

Children of '76

Thank you're happy about the heady turn of South Africa, you ought to hear Dr. Motlana. When I talked to him the other couldn't suppress his elation, and saw no on for trying. This 60-year-old Sowetan noted for the first time in his life—and for party, the African National Congress of had been a member since he was 18.

an extraordinary, almost unbelievable he told me during a quick trip to the sites (he had come to accept an honorary from Denison University in Granville, are scurrying back for the swearing-in of government.) And, he acknowledged, there as when he thought it might not happen. Nelson Mandela must have had his mo- despair along the way, said Motlana, physician and political ally of the newly resident of South Africa. As for his own

and say they really ceased in 1976, a seminal our fight against apartheid, when the took to the streets and virtually destroyed Africa. It happened on the 16th of June, about 10 o'clock, and I was there.

in the first violence occurred, diagonally the Mandela residence at a school called and West High School, I was there. I was when the police turned dogs against unarmed girls and young schoolboys, and I saw those boys take hold of Alsatian dogs—vicious as—and throttle them with their bare hands in them. I saw it all.

then the kids throughout South Africa—as signal—started burning government build- bottle stores, schools throughout the country. r biggest support was in Cape Town, where -called colored children responded to the n of Soweto in a critical fashion. They went own and started burning shops and govern- buildings. The whole country was in turmoil months, and the government didn't know o do. There were trials after trials, and lots of ildren left South Africa to go into exile to he MK guerrilla units that came back in and p power stations.

was quite obvious that apartheid was over." ous, perhaps, but not instant. It would be a shy of 18 years after that doubt-erasing ion before Motlana would finally cast his first as a free citizen.

elation over a transition that still strikes me certified miracle—including the miraculous aneous ascendancy of Nelson Mandela and F. Klerk; the man he replaces as state presi- is, however, tempered by a somber thought: youngsters who made the change possible will and put to benefit from it. Why? Because they school to make the revolution and now have ned adulthood without education or skills. Many illiterate.

his is the sad side," Motlana told me. "I told I'll always remember June 16, 1976. Well the next day, a group of us including Winnie dela and members of the Black Parents Associ- were going around talking to the students in a mpt to persuade them to stay in school. Our age was: Don't burn your schools. And they didn't listen. They just burned down everything. We spent the next two years talking to the ents about the need for them to go back to ol. We failed. They accused us of being sellouts collaborators for trying to get them to go back school. They were not interested in school. eration before education' became their slogan. So now we've got a body of young people—two hree million of them—who in '76 were 12 or 14 15. They're now young mothers and fathers and pletely illiterate. Most are unemployed, and ny are unemployable, and the question is what is new government going to do about this huge

What indeed? The armed forces might have sorbed some of them, but South Africa's new vernment is committed to *downsizing* the mili- y, bloated and expensive as a result of the untry's efforts both to contain its black population d to destabilize its neighbors—Mozambique, An-

gola, Zimbabwe.

The immediate demands will be for money to improve housing and health care and to educate the children for the coming century. Who will supply the money—even the ideas—for looking after the generation that made the miracle possible?

The question, a shadow across Motlana's irre- pressible joy, may be one of the most important the Mandela government will face.

Robert J. Samuelson

The Buck Stops Everywhere

The Clinton administration's latest foray into the foreign exchange markets reminds us that the dollar is not only our money but also the world's. It's used heavily by other countries for international trade, global investment or even pocket cash. Just last year, Cuba made the dollar legal tender. Indeed, the Federal Reserve estimates that about 70 percent of our printed and coined money—about \$330 billion at last count—is held outside the United States. When people don't trust their own money, they turn to the dollar. In the 1980s, it was widely used in Latin America; now, it's used heavily in the former Soviet Union.

The dollar's global role is not just as pocket cash, though. Most traded raw materials (oil and wheat, to name two) are bought and sold in dollars. Similarly, many

"The dollar is not only our money but also the world's."

countries trade in dollars. Japan buys about three quarters of its imports with dollars and sells about half its exports for dollars. Governments hold two-thirds of their foreign exchange reserves in dollars (these funds can be used to cover overseas deficits); the German mark is second at 13 percent. Likewise, the dollar remains the most popular currency for international bank loans and bonds.

The dollar, in short, helps lubricate the global economy and has since World War II. This role has been played differently at different times—and not always benignly. After the war, Europe didn't have enough dollars to buy needed food and machinery on world markets. We provided the dollars through the Marshall Plan. Less constructive was the easy U.S. credit policy of the late 1970s that abetted inflation and created the Third World debt crisis. Countries could borrow cheaply in dollars. These loans financed excess worldwide spending, driving up prices and saddling countries with debts they couldn't repay.

The important point now is that the dollar's unique role explains persistent U.S. trade and current account deficits. (The last U.S. trade surplus occurred in 1975. The last surplus on our current account—trade, plus other current spending such as tourism—was in 1981.) Over time, most countries crudely balance their current accounts, because huge imbalances are corrected by exchange rate movements. A country with big deficits experiences a currency depreciation. Because it spends so much abroad, it has to sell a lot of its money to buy other countries' monies. The value of its money drops. It can't buy so much abroad.

But for the United States, this process breaks down. We don't have to buy other countries' currencies to import, because the dollar is widely accepted abroad. And when other countries earn dollars, they don't always sell them for their own currencies because the dollars can be used for other things. Consequently, the dollar's exchange rate hasn't dropped enough for our current account to balance. In effect, we provide a service to the world in the form of global money and are repaid by being able to import more than we export. That's good for U.S.

consumers but penalizes U.S. exporters and industries competing with imports.

The resulting political dilemma has dogged presidents. They want to help U.S. exports, but the dollar intrudes. This is the predicament faced by the Clinton administration. Until recently, it seemed willing to tolerate a slow depreciation of the dollar (especially against Japan's yen) as a way to improve the trade balance. But last week, it orchestrated a huge intervention on foreign exchange markets by major industrial countries to stop the dollar's slide. Dollars were bought, other currencies sold.

