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THE WHITE HOUSE

WASHINGTON
November 29, 1993 P2:25

MEMORANDUM FOR THE PRESIDENT

FROM: GENE SPERLING

SUBJECT: 1995 BUDGET

As you consider the major choices for the 1995 budget, Bob Rubin thought it would be helpful to flag for you some of the major political and economic considerations relevant to your major investment choices. Certainly, our goal must be to cut lower priority spending to make room for higher priority investments. Yet, it will be inevitable that at some point, we will be choosing among a range of programs that we will consider important, and one thing we must consider is what is our strategy or approach for choosing among priorities. Below, I mention four approaches:

I. INVESTMENT APPROACHES

1. **SHAVE TOP INVESTMENTS:** One of the most logical methods to deal with the tight caps, is to moderate the degree of increases in your top investment. The advantage of this method, is that you are still keeping increases in your major areas, and are just moderating those increases in light of tough budgetary constraints. The disadvantage of this perspective is that it decreases the chances of making major differences in the areas you have identified as your top priorities.

2. **MAKE A TOP 10-15 INVESTMENTS YOUR MAJOR PRIORITY:** Under this perspective you would pick out a top list of investments, decide the amounts that you felt are needed to make these investments successful, and then ask your staff to simply make the budget fit with those increases built in. We did this in the 1994 budget, when you would exclude four or five items, while asking for another shave of the budget. The advantage here is that you do not allow your top investments to be diluted, and preserve key signature pieces for the Administration. The disadvantage is that other members of Congress may be upset to see some items getting such large increases while their issues are getting no increase. Also, it is likely that picking a top 10-or 15 investments will mean no increase for many other areas that you would still consider to be priorities.

3. **FULLY-FUND INVESTMENTS WHERE THE AMOUNTS ARE SMALL:** A sub-component of the above method is to consider bang-for-the-buck calculus in terms of fulfilling investment objectives. There are some areas where the amount we need to find concerns several hundreds of millions or even billions per year. Yet, there are other areas where the difference between fulfilling an investment objective is a matter of tens of millions. Under this perspective, since we will not be able to achieve all of our investment objectives,

we should consider strongly those areas where we can achieve 100% success for a small amount.

4. **HEALTH CARE:** One perspective is to make choices based on how they affect the chances for passage of health care. The advantage of this is that we keep focused and do not let side-issues stand in the way of the coalition we need to pass health care reform. On the other side, the implications of this logic could be sweeping. Indeed, the logic there might be to not fund most of our major investments since such strong funding will require serious cuts that will each have a negative effect on some members.

II. RECOMMENDATION - STRATEGY FOR STRONG SUCCESS IN 15-20 KEY ITEMS: While this memo seeks to raise issues more than answer them, I want to make one general recommendation for approach. I believe that you would be wise to pick a certain amount of areas where we want to hit home runs, and force the rest of the budget to live within those constraints. Ideally, the extra funds would come from spending cuts in non-priority areas. Yet, if necessary we should be willing to do less in our second order priorities to make sure we have clear successes in top priority areas.

In looking at the OMB recommendations, there appears to be full funding for several major investments: 1) WIC; 2) School-to-Work; 3) Goals 2000, 4) 100,000 cops (assuming passage of the Crime bill); 5) One-Stop Shopping Labor. Furthermore, we have near full funding of 6) EITC and 7) Empowerment Zones through the 1993 Budget Act.

The amount of new investments above the OMB mark to bring other investments up to a full-funding -- for another 8 major investments is not an exceptional amount. For example:

8. *Alternative Fuel Vehicles*: This is somewhat of a signature piece that could be significantly expanded for $15 million more.

9. *Ryan White*: The OMB mark is $672 million, which is $93 million above the $579 million enacted in FY1994. For $50 million more, we will be at the full-funding level. As this is both a humane investment and one with a strong constituency, the extra $50 million for full-funding would be worthwhile for us to find. It is another case, where the price for complete fulfillment of campaign pledges is not high.

10. *National Information Highways*: The Commerce request was for $150 million; The OMB mark is for $78 million. Clearly, $50-60 million more could make a large difference in the progress of a signature piece. (rationale discussed below)

11. *Dislocated Worker*: On the discretionary side, Labor asks for $300 million more than the OMB mark to get up to the amount they need. (rationale discussed below)

12. *Community Development Banks*: There is $100 million in the OMB budget for this, which is adequate. Yet, for an additional $100 million we could make a major difference in considerably more communities. Our review so far shows this piece could be very popular and successful.

13. *Head Start*: For reasons given below, we may need to come forth with a $1 billion increase, which requires $376 million above the OMB pad mark.

14. *NIST*: We would be near full funding with $200–$400 million more. (discussed below)

15. *National Service*: Eli wants to go from $575 to $862, while the OMB mark is $715. Thus, $137 million separates OMB from National Service's request

16. *Technology Reinvestment Program*: $400 million more, above the OMB recommendation would mean a major increase.

Clearly, there are other demands on the budget besides these additional nine items. HUD, for example, has serious needs in important areas such as homelessness. Yet, if the Defense Department can include in their budget the $400 million more needed for ARPA, we could have 15 major investments at near full-funding for $1.3 billion more in key investments.

