bring the Chinese to understand that insurance policies for regional security on these matters are sometimes better underwritten by many hands instead of a series of bilateral deals. The one principle that remains sacred is to settle these matters through negotiation and diplomacy. The United States must oppose the use of force and intimidation, especially in bilateral dealings, because this will begin to break down the region into national rivalries and opposing coalitions which in turn will harm U.S. and Chinese interests.

Human Rights. Just as neither the U.S. alone nor the PRC alone can settle these matters alone so the special case of human rights demands a multilateral approach. Washington cannot compel a political revolution in Beijing. Indeed, the United States finds itself very much alone in demanding a quick change from a more authoritarian government; the Asian "model" of development as seen in Taiwan, Singapore, and elsewhere postulates the economic achievement of a "middle class" before liberalization. We are thus left with the unsatisfactory situation of pressing China for human rights with neither great leverage nor much sympathy. That does not excuse us, however, from continuing to argue to the Chinese leadership that its human rights record is a serious impediment to Chinese interests as (1) the PRC tries to play a larger role in the world (2) Beijing argues for its one country "two systems" concept to accommodate the diversity of Hong Kong. Human rights in China will remain a continuing but not decisive aspect of the evolving relationship.

Hong Kong. Britain's turnover of Hong Kong to the PRC is a test case at the juncture of politics, economics and human rights. The issue here is two-fold: 1) whether Beijing's concept of one country, two systems will operate in a way that retains Hong Kong's unique system of law, government, and individual enterprise that have made the city a great economic engine and relatively free society,* 2) whether the act of takeover, in the presence of the world's media, will be free of ugly incidents. Failure on both counts could be highly disruptive of regional economies, including Taiwan's. Violence in particular might severely reduce American flexibility in dealing with the PRC and lead to region-wide tension. All parties involved therefore should work to ease the transition. We should keep this perspective: a successful Hong Kong autonomy would set new standards for Beijing's conduct on such issues as law and human rights within the framework of the PRC's sovereignty.

Economics. U.S. economic interests in China include not only the PRC but also what has been called the Greater Chinese Economy-- Hong Kong, Singapore, Taiwan. The future growth of the region depends on an increasingly open volume of trade. Both the U.S. and China's neighbors also see economic change as the engine that will turn Chinese society and government into more democratic ways. Our material and political interests are therefore best served if the Chinese people are incorporated into the WTO and trade proceeds on a normal basis. This would preclude the annual debate over MFN status which has so bedeviled American politics.

The U.S.-PRC trading relationship, however, should not be "delinked" from important trading issues. Chinese entry into the WTO and indeed the bilateral commercial relationship requires that rules be set and observed. It is Washington's business to press Beijing to observe those rules. We should also make clear to the Chinese that the current lopsided trade imbalance will seriously undermine support for U.S.-PRC economic ties, especially if this is seen to be due to arbitrary barriers against the import of U.S. goods and services.

Presidential Leadership. Finally, Sino-American relations and indeed America's overall position in Asia has been hurt by Washington's preoccupation with domestic issues and a diplomacy related more to crisis than to strategy. There can be no substitute for this kind of Presidential "body language":

- the articulation in Washington, not only in Asia, of America's role as a Pacific power;
- a regular set of exchanges with the Chinese leadership;
- a willingness to work for a Congressional consensus in basic support of the U.S. policy toward China;
- a set of active channels, authoritative and reliable, that includes also military-to-military exchanges.

In conclusion, the United States enjoys today in Asia and in its dealings with the Chinese people a legacy of success. For twenty years, we have led allies, especially Japan, and select coalitions of nations

* The PRC insists that its 1990 Basic Law for the Hong Kong Special Administrative Region, which contains human rights guarantees, supersedes subsequent legislation, including parts of a bill of rights and the election of a legislature, undertaken by the colonial government. Beijing appears to be allowing its local appointees to manage the repeal of these limited changes.

in helping to turn Asia from war and poverty into a region of great progress benefiting not only the PRC but also a prosperous and democratic Taiwan. This process can continue if only the United States is clear-sighted and determined about its actions. Policies such as those outlined above, under presidential leadership, will reduce the risks of the "gamble with history" as the Chinese people increasingly shape their future.