What the administration apparently fears is that more dollar depreciation would aggravate inflation and jeopardize the recovery. A lower dollar would make U.S. exports cheaper and imports more expensive. This would boost economic growth and make it easier for industries competing with imports (i.e. autos, textiles) to raise prices. With the economy already expanding, the extra demand might be too much of a good thing. Inflation fears could raise bond and mortgage interest rates even further.

Will the administration's strategy work? Temporarily, it might. But over the long run, foreign exchange intervention doesn't determine exchange rates. What economists call "the fundamentals" matter more. Two fundamentals now seem critical.

The first involves Japan. In the 1980s, Japan ran massive trade surpluses, because its excess dollars earned abroad were reinvested in dollar assets—bonds, stocks, factories. Between 1980 and 1990, these investments totaled nearly \$700 billion and delayed the yen's rise against the dollar. Now, new overseas investments have abated, and the yen is rising. If Japan doesn't import more, the yen will continue to rise until its huge current account surpluses narrow. Exports will fall, and so will related business investment. This would further hurt Japan's stagnant economy. But the solution lies mainly in Japanese hands.

The second fundamental is inflation. Here, the solution lies in our hands. Markets move on perceptions. If higher inflation is feared, traders will desert the dollar and trigger a general depreciation. The Federal Reserve has tried to quash inflation fears by raising interest rates; the Clinton Administration is talking tougher on inflation. Time will tell whether these steps are adequate. The main point is that higher inflation will tend to depress the dollar against all currencies, not just the yen.

Economists have been confounded by the dollar, because they underrate its role as a global money. The supply and demand for dollars ebbs and flows, reflecting changes in the world economy. Our current account deficits may gradually narrow in the 1990s, because Japan played a big part in their creation and now has enough dollars. Or China may generate new demand for dollars. Or the mark and the yen could relieve pressure on the dollar by playing larger roles as global currencies themselves. We just don't know. There is no clearly "right" dollar exchange rate.

But we should not let this mystery distract us from the major lesson of recent decades. Every time we have let inflation erode the dollar's value, we have created economic turmoil at home and abroad. It happened with the Third World debt crisis. Before that, it happened when the 1960s inflation destroyed fixed exchange rates. We should not let it happen again.

5/11
Rubin Tyson
What do
you think
Samuelson?
RJC

BIG MONEY

The CBO's Sensible Medicine

How to Make the Deficit Vanish as an Issue—and a Reality

By James K. Glassman
Special to The Washington Post

What a difference a year makes! Last spring and summer, the federal deficit was just about the hottest topic in Washington; now the pressure is off.

The Harris Poll found in June 1993 that Americans ranked the deficit as the second most important issue "for government to address,"

COMMENTARY narrowly behind health care. By this month, the deficit had dropped to a tie for sixth place. Only 8 percent of the 1,255 adults polled rated it one of their top two concerns, down from 24 percent.

"It's as though we were encircled by an army in a siege, and then all of a sudden the army disappeared," said one Senate aide.

That's a shame, because—if we

really want to fix the deficit—now is the time to do it. The economy is strong enough to absorb the short-term adverse effects of spending cuts and maybe even higher taxes.

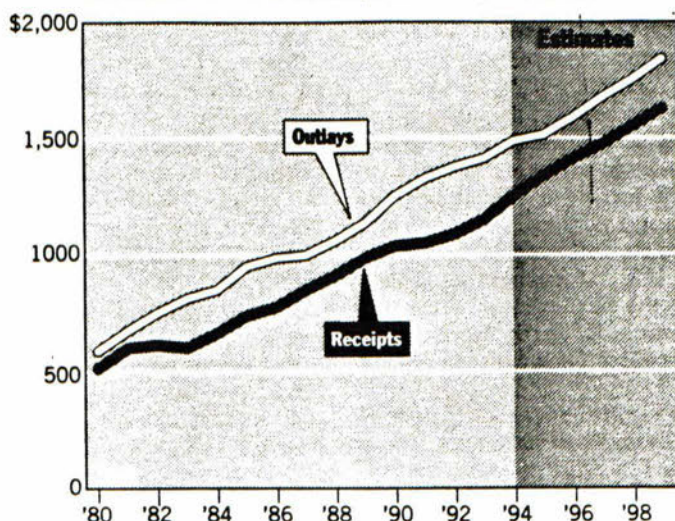
In fact, slowing the economy would be an added benefit of deficit reduction. It would ease the need for the Federal Reserve to tighten monetary policy, and might calm recent jitters in the bond market. Rather than relying solely on the Fed to apply the monetary brakes, how about some fiscal brakes, too?

President Clinton and most members of Congress have been bragging about the \$500 billion in deficit cuts they enacted last year. But these are "cuts" only in the fairy-tale language of government, which holds that you've reduced the deficit if your deficit projections are

See BIG MONEY, G2, Col. 4

THE BUDGET GAP

U.S. RECEIPTS AND OUTLAYS, 1980-1999, IN BILLIONS



SOURCES: Budget of the United States Government, Fiscal 1995; House Budget Committee

THE WASHINGTON POST

CBO Has Compelling Ideas to Curb Deficit

BIG MONEY, From G1

lower than the projections you made earlier in an imaginary number called the "baseline."

The baseline is a moving target. Back in 1990, the budget deal between then-President Bush and Congress called for deficits totaling \$528 billion for the five years starting in 1992. Those deficits comprised the baseline three years ago.

But shortly thereafter, the baseline was moved, and deficit projections for the five years soared to well over \$1 trillion. It was those new baseline figures that became the starting point for the half-trillion dollars in "cuts" produced in 1993.

Even so, the budget that a House-Senate conference will report next week will give the nation deficits from 1995 to 1999 that will total more than \$900 billion. And for the five years after that, the Congressional Budget Office (CBO) sees deficits totaling \$1.5 trillion. Some cut!

Americans probably wouldn't be so complacent if they understood this nasty state of affairs. As it is, they're giving the White House and Congress a free ride.

The truth is that, if the president decided to get serious, the deficit could be eliminated—and without much difficulty. Bill Clinton could go down in history for something actually worthwhile.