Alt Fuel Vehicles	15
Ryan White	50
Info Highways	78
Dislocated Worker	235
CDB	100
Head Start	376
NIST	300
National Service	140
	$1.3 billion

It is worth seeing for illustrative purposes that much of this could be paid for just by decreasing other investment areas, that while important, may not be as high priority as these investments. For example, the investments below represent increases in our budget of $2.8 billion.

Federal Crop Insurance:	300
Rural Development Initiative	130
Food Safety	22
Census	35

Chapter 1	655
Education Research & Stats	73
Elementary and Secondary Teacher training	151
Conservation R&D	200
Jobs Corp	143
Salaries and Expenses	103
Transit Formula Capital Grants	392
VA Medical Care	260
Mission to Planet Earth	314
	$2.8 billion

Clearly, many of these are important, and should perhaps be on the top list. But I mention this for the purpose of showing what is doable if we are able to prioritize among our priorities.

III. EXPLORING OTHER WAYS OF CUTTING:

1. **Penny–Kasich Legislation**: We should do a review of the Penny–Kasich cuts and consider them in light of the fact that it receive 213 votes. Many of these cuts we may not like, but if there are 213 members on the record for them, and we may want to reconsider them in light of the fact that they could help fund some of our key investment initiatives. Furthermore, it would reinforce our message that we needed many of the spending cuts just to hit our existing caps.

But would vote be there to fund own investments rather than for deficit reduction? NO

2. **Entitlements and Tax Expenditures**: Two of our main investments, welfare reform and worker training require significant funding on the PAYGO side of the budget. Clearly, from a purely policy view, the tax expenditure side of the budget has significant inequities in terms of progressivity. The overwhelming political instinct will be not to open up the tax side at all, yet it seems right for us to at least explore some options and consider whether there is any political logic in being able to tie some tax expenditure cuts to worker training or welfare reform. The other place is clearly means testing entitlements. Again, we should see if there is a political logic that would allow for some coalition that would make something viable. Finally, the Republicans will be looking for entitlement cuts that call for draconian cuts for immigrants. We need to figure out what is legitimate and expose what crosses the line.

IV: OVERALL PRESENTATION ISSUES:

1. **Listing Spending Cuts:** We should consider how to bunch together or list all of the areas where we are calling for spending cuts to meet our deficit targets. The pro side here, is that we would make sure that we do not bury our spending cuts, by at least presenting them together. The down side, is that if there is $50 billion in spending cuts, we may not be able to control the message that these cuts are needed to meet existing targets, and the highlighting of cuts may lead to more pressure to reduce the caps.

2. **Major and Visible Cuts**: One of the main problems we had in the budget debate, was that we did not get attacked enough on spending cuts. If we wish to address this, we need to present some highly visible and bold spending cuts, and relish the fight against them even if we lost. Some will say, however, that such fights will hurt our relationships needed for the passage of health care and other major initiatives.

3. **Tying Investments**: If we want to stress the notion that we are doing good things without making taxpayers pay one extra cent, we may want to tie specific cuts to investments. It is also a way of focusing on the very economic and value choices we want to highlight. Furthermore, if the technology community sees cutting a pork project as their ticket to NIST increases, we may be able to get more support for the cut in question. Furthermore, it can allow us to present things to the public in very favorable way as to the trade-offs we are calling for, while highlighting that we are stressing tough cuts to pay for new investments. The other major issue is whether there are any specific ways to do this legislatively, or whether this is purely a matter or presentation.

4. **Balanced Budget**: We must prepare and present this budget in a way that makes the public understand how tight discretionary spending is and the contradictions between those who support the balanced budget and yet will yell at us for not funding more of Program A. We must have a simple message. We can only do the programs members of Congress care about if they fight for them, and that if they are also calling for a balanced budget amendment, we will assume that they are in favor of doing less for the programs they care for.

V: MAJOR ISSUES AREAS:

1. **Human Resources**: In the FY1994 budget, we had great victories in the EITC, reforming student loans, and achieving significant funding for worker training, WIC, and Ryan White were near our full-funding request. But there is no hiding that on the discretionary side, our success in some of the most key investments were sub-par. Indeed, our high percentage of priority investments in FY1994 was due a lot to a significant percentage of our mass transit and highway funds. Both the New York Times and the Washington Post have reported that we only achieved 1/3 of our key education investments. School to work received 50 of the $135 requested. Goals 2000 received 105 of $450 requested.Drug-free schools did not have an increase, Worker training got half of what was requested, and Head Start received $550 Budget authority of 1.3 billion requested.

MAJOR ISSUES IN HUMAN RESOURCES:

> **602 (b)**: We must remember that our human resource investments strategy, but it will mean next to nothing unless we have a strategy for ensuring that the 602(b) appropriations allocation is large enough to handle our increases. Once that amount is set, any increase in Head Start competes directly with worker training or Goals 2000.

We need to take this into account as we are preparing the budget and we need a serious legislative strategy for increasing the Labor-HHS 602(b) appropriation.