THE WHITE HOUSE
WASHINGTON

Date

6-5

To:

Albion

From:

The Staff Secretary

Are you fine
with this
letter?

Paul

THE WHITE HOUSE

WASHINGTON

1997 JUN 4 PM 3:05

June 4, 1997

ACTION

MEMORANDUM FOR THE PRESIDENT

FROM:

SAMUEL BERGER *San*
JOHN HILLEY *John Hilley*
BRUCE REED *Bruce*
CHARLES RUFF *CR*SUBJECT: Response to Representative Maxine Waters Regarding
Programs to Combat Drug UsePurpose

To reply to a letter from Representative Waters.

Background

Maxine Waters wrote you with two general requests (Tab II). She is outraged at the sentencing disparity between crack and powder cocaine offenders, and she wants a timely and exhaustive answer to the allegations that CIA and DEA were involved with the Contras in bringing drugs into the United States. Your response lays out your policy on reviewing the sentencing guidelines. It also states that the CIA and Justice IG reports will be completed by the end of September. We have left unanswered her request for you to mention these topics at an earlier press conference, but we will provide copies of your response to General McCaffrey, AG Reno and George Tenet to make them aware of the importance you attach to these issues. CIA, Justice and ONDCP have all coordinated on this response.

RECOMMENDATION

That you sign the letter at Tab A.

Attachments

Tab A Response to Representative Maxine Waters
Tab B Incoming Correspondencecc: Vice President
Chief of Staff

THE WHITE HOUSE

WASHINGTON

Dear Maxine:

Thank you for writing to share your views about the effect of drug trafficking on the African American community. I, too, am deeply concerned about the crack addiction, distribution and associated violence that continue to plague many American communities.

At the same time, I fully understand your concern about the substantial disparity between sentences for crack- and powder cocaine-related offenses. I commend the U.S. Sentencing Commission for moving forward with recommendations to Congress to reduce the disparity between crack and powder cocaine penalties. These recommendations, released on April 29 of this year, will be given serious consideration by my Administration. I have assigned Director McCaffrey and Attorney General Reno to review the Commission's recommendations and to report back to me with 60 days after their release.

With respect to allegations that CIA and DEA were involved with the Contras in bringing drugs into the United States, I remain committed to getting to the bottom of this story. We expect both the CIA and Justice reports to be thorough and completed by the end of September. We will then brief the relevant committees and undertake to make both reports public to the extent possible.

I am sending copies of this letter to the Attorney General, the Acting Director of Central Intelligence and General McCaffrey to stress my strong views on both these issues.

Sincerely,

The Honorable Maxine Waters
House of Representatives
Washington, D.C. 20515-0535

cc: Attorney General Reno
Acting Director of Central
Intelligence Tenet
General McCaffrey (ONDCP)

Congress of the United States
House of Representatives
Washington, DC 20515-0535

February 24, 1997

1484

William J. Clinton
President of the United States
The White House
1600 Pennsylvania Avenue
Washington, D.C.

Dear Mr. President:

I have been working with the Director of the Office of National Drug Control Policy (ONDCP), Barry McCaffrey and Director of the Office of Management and Budget, Frank Raines on programs to combat drug use in our society. The eradication of drugs is the number one priority of the Congressional Black Caucus (CBC) for this term of Congress. The CBC will be unveiling its program to deal with the drug program in the very near future.

I have worked well with ONDCP and am delighted with the overall tenor and thrust of this year's drug strategy, especially the proposed increases in drug treatment, prevention, and education. We believe that these emphases are crucial components of a successful long-term program of drug abuse reduction.

In addition, there are two other issues which are of primary concern to Members of the Congressional Black Caucus and their constituents. Our community is outraged by the disparity in sentencing between crack and powder cocaine. We have been inundated with letters from prisoners, their families, and other concerned citizens who have seen extremely lengthy prison terms applied to small- and first-time offenders for crack-related offenses. It is impossible for us to discuss the problem of drugs in our communities without addressing this concern.