How to cut the deficit? The best place to start is a fat book the CBO publishes every year, listing sensible—if politically difficult—budget cuts. The new volume, issued last month, lists

197 possible spending and revenue measures that would turn the trick, if politicians could summon the will.

For example, we could save \$2 billion over five years (everything in budget-talk is over five years) by killing operating subsidies for Amtrak, \$1 billion by abolishing the Bureau of Mines and \$7 billion by eliminating federal grants for local wastewater treatment plants.

We could save another \$7 billion by reducing federal aid to mass transit, \$3 billion by halving federal aid to the arts and humanities and \$8 billion by axing the Low Income Home Energy Assistance Program, a vestige of high oil prices 13 years ago.

Making tiny adjustments in the \$85 billion annual federal payroll could save \$10 billion by 1999, and lowering target prices for farmers in agricultural commodity programs could cut the deficit by \$11 billion.

Then there are items that the CBO doesn't cite—for example, the astounding \$193 million that has been budgeted next year for Howard University here in Washington, ostensibly a private institution. Howard has received \$1 billion over the last five years, covering more than half of its operating costs.

Big savings could come from small changes in entitlements. For example, the CBO estimates that the deficit can be cut by \$109 billion over five years if the government limits increases in benefits for programs such as Social Security to the rise in the consumer price index minus 2 percentage points.

Here are a few reasonable revenue-raisers:

- Increase the gasoline tax by 10 cents a year for five years. CBO estimates we could raise \$127 billion this way, and our prices at the pump will still be less than half what Europeans pay.
- Limit all itemized deductions to 15 percent, instead of as much as 39.6 percent for rich taxpayers. That would raise \$274 billion over five years, estimates the CBO.
- Limit mortgage interest deductions to \$20,000 a year for a joint return and \$12,000 for an individual. That would cut the deficit \$32 billion.
- Suspend the indexing of tax brackets for just one year. Deficit cut: \$46 billion.

The problem with raising more revenue, of course, is that the government just spends the new money. That's what happened, for example, from 1987 to 1993. Revenues rose \$300 billion, but spending rose \$400 billion.

Still, it's clear from the numbers that, with strict controls, the federal deficit can be wiped out by the year 2000. There will be some pain but, surprisingly, not a great deal.

But we have to change the fraudulent language of budgeting. In a good first step, Reps. Christopher Cox (R-Calif.) and Charles W. Stenholm (D-Tex.) added a non-binding measure to the budget resolution that replaces baseline budget comparisons with real, year-to-year actual vs. budget comparisons—just like every business uses. Let's make that measure binding, and get on with the cutting.

The Redemption of Michael Milken

The Former Junk Bond Giant, Feted by King, Cosby, Calvin and ... Clinton?

By David A. Vise
Washington Post Staff Writer

NEW YORK

It was hard to believe the man on the other end of the crackling phone line was really President Clinton.

But there he was, just after 9 p.m. Tuesday, addressing many of the nation's wealthiest financiers, top medical researchers and prime-time celebrities who had gathered at the tony 21 Club in Manhattan to honor Michael Milken and support him in his fight against prostate cancer, which kills 38,000 American men every year.

"I think this effort getting people in the private sector to work with health care folks to find a better way to provide health care and to find a

cure for prostate cancer is really great," Clinton said.

"I'm glad to have a chance to kind of show my support for this. Most of my time I've spent working on the problems of breast cancer because my mother had it. But I know how many of literally millions of men have been diagnosed with prostate cancer and so many have lost that fight, but a lot can win and I really commend you for what you are doing."

Clinton previously had criticized the Milkenesque 1980s as "a decade of greed." But on this night, the president had kind words for the man who was legendary for being at his desk by 4:30 a.m. each morning until the junk bond boom went bust and he went to prison on securities fraud charges.

"He has a lot of energy, I'll tell you, I'm im-

pressed," Clinton said of Milken. "He makes me look like a piker. He makes me look like I'm on vacation every day, he has got so much energy."

Asked to comment on the propriety of the president phoning an admitted felon, a senior administration official said, "It was a fundraiser for prostate cancer, which I think is a worthy goal. I don't think he praised what Milken did."

Clinton addressed his remarks to former football great Rosey Grier, who accepted the White House call and stood near Milken as the president's voice filled the room. Moments later, with President Clinton off the line, Milken offered up a titillating morsel about his fellow 47-year-old risk-taker:

"This is not my first phone call with Bill Clinton. When I was in prison, I could only make col-

See MILKEN, G3, Col. 3

Michael Milken, Remaking His Image

MILKEN, From G1

lect calls. I was talking to [newspaper editor] Brian Greenspun from Las Vegas and all of a sudden Bill [who was in Las Vegas campaigning for president] was on the phone. All of my calls were taped and I could just see it, 'Bill Calls Mike for Advice on the Economy.' I told him we would have to talk another time."

That time came Tuesday in New York, where the financier who is more reviled and revered than any other figure in modern U.S. financial history was the toast of the town.

It was the latest in a series of public events and private initiatives that are part of a carefully orchestrated Milken comeback campaign that has included an image-boosting appearance before the Congressional Black Caucus and the formation of a presidential honor board for his cancer foundation made up of former presidents Bush, Reagan, Carter, Ford and Nixon.

Having lived an extraordinary life that took him first to multibillion-dollar wealth and then to infamy, Milken is now facing the threat of death in the same fashion. Only this time, instead of using his missionary zeal to sell junk bonds, he is spending enthusiasm on cancer research that might lead to a cure that would save his life and those of tens of thousands of others.

As before, he is not alone. Milken's annual junk bond conferences in Beverly Hills drew the most aggressive captains of industry and finance to meet and do deals. The networking Tuesday matched many of those same money men with the leading researchers from Memorial Sloan-Kettering, Johns Hopkins, the National Cancer Institute and other leading medical institutions.