This means that we must make sure we are fully on top of how the health care budget intersects with the rest of our priorities. If our public health care investments come in as discretionary spending, and fall under not only the discretionary caps but the Labor-HHS 602(b) appropriations allocation, we will face a severe hit on the rest of our human resource investment. Ensuring that those health care spending are set us as capped entitlements -- or in some way as not coming under the discretionary caps -- must be a major issue.

HEAD START:

- **Where We Are:** By far our major FY1995 human resource issue on the investment side is Head Start. In FY1994, we hit only 35% of our Head Start request, and were under the $600 million increase that Bush called for in his last budget. That of course is unfair to us as this was his only strong year for Head Start. The amount in Vision of Change for FY 1995 was $1.8 billion. We have virtually no chance of hitting that amount, and with only a $550 million increase from last year, few would expect us to still ramp up that fast. Despite that, I believe there are problems with the $624 million increase that the OMB budget recommends. It is still a major increase, but it is far below our schedule and fails to get well over the $600 million hurdle--which is an imperative.

- **Realistic Goal:** What may be most important to CDF and others is that we keep our commitment to full-funding, even if it is a more phased- in schedule. If we could aim for closer to the $1 billion that HHS calls for, make a full-funding commitment, and insist that a precondition for increases are quality reforms, we could be in good shape. Yet, finding another $350 million in this budget is a major task.

- **Broader Coalition:** We need to get a political strategy for this. We need to work to get Republicans who call for Head Start increases in their rhetoric. We also need to get business leaders who support such increases to form a business for children coalition to help raise the profile of these investments and give them a business and economic validation. I believe that the Head Start advocates will be successful in somewhat rehabilitating Head Start from the criticisms from last year.

WORKER TRAINING AND LABOR:

• **Dislocated Workers:** In terms of FY1994, we got $600 million of the $1.4 billion we requested. For FY1995, the OMB budget allows for only a $47 million increase, while Labor is looking for $270 million more for the first year of the dislocated worker program. Yet, even this rests on the assumption that we can find an entitlement source to pay for an additional $1 billion a year on the PAYGO side. Therefore, strong funding for the first year of the dislocated worker training program would require an additional $300 million for worker training.

• **Other Key Investments:** With this increase, we would have a strong labor investment agenda for FY1995 on the discretionary side. School–to–Work is on line for the $300 million needed for FY1995, and the OMB mark for one-stop shopping is the is the same as the $250 million that labor is requesting. Labor wants an additional $255 million for Jobs Corp, while OMB has less, but still an $143 million increase.

• **OSHA:** Another major issue is that labor will want over $100 million more for OSHA funding. The key here is that we must consider this in the context of our overall labor agenda. The more we are able to deliver on the non–budget side of their agenda (striker replacement) the less this will stand out. Yet, if other legislative areas are not doing well, this OSHA funding could be politically important.

NATIONAL SERVICE: The National Service Initiative has $575 million for FY1994. Eli has asked for $862 -- an $287 million increase. OMB calls for $715. Even with the full increase, there will be some who say that we have not lived up to the vision on the campaign. Yet, if we are making good progress and if the perception is that National Service got its full request, it would help. This is one our most visible investments. We should find the extra $140 million.

INCOME CONTINGENT LOANS: We will not be doing enough for Pell Grants to make this a major investment item. We need to have a strategy for reviving the notion of universal EXCEL Accounts that allow us to show that we are offering every student new options. This means giving this initiative more lift and more promotion.

2. INFRASTRUCTURE:

• **ISTEA:** In the budget presented by OMB, there is no question that the major area of controversy is that there is $2 billion less for ISTEA. Alone, this cut in politically untenable. Yet, it is a far closer call in the context of the overall budget. Finding this $2 billion in the rest of the budget would be very difficult. As the cuts are in demonstration projects, those most upset would be members of Congress and mayors.

If we do this, we would have to be careful about our other investments that are critical to Mayors. It will certainly hurt us with many of the infrastructure groups that are part of our base. Yet, the real political issue, however, is Congressional. There is a constant call by the budget cutters to cut highway demonstration projects, yet there is still no proof that Congress can stomach this. There is also a serious political issue in that the highway trust funds will be seen as going up at the same time that highway authorizations are going down and airport assistance is being transformed from loans to grants.

• **Transit Grants:** There is some good news in the initial OMB presentation. Capital transit formula grants that took a major increase in FY1994, would go up another $392 million in FY1995. Yet, there is a call for phasing out operating subsidies that tend to hit smaller more rural communities.

• **Environmental Infrastructure:** On the environmental infrastructure side, the OMB budget increases the Clean Water State Revolving Funds by $360 million and the Drinking Water State Revolving Funds by $101 million, which would put us over $300 million above the last Bush budget in this area.