To that end, would it be possible for you, at your press conference tomorrow, to give recognition to this issue? It would be useful if you described your awareness that this issue is of great concern to many Americans, and pursuant to Congressional directive and the U.S. Sentencing Commission's charge, that the disparity question will be reviewed again this year.

Second, the startling revelations of alleged Central Intelligence Agency (C.I.A.) and Drug Enforcement Agency complicity in the drug trade with the Nicaraguan Contra in the 1980s have shocked much of America. This is an issue that has created more debate and discussion among African-Americans in particular than any public policy issue in recent times.

President Clinton

As you know, both the Justice Department and C.I.A. Inspectors General (I.G.) are in the process of conducting investigations into these allegations. I would like to know whether you could, again, during your press conference tomorrow, acknowledge these investigations. Although to date, no firm conclusions have been drawn from either the Justice Department or C.I.A.'s I.G. of U.S. government wrongdoing, your mention of the investigations and the significance of their timely, thorough, and exhaustive completion would show many Americans we are serious about getting real answers to these questions once and for all.

Thank you for your consideration of this matter. I look forward to working with you in the future.

Sincerely,



MAXINE WATERS

Jerry Jones 56625

McCaffrey needs consent on sentencing

JUNE 4, 1997

'97 JUN 4 PM12:49

RECOMMENDED TELEPHONE CALL FOR THE PRESIDENT

Copied
Smith
Baldick
cos

TO: State Senator and Mayor Jim McGreevey

DATE: June 4, 1997

RECOMMENDED BY: Craig T. Smith and Nick Baldick

PURPOSE: To congratulate him on his victory in the New Jersey Democratic gubernatorial primary.

BACKGROUND: The New Jersey Democratic Primary was held yesterday between Woodbridge Mayor and St. Sen Jim McGreevey, Rep. Rob Andrews (D-1), and former Morris County Prosecutor Michael Murphy. McGreevey was not able to declare victory until 1:00 am today. According to *The Bergen Record*, the results with 99.5% of the vote reported were:

	<u>Percentage</u>	<u>Raw Vote Total</u>
McGreevey	40%	144,092
Andrews	37%	136,315
Murphy	21%	77,826
Marmo	2%	6,079

Only 35% of the electorate turned out, casting a total of 365,312 votes.

It had been a tight race between McGreevey and Andrews, with Murphy capturing some momentum in the last two weeks. Many people attributed McGreevey's victory to a solid get-out-the-vote campaign. According to *Newark The Star Ledger*, McGreevey also owed part of his victory to the endorsements he won from 12 county organizations. These endorsements gave him prominent placement on the ballot as well as a large number of GOTV volunteers.

Now he will turn his focus toward Governor Christie Whitman (R) and reaching the mass electorate with his message. This message is centered around his two signature proposals which are: letting the voters elect the state's insurance commissioner, and abolishing the property tax as the primary means for funding schools. Last

McGreevey called
you back

night both McGreevey and Whitman pledged to make the upcoming campaign about the issues. McGreevey said, "I will not gratuitously attack you or your family. This campaign should be about building up this state."

According to the most recent Mason Dixon Poll of 804 likely voters conducted May 27-28, Governor Whitman is still a solid favorite in the general election.

General Election Matchups

Whitman	52%
McGreevey	33%
Undecided	14%

	<u>FAV / UNFAV</u>		<u>ID</u>
Whitman	51%	36%	100%
McGreevey	24%	17%	81%

Sen. McGreevey's campaign Co-Chairs were:

- 1) St. Sen Ray Lesniak (D)
- 2) Cong. Frank Pallone (D)
- 3) St. Sen. Wynona Lipman (D)
- 4) St. Sen. John Lynch (D)

TOPICS OF DISCUSSION: To congratulate the primary winner on his victory.

CONTACT PERSON &

TELEPHONE NUMBERS: Jim McGreevey: Contact: Campaign Manager- Doug Heyl

Jim McGreevey will be in his campaign HQ
between 1:00 pm and 4:00 pm today.

Campaign HQ:	908-650-1997
Heyl's Cell:	908-420-4908
Heyl's Pager:	919-873-2982

DATE OF SUBMISSION: June 4, 1997

ACTION: _____