Corporate raider Carl Icahn was on one side of the room, Revlon Group Inc. Chairman Ronald Perelman with his trademark cigar on the other. For-

mer high rollers from Milken's defunct Drexel Burnham Lambert Inc. reunited over cocktails and mega-shrimp and exchanged greetings and tips with the powers-that-be from Bear Stearns & Co. Designer Calvin Klein ate to Milken's left and physician-researcher Howard Scher dined to his right. Larry King, who will have Milken on his talk show soon, opened the program, and Bill Cosby, who poked fun at the financier, closed it.

Outsiders might puzzle over so much open adulation of an admitted felon who remains on probation, but the insiders here are united by a belief that Milken has paid too dearly for whatever he did wrong. The demise of Drexel and Milken's mammoth fines and prison term were bad enough. But now, Milken was telling his friends that his wife Lori was convinced that his cancer was due to all the stress.

"This for me is payback time," said Marshall Cogan, the 21 Club's owner who hosted the dinner and told how Milken twice had saved him from the clutches of creditors.

"I still respect him, and I know there was a lot of bad publicity, but I think he did important things," Carl Icahn said.

"Part of it too is empathy from people who don't feel he was treated fairly," said leveraged buyout maven and Fruit-of-the-Loom executive William Farley.

"I would do anything for Michael without limit," said Steve Wynn, who once ran bingo parlors in Maryland and is now Las Vegas's leading croupier as top executive of The Mirage. "I would do just about anything to extend his life a week."

Along with Wynn, the roster of dinner co-chairs included Washington power broker Vernon Jordan and media magnate Rupert Murdoch. Seven members of Congress, including prostate cancer survivor and Senate Minority Leader Robert Dole, also were

listed on the honorary dinner committee. King said that Dole, who was not at the dinner, would appear on his show with Milken.

Milken, who looked fit, said in an interview that he has responded well to hormone and radiation therapy and that his cancer was in remission. But over the years, he has lost his father, his stepfather, his mother-in-law, two aunts and two cousins to cancer, and the prognosis for a man his age with advanced prostate cancer is uncertain at best. "The treatments they give you delay [prostate cancer] rather than cure," Milken said.

He has established and funded a public foundation, CaPCure (Association for the Cure of Cancer of the Prostate) with more than \$4 million to sponsor research on cures for the disease and its links to breast cancer, and is pressing for an expansion in the \$50 million federal research budget.

Notwithstanding the president's phone call, Milken attacked Clinton's health care reform plan as ill-conceived because, he said, it set in motion the dismantling of medical research labs by pharmaceutical companies.

"In the last year and a half the market value of pharmaceutical companies has fallen by \$78 billion," Milken said. Wall Street, he said, is telling the drug companies that, "you are going to have to cut research because there is a perception that prices are going to be regulated. . . . Medical research and breakthroughs will slow down."

After the dinner ended, Milken greeted Frank Sinatra at another 21 Club gathering, sources said. In a later interview, he reached for a book of charts and pointed to a curve showing how regulation of medical industry profits would decimate research. "What I'm trying to accomplish is to make sure this chart doesn't come true," he said.

Staff writer Ruth Marcus contributed to this report.

THE WHITE HOUSE
WASHINGTON

DATE: 4/19/94

TO: LAURA TYSON
BOB RUBIN

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



THE CHAIRMAN

EXECUTIVE OFFICE OF THE PRESIDENT
COUNCIL OF ECONOMIC ADVISERS
WASHINGTON, D.C. 20500

THE PRESIDENT HAS SEEN
4/19/94

94 APR 18 P7:37

April 15, 1994

MEMORANDUM FOR THE PRESIDENT

FROM: LAURA D. TYSON *Laura D. Tyson*
SUBJECT: Blue Chip Suggestions for Raising Productivity

You asked about the list of 15 suggestions for raising productivity from the Blue Chip panel of forecasters. The ranking from the April 1994 Blue Chip report is attached. It is based on a survey conducted in 1988, though we believe it would also reflect the current thinking of the panel and the business community.

The attachment also reports the Blue Chip panel's recent evaluation of a list of the benefits of productivity growth that we included in the 1994 *Economic Report of the President*.

Attachment

*These ideas
should be
evaluated.*
B

CC VP
Mack
Rubin
George

Special Questions:

I. In June of 1988, we asked the panel members to rate 15 suggestions for boosting U.S. productivity growth on the basis of economic soundness and political feasibility. In this instance, 10 equals great economic soundness and high political feasibility and 1 equals very unsound economically and politically unlikely. The suggestions have been ranked according to the combined consensus scores for economic soundness and political feasibility.

RANK	Suggestions For Boosting Productivity Growth	(1 To 10 Rating Scale) ¹	
		Economic Soundness	Political Feasibility
	1. Increase the quality of education, including appropriate financial support for job training and retraining. Consider partial tax credits for college tuition.	7.8	6.7
	2. Avoid protectionism and let dollar seek competitive levels. Eliminate the restrictive aspects of the 1988 trade bill.	8.6	5.3
	3. Reduce federal deficit which will lower <u>real</u> interest rates and stimulate investment.	7.7	5.6
	④ Support portable pensions and other incentives to encourage workers to move on to high productivity jobs.	6.9	6.0
	⑤ Expand the use of profit-sharing to stimulate individual workers' productivity.	7.0	5.8
	? 6. Further improve the climate for market-related capital investments.	7.2	5.3
	⑦ Lessen regulatory impediments -- complete deregulation efforts now under way.	7.7	4.7
	⑧ Include productivity and profit-sharing provisions in union contracts. Encourage increased cooperation between management and labor.	6.7	5.7
	? 9. Encourage increased private savings by modifying taxes on interest income and the elimination of taxes on dividends. If revenue is needed, expand taxes on consumption.	7.8	4.0
	10. Increase funding and expand tax credits for R&D at both private and university levels.	6.7	5.1
	11. Lower capital gains taxes to encourage useful investments and new technology.	7.4	3.9
	12. Challenge individuals to have more pride in workmanship and encourage greater personal responsibility. Point out that this is each worker's fastest way to fill his pocketbook.	5.2	5.7
	13. Restore income averaging for tax purposes to encourage initiative in risking new ventures.	5.4	3.9
	14. Call a White House conference on productivity. Make greater useful output per unit of labor the president's number one economic goal.	3.0	5.9
	15. Limit federal spending to a percentage of GDP.	5.4	3.2

¹Based on responses from 43 panel members.