• **High Tech Infrastructure**: The OMB budget has no funding for high speed rail or MagLev. Our danger here is that these investments represent your commitment to a futuristic, year 2000 infrastructure. There may be good policy reasons for not funding the high speed rail, but if this is the case, we must ensure that we have strong commitment to information highways as an investment for the future. Therefore, if high speed rail is out, we need to make sure there is serious funding and promotion of the information highway as well as any advance in smart highways. We can then talk about a movement to environmental infrastructure, information highways, and mass transit as representing a shift to new priorities in infrastructure. The cuts in highway must be seen as cuts in pork; we must distinguish between good spending and bad spending in a period of

3. COMMUNITY DEVELOPMENT:

• **New Initiatives:** On one hand, this is an area where we can claim much success in terms of putting new initiatives and where our future success can be determined largely by our efforts in promoting our new ideas. We have passed Empowerment Zones, and our close to success at CRA reform and Community Development Banks. This hat-trick tells a nice story of economic empowerment and the success of new ideas. Much of the future success may be determined on how much time we spend promoting the ideas, and getting businesses and major corporations excited about helping to make this a success.

• **Highlight Community Development Banks:** CDBs is an area where we are looking to spend $100 million, yet where $100 million more could make a major impact on the success and expansion of a new trademark initiative at a low cost.

• **Gaps in Base Hud Programs:** The negative reality of this part of the budget is the philosophical and political one that Secretary Cisneros points out. At a philosophical level, much of what HUD seeks to spend on is for the poorest Americans, and they are trying to build back after a decade of severe retrenchment and waste. Yet, addressing this in dollar terms is next to impossible with the current caps. On the political side, it is the Mayors who will largely determine how your urban initiatives are judged, and they are unlikely to help with much if we are cutting the programs that we they see as their lifeblood -- mainly CDBG as well as HOME.

• **Two-Prong Approach:** It seems to me, that we need a two-prong strategy here. The first prong is to ensure that we do what is needed to make sure your most innovative and visible investments are well-funded. That means we should not skimp on Community Development Banks or Empowerment Zones. HUD wants extra money for Empowerment Zones so that there will be tangible construction in them in the first couple of years, which is an idea worth considering since it will be difficult to spend the Title XX money that way. The second prong is to try our best to find some additional funds for HUD -- though not nearly as much as Secretary Cisneros and all of us would like -- and see what is the best package we can put together that will fly with the cities. Here we may want to look beyond HUD to Ryan White and mass transit, and do a "cities cross-cut" to see what our who story is. My general feeling is that we are going to have to try to preserve the $4.4 billion in CDBG, and that we should try to do more on the homeless initiative and help for distressed housing, while accepting OMB's severe cut in public housing construction. Despite the major cuts in public housing construction in the 1980s, there does not seem to be enough confidence that we know how to spend this money, and without a major hit somewhere there is no hope of doing any of the new stuff that Secretary Cisneros wants. The other thing we should do is try to give the Secretary funding for his new ideas within the Empowerment Zones as a way of keeping costs down in FY1995 and ensuring that we have enough discretionary funds for economic development to make the empowerment zones work.

4. **AIDS:** As mentioned above, we should at a minimum fully-fund the Ryan White Act.

5. **DEFENSE CONVERSION**: Clearly an areas where we want to be strong is on defense conversion. We can make major strides for reasonable amounts of funds, and we should find a way to do so. Overall, there are many programs that are included in our defense conversion initiative, including our technology programs and programs taking place in the defense department to help base closures and provide severance pay for military personnel. Yet, there are four programs that will be our most visible and will be most clearly understood as defense conversion initiatives by the Administration. One is the Office of Economic

Adjustment in Defense, which received $39 million in funding in FY1994 and is scheduled to get the same in FY1995. A second is the Economic Development Administration in Commerce, which got $80 million in FY1994 and is scheduled to get the same in FY1995. The third is the Technology Reinvestment Project, which got $474 million in FY1994 and is scheduled to get $575 million in FY1995 (despite the fact that Defense amazingly asked for only $325 million). The fourth will be our worker training program.

• **Full–Funding The Three Most Identifiable Defense Conversion Programs:** If we look at the first three, major funding increases for the Office of Economic Adjustment would be a doubling of their funds to $80 million and an increase in the EDA to $100 million. Thus, in these two programs we could be seen as having a far larger presence in helping communities for $60 million more in one of your top priority areas. As to TRP, this program is a tremendous success, highly visible to communities, and perfectly reflects economic conversion. Dellums and Schroeder will clearly ask for more than we do -- probably $1 billion. While I know that defense is squeezed, they make up half of the entire discretionary budget. If they were to fund OEA at $80 million and the TRP at $1 billion we would be asking them to absorb only $465 million more in their budget, while allowing us to be seen as making a major increase in defense conversion, instead of letting others take the lead. It would allow us a visible new increase to demonstrate to members of the California delegation what is at risk with the balanced budget.

6. **TECHNOLOGY**: In addition to TRP and information highways, it seems clear that increases in NIST and NSF represent what most of our people and advisors like John Young believe is the right spending. Commerce asks for $1 billion for NIST, a highly successful part of the government, which funds many of our top priorities such as the Advanced Technology Project and Manufacturing Extension. The OMB mark is $690 million. National Science Foundation wants an increase from $2.9 billion to $3.67 billion, while we increase only to $3.20 billion. It seems that here is a place where we should highlight these two areas and look through the NASA and Energy budget -- as well as the rest of the Commerce budget -- and ask whether other science projects really are worth as much as these.