II. In this year's "Economic Report of the President," there was a list of some beneficial effects of rising productivity. We asked the panel members to rate each of these effects according to their relative importance to future economic growth. Again, we have used a 1 through 10 rating scale, with 10 equaling great importance and 1 equaling little importance.

RANK	Beneficial Consequences Of Productivity Growth	(10 = Great Importance ¹ 1 = Little Importance)	
	1. <i>Periods of rapid productivity growth have been accompanied by increases in real wages. The prices of products in industries experiencing productivity growth also decline relative to wages. This decline in product prices means that real wages tend to rise during periods of rapid productivity growth.</i>	8.5	
	2. <i>Periods of rapid productivity growth have also been periods of low inflation. Productivity growth allows nominal wages to increase without putting pressure on prices.</i>	8.2	
	3. <i>The prices of goods produced by industries that have had rapid productivity growth have fallen relative to those of goods from industries with slower productivity growth.</i>	7.7	
	4. <i>Periods of rapid productivity growth have not been associated with large increases in unemployment. In periods when productivity growth was more rapid, such as the 1960s, unemployment rates have tended to be low. In contrast, periods with slow rates of productivity growth, such as the 1970s, have been periods of relatively high unemployment.</i>	7.0	

¹Based on responses from 43 panel members.

EXECUTIVE OFFICE OF THE PRESIDENT
COUNCIL OF ECONOMIC ADVISERS
WASHINGTON, D.C. 20500

April 15, 1994

94 APR 15 PM 2:33

MEMORANDUM FOR THE PRESIDENT

FROM: Council of Economic Advisers
National Economic Council
Department of Treasury

SUBJECT: Recent Market Movements and the Economy

David Gergen suggested that you would like a memo on what we think is going on in the stock and bond markets, and what that might mean for the economy. Although this memo reflects a rough consensus, we do have some differences of opinion, which are duly noted below.

The Nature of Financial Markets

Financial markets are inherently volatile because they are influenced heavily by expectations about the future and can be buffeted by so-called technical factors. In consequence, market movements are not only extremely difficult to predict, but are often hard to explain **even after the fact**.

One thing we do know about financial markets is that they frequently react to news by much more than can be justified by "the fundamentals." (The recent bond-market episode is an example--"technical factors" like leveraged hedge funds, derivatives, etc., contributed a great deal to the run-up in long-term interest rates.) Also, when markets get in a certain "mood," they can focus on certain catalytic events and ignore contrary signals. For example, the bond market sold off on allegedly bad inflation news in the NAPMs February survey, but did not react positively to good inflation news in the March survey.

That markets frequently "overshoot," however, does not give us any strong reason to think that they will quickly or reliably snap back, for market movements tend to be persistent. Some of your advisers do not believe, for example, that 30-year bond rates will return to the 6.5-6.75% range.

The Stock Market

Given the sharp rise in interest rates, there was nothing very surprising about the drop in stock prices. (Both data and logic point to a negative correlation between stock prices and

interest rates.) Furthermore, many market participants thought stocks were "overvalued" and were expecting a "correction." Hence we focus on the bond market.

Recent Bond Market Movements

Why did bond market fall so sharply? We believe there were several contributing factors. These explanations are **not** mutually exclusive; in fact, several are intimately linked.

1. Greater optimism about the U.S. and world economy.

The economic news in recent months has been almost all good--especially in the United States, but prospects elsewhere in the G-7 have also brightened somewhat. Hence numerous forecasters have marked up their forecasts. This can have two effects on the bond market:

- If market participants expect a stronger economy to bring with it greater demand for credit, real interest rates will rise.
- If market participants expect tightening markets for goods and labor to lead to higher inflation, the expected-inflation component of the nominal interest rate will rise.

Each of these effects raises nominal interest rates. The recent bond market slump probably contains elements of each.

In fact, we do not view the recent economic data as terribly surprising; were we redoing our official 3% real growth forecast for 1994 today, we would probably raise it only slightly. Still, recent news has been better than expected and market participants may have found it more surprising than we did. Furthermore, though the inflation signs for 1994 are very good, some market participants may be worried about inflation beyond 1994--even though we forecast only a slight uptick in inflation. Finally, as noted above, markets often move by large amounts on news that may not seem very important.

2. Technical market factors.

There is by now considerable anecdotal evidence that hedge funds, investment banks, commercial banks, and other professional traders with highly leveraged positions have taken a bath--which has led them into massive liquidations of, especially, long-term bonds.

The event or events that kicked off the selling spree could have been the greater economic optimism just noted, fears of inflation, the fall of the dollar/yen exchange rate, fears of Fed

tightening, or anything else. But once a selling wave gets started, it can follow its own momentum for a while. Initially, the hedge funds were too bullish; now they may be too bearish.

3. Miscellaneous "political" factors.

A variety of other "political" factors, none of them terribly important in terms of economic fundamentals, have probably contributed to the markets' malaise. Among these are fears of a U.S.-Japan trade war, tensions in Korea, the Mexican assassination, Whitewater, etc. A "happy" market would probably have ignored all these things; a market that is down-in-the-mouth may not.

4. The Federal Reserve's actions.

Did the Fed push up bond rates by raising the Federal funds rate on February 4? This is the question over which your advisers disagree most. The following discussion sticks to a narrow issue: Did the Fed's actions contribute much to the markets' decline? It does **not** (except implicitly) make any judgments on whether the Fed was right or wrong.

First some points of agreement. We all believe that the financial storm clouds were gathering before February 4 and, like the air before an electrical storm, looking for a precipitating event. We all agree that the Fed's action was at least one of the precipitating events. But we disagree (as do market pundits) about how big a factor it was.