Budget mtg. Cabinet Rm 11/29

B Rubin - Introductory remarks (- overview - agency by agency - cross-cuts)
VP: Wrap up appeals by Dec. 22

When infl'n goes down it hurts us because caps have to adjust down
DOD claims budget was based on lower infl'n than exists, so they're taking a hit

Health care - add'l discretionary $
GATT - lost revenues (make up via discretionary)
crime bill - will lower caps
welfare reform
Dislocated workers
Camp. Fin.

PODRS: have to think thru where we want to go on welfare pre 12/22

PAYG?

Ag
Energy
DOT
] Cut agencies to provide funds for others
HUD doesn't do well either

Cutting BA in effect cuts agencies in out years

LP: Dec'n

(A) Is your major Theme

- Health
- Welf
- Dislocated workers
- Crime

plus consolidate & keep on track key investments might improve the 70% record of last year

(B) Stress these themes ± restructure of priorities (as indicated in LP memo pp. 4-7 "BOLD OPTIONS")

NP & GS speak against B in light of election year

But this: not include the major proposals -- which'd take $9-10 b.

(see ~~attached~~ handout)

i.e. you couldn't really better the ~~to~~ investment record if you do your major proposals (health, welfare, disloc'd workers, crime)

LB - can't give Dems too many tough votes in '94

POSS: Dems'll favor Crime Welf + H.C.

GS: welfare will be tough vote unless bipartisan & while some good things in R alternative it rides on back of immigrants

POTUS: "R plan is kill every 2d immigrant & make a profit"

BR/LP: There'll be some tough battles just to meet the PAD marks (eg soil conservation, REA etc.)

Gene Sp. walks thru his memo (LP earlier walked thru his)

LP: "If 'plus up' on ~~of~~ anything NIST, nat'l service, whatever, then have to find offsetting reductions

POTUS -- B-K wouldn't passed if no Def. cuts

many who voted for our budg now thinks Def. underfunded

GS: you can't come off your Def. number so let's take it ~~off~~ off table & save time

VP: Liberals will be ~~off~~ upset so you'll need a strong pitch, assume Commander in Chief role fight against Def. cuts that libs will want & this'll help against attacks by the right that we're hollowing out the army

POTUS: Def. will claim they're $50b down over 5 years bec. of higher than anticipated infl'n + Cong. raised pay too much

GS - draw ~~[illegible]~~ overall line early now, help us politically (i.e. agrees w/ VP) (& maybe paves way to move some $ around w/i DOD budget -- eg conversion)

LP: walling off defense will hurt us re other requests (State req. is $4b/yr above what OMB had figured)

T Lake: Not just politically -- if you whack defense it will hurt our readiness & nat'l security ~~[illegible]~~ already $10b/yr short bec. of pay raise & infl'n

HP - ~~don't~~ assume you'll be able to shift $ around w/i DOD for, eg, conversion

BRubin - if we spend 5 times more than anyone else for Defense but it crazy not to cut Def. $10b a yr for economic devel, inner cities etc.

Gergen -- don't we have to ask our military guys whether we are hollowing out army? How have this discu'n in vacuum

(mr. franks) Reich -- look at things like intelligence - CIA is only 15% of Intellig. budget & lots of the rest is just spinning around looking for something to do
TLake: what?!

LP - Stress we're still on downward trend of deficit, lowering int rates & doing ~~deficit~~ investments w/i this framework -- That's our message

LP: If keep Def. off limits, don't want cut DOE labs more etc. etc. Q is where do you get your $

POTUS: Leon have you calculated extra tax NY going to pay?

POTUS - If $100b more this year ~~70b~~ $70b for deficit reduct'n & $30b for entitlmts/interest

VP - I know tough ~~bad~~ to take on entitlements but isn't it crazy for all of that $30b to go to entitl. We can't get out of this box w/ incremental approaches think boldly strategically

POTUS -- Well, we can do a little more Leon's ~~pt~~ (memo) pts out

POTUS: Can we find agreed way to score systematic changes like procurement reform

VP revolutionary fervor to do big bold stuff in Congress

~~GS~~ - GS -- PK got 60-70 Dem votes only bec. it was a free vote not tough

to talk about means testing etc radical stuff in an elec'n year in view of other things we're doing is foolhardy

HP - cutting entitl. wouldn't free up discretionary spending anyway (unless change rules)

LP at some pt POTUS - guys will be ready to trade bigger def. for bigger ~~discretion~~ domestic

POTUS: We have to get to new ways of thinking about fed'l spending not just paygo discretionary etc.