Most of us are inclined to attribute considerable importance to the Fed's actions, which helped trigger the market slump by:

- Serving as a catalytic event which focused market attention on inflation and signalled the end of low interest rates. On this view, the Fed affected the timing of the markets' declines more than the magnitude.
- Creating expectations (which were reinforced on March 22) that **many** more such increases in interest rates were in the offing. On this view, by moving in increments of just 25 basis points the Fed has:
 - fostered the belief that short rates were now going to move up steadily, perhaps by 200-300 basis points;
 - heightened market uncertainty over where this process will end.

On the other hand, some believe that the Fed's actions were at most a minor contributor to the run-up in bond yields. They:

- Point out that bond rates normally rise in recoveries and were moving up before February 4.
- Suggest that markets may have been disappointed that the Fed moved so timidly.
- Suggest that moving by 25 basis points at a time is prudent in nervous markets.

Implications for Economic Growth

Does the recent run-up in bond rates (and decline in stock prices) damage prospects for economic growth? The answer depends on what moved the markets.

To the extent that the first explanation (faster expected growth) is correct, the market is registering its confidence in the economy. If anything, that should lead us to **raise** our growth forecast (and also our inflation forecast) despite the higher interest rates. The fact that consensus forecasts for 1995 have not been lowered gives us some confidence in this explanation.

To the extent that factors other than growth explain the run-up in interest rates, however, the market slump is a negative for growth. How negative? That depends on how long the high interest rates last. If this proves to be a financial spasm that lasts only a few months, the effects will be minimal. If, on the other hand, long-term interest rates rise permanently by 100-150 basis points (relative to our January forecast), growth could be reduced by 1-1.5 percentage points--mainly in 1995.

Somewhat slower growth in 1995 and somewhat faster growth in 1996 might be welcome. The economy is probably capable of growing about 8% over the three years 1994-1996 before reaching normal capacity. The more we "use up" in 1994 and early 1995, the less will be "left" for late 1995 and 1996. However, we are all skeptical that we, the Fed, or anyone else can fine-tune growth that subtly; and the CEA is worried that slower growth in 1995 is more likely to bring slower than faster growth in 1996.

As noted above, your advisers differ on the weights to attach to these various explanations. CEA and NEC put more weight on the Fed's actions, at least as the triggering event, while Treasury puts more weight on economic growth. All agree that once the trigger (whatever it was) was pulled, the so-called technical factors played a major role in propagating and magnifying the initial shock.

What Should the Administration Do?

The short answer is: nothing. In fact, there is little we **can** do to help. A number of things we **could** do would certainly hurt. Among these are:

- bashing the Fed
- vilifying the markets
- looking nervous and confused
- busting the budget
- aggravating inflation by adopting industry-specific policies that raise prices

So far, we have not done any of these, except the last--which is the subject of a separate memo you have already received (copy attached).

Your advisers all agree that you should use the Presidential bully pulpit to keep people focused on the strong economic fundamentals (steady growth with low inflation) rather than on the markets. We disagree somewhat on the extent to which the Administration should be using words like "the market is overreacting" (or synonyms thereto).

- Those who support words like "overreacting" argue that they help the public keep things in perspective and maintain the focus on the fundamentals, not on market gyrations.
- Those who oppose such statements worry that such words sound pejorative and might be interpreted as suggestions that markets are "wrong"--which is not reassuring.

Attachment

THE WHITE HOUSE

WASHINGTON

April 12, 1994

MEMORANDUM FOR THE PRESIDENT

FROM: LAURA TYSON *for XR*
BOB RUBIN *for RER*
ALAN BLINDER *for AD*

SUBJECT: **Prolonging the Expansion Through 1996 by Saying No**

The Problem: Inflation as a Threat to Expansion

At present, the economy is moving upward at a nice pace, and the single biggest threat to continued expansion through 1996 is not that the expansion will die a natural death, but rather than it will be cut short by rekindled inflationary pressures instead of the relatively modest inflation we expect. More precisely, the main dangers to the economy stem from the likely reactions to a prospective rekindling of inflation by:

- the Federal Reserve -- Historically, almost all of the business expansions since World War II have been ended by a tightening of monetary policy, generally in reaction to inflation.
- the bond market -- Fears that rapid growth will put pressures on capacity, thereby leading to higher inflation, are already agitating the bond market vigilantes.

The conclusion is simple: At this stage, minimizing inflation may be the single most important thing we can do to prolong the expansion through 1996. Administration officials can and do say over and over again that inflation is under control. But what we do matters more than what we say.

Inflationary Policies Hurt

On a variety of fronts, the Administration is being pressured to take actions that raise prices -- and is sometimes succumbing to those pressures. A partial list of recent and current examples is:

- the international agreement to limit aluminum production has raised aluminum prices about 15%;

- proposed regulations requiring the use of ethanol will raise the prices of both corn and oxygenated gasoline;
- sharp reductions in imports of Canadian wheat would raise U.S. wheat prices, which are already high;
- by limiting imports of Canadian softwood lumber, we have helped raise the price of lumber, and thereby of houses here;
- an import fee on oil or refined products would raise energy prices;
- anti-dumping laws (which must be rewritten to accommodate the Uruguay Round) and, especially, the way those laws are administered, make imports more expensive; and
- withdrawal of MFN status from China would raise prices for a variety of products, e.g., apparel.

It is no accident that many, though not all, of the items on this list are trade issues. In the modern global economy, imports act as a safety valve which limit price increases for particular commodities when capacity constraints arise in the U.S. (Canadian wheat imports are a good example.) But imports have little or no domestic political constituency.

Each of the policies on the preceding list is like a minor self-inflicted OPEC shock and can be opposed on strictly economic grounds -- as the CEA consistently has done. While it is true that each decision, taken by itself, is "small potatoes," together they can amount to real money. And therein lies the political case against them.

Which Politics Are Correct?

Conventional politics creates a strong tendency to look not at the whole building, but at the individual bricks. ("All politics are local.") Each brick looks politically attractive because the forces lobbying for the special favor are concentrated, organized and vocal, while the forces representing the general public interest are diffuse and often silent. The problem is that, when you add up all these price-increasing bricks, you get a more inflationary building than you otherwise would have.

A more steadfastly anti-inflation policy would favor free trade, promote competition and oppose cartelization, abolish restrictive practices like the Jones Act and cargo preference, and routinely turn down requests to tilt market outcomes in favor of producers (e.g., aluminum, oil, wheat).

We realize that it will not be possible to ignore political realities in all of these cases, but if we do not resist policies with inflationary effects, brick-by-brick, the economic impact will be higher interest rates and slower growth, which is both bad economics and bad politics. Furthermore, if we can make the case that the economically right decisions are good for working America -- because they keep prices low -- perhaps these decisions do not have to be politically unpopular.

THE WHITE HOUSE

WASHINGTON

November 5, 1993

Dear Mr. Speaker:

I write to express my firm opposition to the proposed balanced budget amendment to the Constitution of the United States (S.J. Res. 41 and H.J. Res. 103). While I am deeply committed to bringing down our Nation's deficit, this proposed balanced budget amendment would not serve that end. It would promote political gridlock and would endanger our economic recovery.

The Administration fought hard to pass a historic deficit reduction plan because we believe that deficit reduction is an essential component of a national economic growth strategy. As you know, I worked tirelessly with the Congress to gain passage of the largest deficit reduction package in the Nation's history. This legislation includes a "hard freeze" on all discretionary spending, a virtually unprecedented constraint on Federal spending. Through the National Performance Review, a new rescission package, and a major proposal to limit the growth of Medicare and Medicaid through comprehensive health care reform, we are taking continuing steps to keep the deficit on a downward path. I have also long supported such procedural innovations as enhanced rescission authority or a line-item veto and would consider workable budget proposals that distinguish between consumption and investment. The Bipartisan Commission on Entitlement Reform will come forward with suggestions on controlling entitlement costs and other serious budget reforms. Thoughtful, specific reforms are better policy than a rigid Constitutional amendment.

The balanced budget amendment is, in the first place, bad economics. As you know, the Federal deficit depends not just on Congressional decisions, but also on the state of the economy. In particular, the deficit increases automatically

whenever the economy weakens. If we try to break this automatic linkage by a Constitutional amendment, we will have to raise taxes and cut expenditures whenever the economy is weak. That not only risks turning minor downturns into serious recessions, but would make recovery from recession far more difficult. Let's be clear: This is not a matter of abstract economic theory. Contractionary fiscal policy in the 1930s helped turn an economic slowdown into a Great Depression. A balanced budget amendment could threaten the livelihoods of millions of Americans. I cannot put them in such peril.

Moreover, at presently anticipated growth rates, the deficit reduction required by this amendment could be harmful to average hard-working American families. Supporters of this amendment must be straight with the American people. Given the current outlook for the FY 1999 budget, the amendment would require some combination of the following: huge increases in taxes on working families; massive reductions in Social Security benefits for middle class Americans; and major cuts in Medicare and Medicaid that would make it impossible to pass meaningful health reform legislation. This latter result would be particularly ironic and counterproductive because comprehensive health reform is our best hope not only for providing health security for all Americans, but also for bringing down the long-term structural deficit. The fact that these consequences will not be clear to most Americans for a few years does not relieve us of the responsibility of facing them today.

We must reject the temptation to use any budget gimmicks to hide from the specific choices that are needed for long-term economic renewal. The amendment by itself would not reduce the deficit by a single penny. The only way we can continue to make progress on bringing down the deficit while investing more in our future is to continue the process of making tough and specific policy choices. If we avoid such straightforward debate now, the likely outcome will be accounting subterfuge and gimmicks when the easy promise of a balanced budget amendment runs up against difficult political realities. A gridlocked Congress would encourage members to look for an easy way out -- for example, by moving more Federal programs off budget or by imposing more unfunded mandates on the States. Ironically, the amendment might encourage less rather than more fiscal responsibility.

The amendment's potential impact on our constitutional system is as troublesome as its effect on the economy. The proposed amendments are so vague and complex that budgets quickly could be thrown into the courts to be written by appointed judges with life tenure, rather than the people's elected officials in the Congress. Surely, we can do better than this.

3

Finally, I believe that economic and budgetary decisions should distinguish between investment and consumption. Those who manage a family budget know that there is a fundamental difference between spending money on a lavish meal, and paying the mortgage on a home that is an investment in one's future economic security. Under this balanced budget amendment, there is no distinction between cutting a dollar in waste and a dollar in a valuable investment in technology that could make us a richer and more competitive Nation in the future. That is unacceptable to me. We need to find ways to reduce the deficit and increase investment in ways that enhance not undermine the economic security and potential of our people and their communities. We must bring down the budget deficit at the same time we make progress on bringing down the investment deficit through investments in those who helped us win the cold war, through more resources to fight drugs and crime, and by giving all Americans the opportunity for quality education and training throughout their lifetimes.