DG - don't sweep off what VP says re entitl.
private conversations
GS - no such thing as private conversations word'll get out that WH considering ~~cuts~~ SS cuts & we'll get killed

DG - but if you have to move som in Cong... prerogative
GS: you don't! ~~[illegible]~~ was a free vote
LP & ~~[illegible]~~ don't forget PK took COLA freeze off the table

EJ Disorganized article re Camden re elec'n brilliant

POTUS: If we ~~cut~~ there saying spending bad the right'll always outflank us ~~to~~ on deficit only work if good for economy & creates jobs
Can't be a fetishist on spending
if we cut entitl.
just to cut spending R's will outflank us & we'll never win
Dem. way to do it has to be to incr. jobs & income
Tim Penny is from self-sufficient agrarian district where all spending is bad
can work - but our message is

What worked for us in elec'n & what worked for Chretien

jobs

(Tyson: create commn re nature of fed'l spending issues POTUS mentioned a couple pages & back)

TL: we're not holding line on Defense by cuts already -- we're trying to hold line on rate of cuts

~~LP~~ & LB (& LP) both agree not to talk on entitl. & in '94

& LP pts out we're doing health care biggest entitlmt

POTUS - let Kerrey commn do its thing

gen'l - you'll have fight of your life cutting $100b from medicare just to shift it for other ie. health care proposes

TOD

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

THE DIRECTOR

November 29, 1993

MEMORANDUM TO THE PRESIDENT

FROM: Leon E. Panetta

SUBJECT: Thinking About Budget Options for FY 1995 and Beyond

The purpose of today's session is to provide you with an introduction to the hard decisions you will have to make in the next month on the FY 1995 budget. Before you start into the meetings devoted to each agency's particular budget problems, we thought it would be useful to have a discussion of the "big picture," to focus on alternative overall budget strategies, to illustrate a few options, and to find out which ones you might want to explore further.

Most of our discussion - today and over the next month - will focus on the agonizingly difficult problem of funding the Administration's most important priorities within the tight discretionary caps. Discretionary spending (expected to be capped at about $539 billion in FY 1995) is only about 35% of federal spending. Mandatory spending expected to be about $984 billion in FY 1995, including $211 billion in net interest), is much bigger and still growing. While you will probably want to defer decisions about fundamental changes in mandatory spending until after the Kerrey Commission reports in May, some mandatory spending issues must be faced in the budget. For example, we must identify mandatory offsets for the Uruguay Round and the Generalized System of Preferences totalling about $9 billion for 1995-99. Moreover, some issues have both mandatory and discretionary aspects. For example, if you decide to move ahead with welfare reform or a broad dislocated worker program, we will have to talk about both the mandatory and discretionary spending implications of these proposals.

The other big aspect of budget policy, of course, is revenues. You will have to decide whether you want to recommend any tax changes this year (other than those already proposed in the Health Security Act) and, if so, which ones. Several of the so-called "extender" provisions that were given short-term funding in the Reconciliation Bill this past summer will come up for renewal again in FY 1995.

THE HARD FACTS OF THE HARD FREEZE

The hard freeze means quite simply that there will be no more money in FY 1995 for discretionary spending. Indeed, there will be less. Discretionary outlays will be about $542 billion in FY 1994; but after the necessary adjustment for the crime bill (which will probably reduce the caps) and for lower than anticipated inflation (no good deed goes unpunished!) the outlay cap for FY 1995 will probably be $539 billion. These severe constraints mean:

- Funding all the investment programs identified in "A Vision of Change" at the levels we set for FY 1995 and beyond is simply not possible.

- Even fairly modest increases in your short list of high priority investments will require painful cutbacks in a wide range of other programs. (See Attachment A.)

In this budget you face a zero-sum problem. The pluses have to equal the minuses, because the total is not increasing.

ALTERNATIVE BUDGET STRATEGIES

Given the zero-sum situation, you could adopt one of several budget strategies.

- Target Moderate Increases on Priority Investments.

  OMB has put together a set of recommended agency budgets that represent one example of such a strategy. The OMB recommended budgets allow moderate increases in most of your current list of high priority programs - paid for by squeezing down a lot of other programs. (See Attachments B and C.)

- Direct Larger Increases to a Short List of Very High Priorities.

  You might want us to assemble an additional "pot" of resources (by making additional cuts in non-priority programs) and use it to give special emphasis to a small number of especially high priority programs or themes. This would require picking some themes over others (e.g. technology, but not infrastructure; children, but not environment). Investments on the current priority list that were not chosen for special emphasis would get smaller increases or even remain at their FY 1994 level; other programs would be squeezed down.

- Make Bolder Changes that Reorder Federal Activities.

  You could decide to make a major impact on some important aspect of national life over the next several years by dramatically altering what the federal government does (for example, a children's budget including major educational reform). At the same time, however, you would have to propose some major activities to be eliminated. In this zero-sum situation, any bold proposal for what the federal government SHOULD DO <u>must</u> be accompanied by an equally bold proposal for what it SHOULD NOT DO.

The following sections illustrate some variants of these strategies. Each option focuses first on where the resources would come from, then on what would be done.

MODERATE INCREASES IN HIGH PRIORITY INVESTMENTS

As you remember, in August OMB gave each major agency a guidance level for its FY 1995 discretionary budget submission. These guidance levels reflected OMB/NEC judgment about your relative priorities and were designed to meet the discretionary caps in the aggregate. (Actually, they were designed to meet the original outlay caps of $542 billion--the additional $3 billion downward adjustment was not anticipated in August).

The budgets submitted by agency heads exceeded the adjusted FY 1995 outlay caps by about $16 billion, even though most agency heads made cuts that will run into substantial opposition on the Hill.

When these agency budget submissions came in, OMB staff went over them carefully. I held a review meeting on each major agency budget and made decisions on a set of OMB recommended budgets to serve as starting points for your decision process.

These recommended budgets allow moderate increases in almost all of the programs on your short list of high priority investments, except highways. Outlays for these investments, which were $55.3 billion in FY 1993 and $58.6 billion in FY 1994, would be $64.1 billion in FY 1995. (Details by agency are shown in Tab C of 1995 Budget Overview.)

However, these OMB-recommended increases in priority investments require severe cutbacks in a wide range of other programs. (These are displayed in attached Attachment A.) These cuts will cause pain, but they (or others of equal magnitude) are unavoidable if the priority investments are to receive increases in funding.

Not surprisingly, almost all agency heads believe that OMB has seriously underfunded your most important priorities and cut too deeply into other programs! While our choices are not the only ones possible, it is the tight caps that make pain in virtually every agency inevitable.

LARGER INCREASES IN A SHORTER LIST OF PRIORITIES

You might want to make bigger increases in priority programs, especially in a few of them, than are possible under the first strategy. If so, we could scrub the budget again and put together a "pot" of programs and projects thought to be ineffective or low priority. You could then challenge the Congress to cut these programs and projects and use the "pot" to increase funding for a short-list of especially high priority initiatives. OMB has put together a first cut at such a "pot" (see Tab 22 in 1995 Budget Overview). Note that these cuts are in addition to those we suggest are needed just to get to the caps. The OMB "pot," which includes only domestic agencies, totals only about $6 billion in FY 1995 outlays (rising to about $10 billion in FY 1999), $10 billion in 1999 outlays, but could be augmented by some reductions in defense, intelligence, international affairs. Additions to the "pot" could come from a variety of other sources, but finding big additions would require taking on some daunting political adversaries, such as veterans. Some suggested increases are shown in Tab 21. You might want to devote the entire "pot" to one or two initiatives such as Headstart, National Service, or skills training.

BOLD OPTIONS

If you want to think about bolder changes, it may be worth starting with a few "big think" options that would fundamentally change what the government does.

Option One: Phase Out Most Federal Infrastructure Programs; Invest in Children and Young People.

Rationale: Federal grants for infrastructure projects (costing about $30 billion in FY 1994 outlays, or 12 percent of the domestic discretionary budget) often result in inefficient allocation of infrastructure resources and invite wasteful pork barrel spending.

It would be preferable to establish a federal infrastructure bank (off budget) to help states and localities finance highways, airports and other infrastructure projects backed by user fees. States and localities are better judges of their infrastructure needs. Reliance on user fees would direct infrastructure funds into economically productive uses. In particular, charging fees for the use of crowded urban roads would reduce travel times, improve air quality and generate funds for dramatic improvements in mass transit. (Installing sensors in cars and billing users of congested roads, like billing for telephone service, is technologically feasible).

The Federal government could make a greater contribution to long-run economic growth by using the released grant funds to improve the lives and skills of children and young people.

Reductions: Eliminate highway and airport grants (except 30% match on maintenance of interstates); eliminate mass transit operating grants and phase out operating subsidies. Eliminate maglev and high speed rail (not economically viable). Reduce waste-water grants and Corps of Engineer water projects. (Redirect Corps into environmental clean-up activities).

Establish federal infrastructure bank. Encourage user fees on infrastructure projects, especially congestion fees on urban roads and major airports.

Phase down would be slow, because infrastructure spends slowly and projects in the pipeline should be completed. By the end of five years, however, $15-20 billion a year could be available for other uses.

Increases: Gradually increase funding for a wide range of programs affecting children (Head Start, WIC, Chapter 1, Evenstart) and young people. Emphasize accountability and quality. As funding becomes feasible, launch aggressive effort to reform education and training.

Build on Goals 2000 and School-to-work, but add incentive grants to improve chances for real change. Increase Job Corps and other training programs for teens and young adults.

Downside: Vigorous political opposition. Some economic disruption. Allegations that infrastructure programs produce tangible results, while no one knows how to reform education or measure the results of programs for young people.

Option Two: Leave Education, Training and Other Direct Services to People to the States; Create Jobs and Rebuild America.

Rationale: Education, training and social services are primarily State and local functions. Effective programs must have strong local support and be adapted to local needs and priorities. The federal role is often marginal (for example, in elementary and secondary education). It is hard for Washington to be sure funds are well spent without creating rigid controls that are inherently counter-productive. It is hard to measure results. Most evaluations of the effectiveness of federal education and training programs have been disappointing.

Hence, it would be preferable to phase out the "soft" programs in favor of promoting growth and jobs by aggressive, visible modernization of infrastructure broadly defined. This option could change the face of America in 5 - 10 years. It would create high wage jobs in construction and technology. Funds could be targeted to areas that are hit by defense downsizing and other types of job loss. It could make cities more liveable and rescue declining regions.

Reductions: Gradually reduce federal grants for elementary and secondary education and for training programs to free up $30 billion a year by 1999. Start by eliminating small categorical programs, but gradually phase out bigger programs (ESEA, JTPA, Vocational Education as well). Keep programs that are national in character (e.g. Job Corps and National Service), or require national support (education research).

Increases: Shift the funds to highways, railroads, airports and mass transit, technology, information infrastructure, environmental infrastructure, urban and rural development.

Downside: Any cutback in "people" programs would be seen as a betrayal of promises. Devolving those programs to states (even with aggressive federal bricks and mortar program) would require new revenue sources for states and localities, especially poor ones, if services were not to suffer.

Option Three: Reduce Defense and Intelligence; Fund a More Aggressive Program of Economic Revitalization.

Rationale: Now that the Cold War is over it is time to reevaluate the threats to American security. The military threat has receded and changed character. Instead of massive forces directed at the Soviet Union, we need a smaller leaner, more flexible military, backed by a stronger, more productive economy. The greatest threat to US security in the future is a stagnant economy, falling behind others in productivity growth, which makes us unable to compete in world markets or take a leadership role in solving world problems.

Reductions: The Defense budget is already under pressure. DOD is asking for additional funding to cover inflation and pay increases, as well as increases in its defense conversion and peacekeeping responsibilities. This option would involve reducing forces as follows:

- Accelerate the military personnel reduction currently planned to reach a 1.15 m. person active-duty military by FY 1998 ($44.2 b.). This force would be capable of responding to only one major regional contingency, rather than two nearly simultaneous ones. It would be roughly 300,000 below the current force structure target, leaving a force of 8 active Army divisions (v.10), 9 Navy carriers (v.12), two Marine divisions (v.3) and 10 active duty tactical Air Force wings (v.13);

- Declare a moratorium on military construction (including family housing) and accelerate the civilian personnel reduction to reach a level of 603,000 by FY 1999 (191,000 below the current target, which loses 152,000 over the next five years) ($29.3 b.);

- Carry out a 25% cut in R&D on new military programs over the next five years and a 5% cut in planned procurement spending (roughly $25.5 b.).

- Reduce intelligence spending proportional to the decline in the overall defense budget ($18.3 b. from current baseline).

These decisions would accommodate the pay and inflation problems of the Defense Department, increase defense conversion moneys (though dramatically more would be needed if this cut were enacted), fund peacekeeping through DoD, and provide for the State Department's desires for a $4 b. addition to their budget (in each year for the next five). It would leave $50 billion for other purposes.

Increases: Use these funds to increase basic science, the development of civilian technology, an aggressive program of urban and rural development and reform of the education system. Put substantial resources into goals 2000 and School-to-Work and use them to leverage a significant upgrading of the skills of those entering the labor force.

Downside: Would be severely criticized for endangering national security, damaging the readiness and power of our armed forces, and disrupting the economy in the short-run.

Choosing any of the bold options (or any variations which require deep cuts in major programs which you have approved in the past) would require an enormous commitment of your, and your Administration's, time and effort to sell the new budget strategy to the public as well as to the Congress. The benefits might be great, but the commitment required to bring about big changes should not be underestimated.

IMPROVING EFFECTIVENESS WITHIN MAJOR OBJECTIVES

In addition to examining agency budgets and recommending changes that would keep those budgets under the caps, OMB has identified major "cross-cuts" or Administration priorities that cut across agencies (see page F-5 ff. in <u>1995 Budget Overview</u> for description of cross-cuts). Of these, a dozen seemed to us worthy of special attention: infrastructure; drugs and crime; commercialization of technology; children's programs; health care; trade promotion; urban and regional development; business development; training and post-secondary education; environment; national security; international affairs.

Together with White House staff, we have examined each of these areas and are prepared to discuss with you some possible shifts of emphasis within those categories that could improve the effectiveness of our efforts to reach Administration goals. What follows is a short, incomplete list of some ideas that we believe deserve exploration. The point of this list is just to give you flavor of the kind of issues that we believe should be raised:

1. Invest more in Head Start by eliminating Impact Aid.

2. Invest more in Job Corps (and maybe Youth Fair Chance) by eliminating JTPA youth program.

3. Create community service jobs and provide child care for the parents of poor children by eliminating or scaling back EDA, ARC, CDBG, LIHEAP.

4. Substitute loans for grants and make other changes to dislocated workers proposal and use the freed up resources either to pay for income support or to expand Pell grant eligibility and/or awards.

5. Phase out the employment service and substitute one stop career centers which will serve all comers, including dislocated workers and AFDC recipients.

6. Increase Ryan White - AIDS treatment and reduce funds for Agency for Health Care Policy and Research.

7. Increase funding for treatment of hardcore addicts and cut funds for international narcotics programs.

8. Reduce funding for DOE labs and increase funding for NIST in Commerce.

9. Reduce funds for promoting agriculture exports; increase programs for increasing exports of manufactures and services.

FEDERAL EMPLOYMENT

The dollar decisions this year will be tough enough, but our commitment to cut Federal employment will require even more difficult choices. Most agencies are over the FTE limits and may have very convincing cases for additional FTEs to make high priority programs work better. Passage of the Sabo amendment would make the problem appreciably more severe, because it lowers FY 1994 and FY 1995 FTE ceilings below the levels we have been assuming.