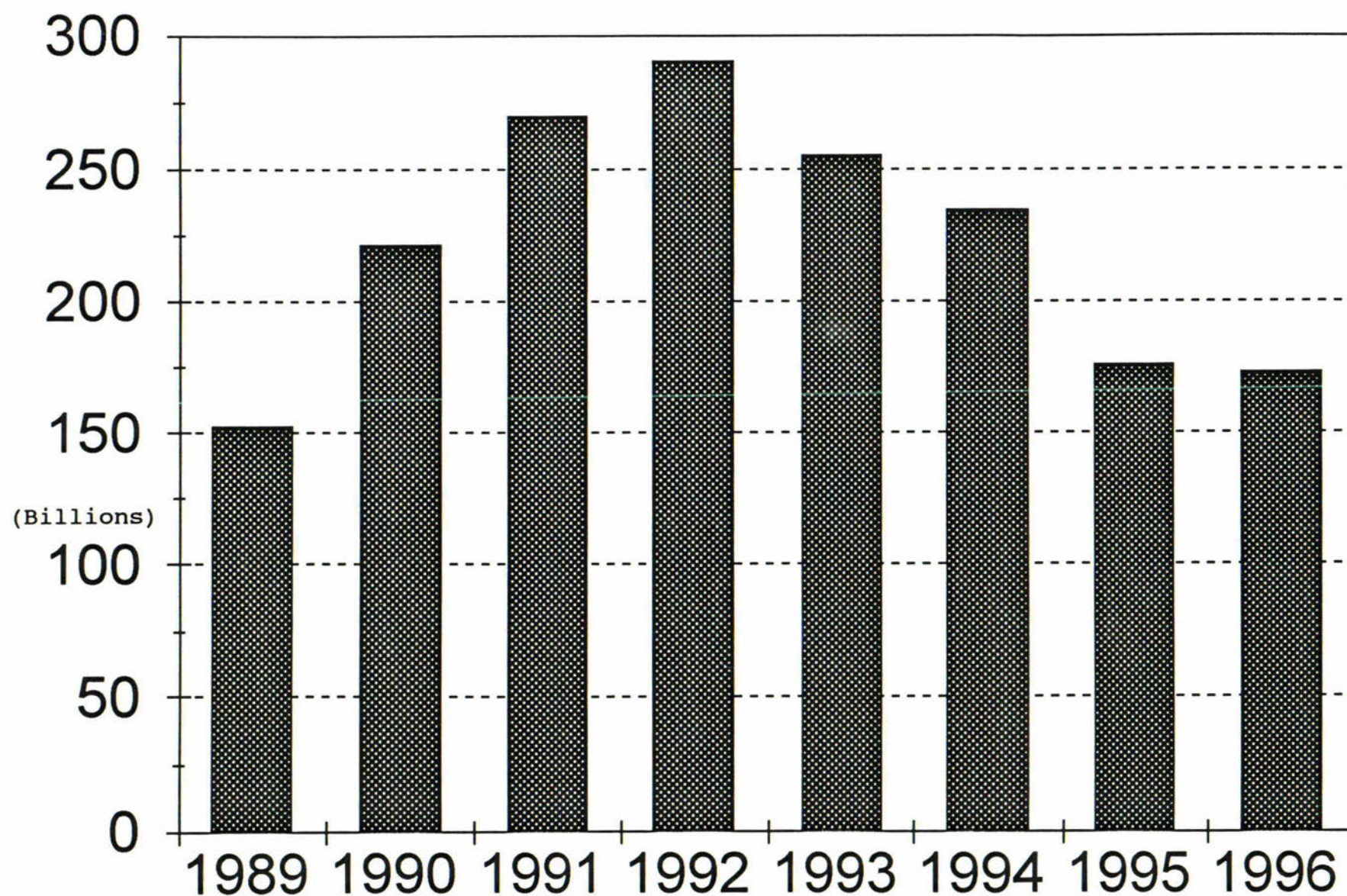
I remain firmly committed to the goal of deficit reduction. But I am just as firmly opposed to this balanced budget amendment, because it would simply delay honest debate over the hard choices needed for long-term economic growth and could imperil the economic stability of the Nation and our fledgling recovery.

Sincerely,

Bill Clinton A

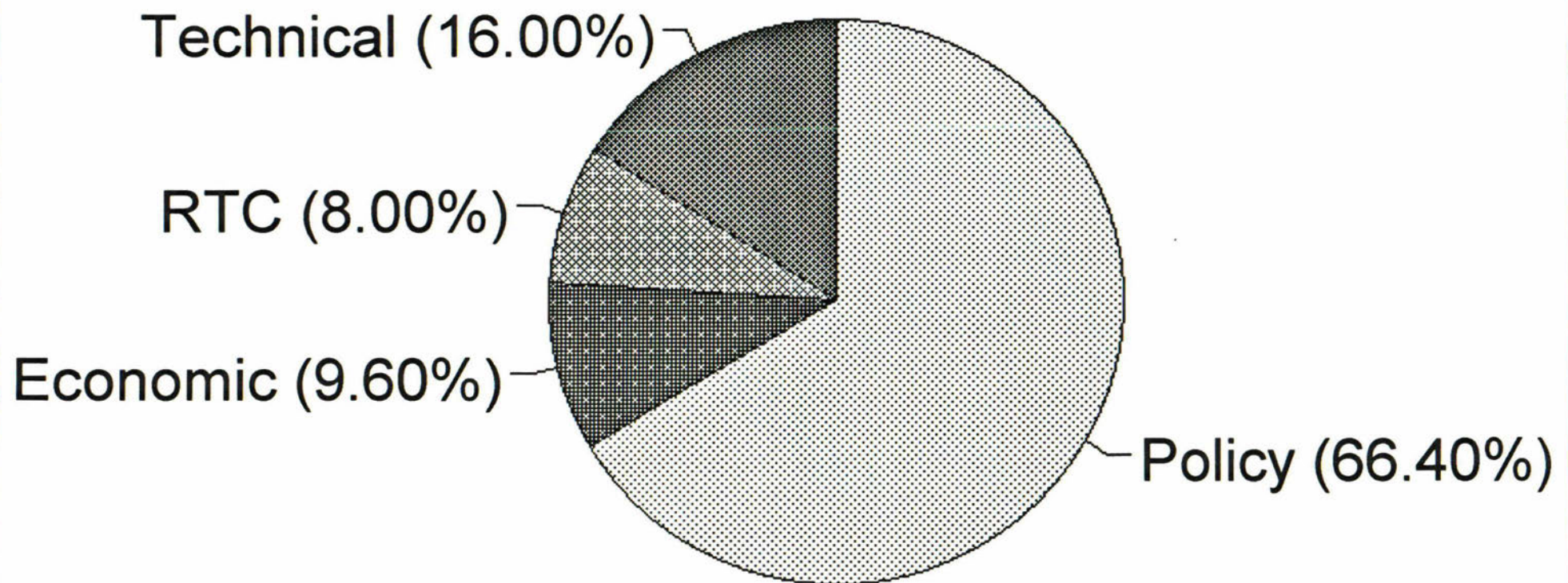
The Honorable Thomas S. Foley
Speaker of the
House of Representatives
Washington, D.C. 20515

Bush Deficits Grow; Clinton's Shrink

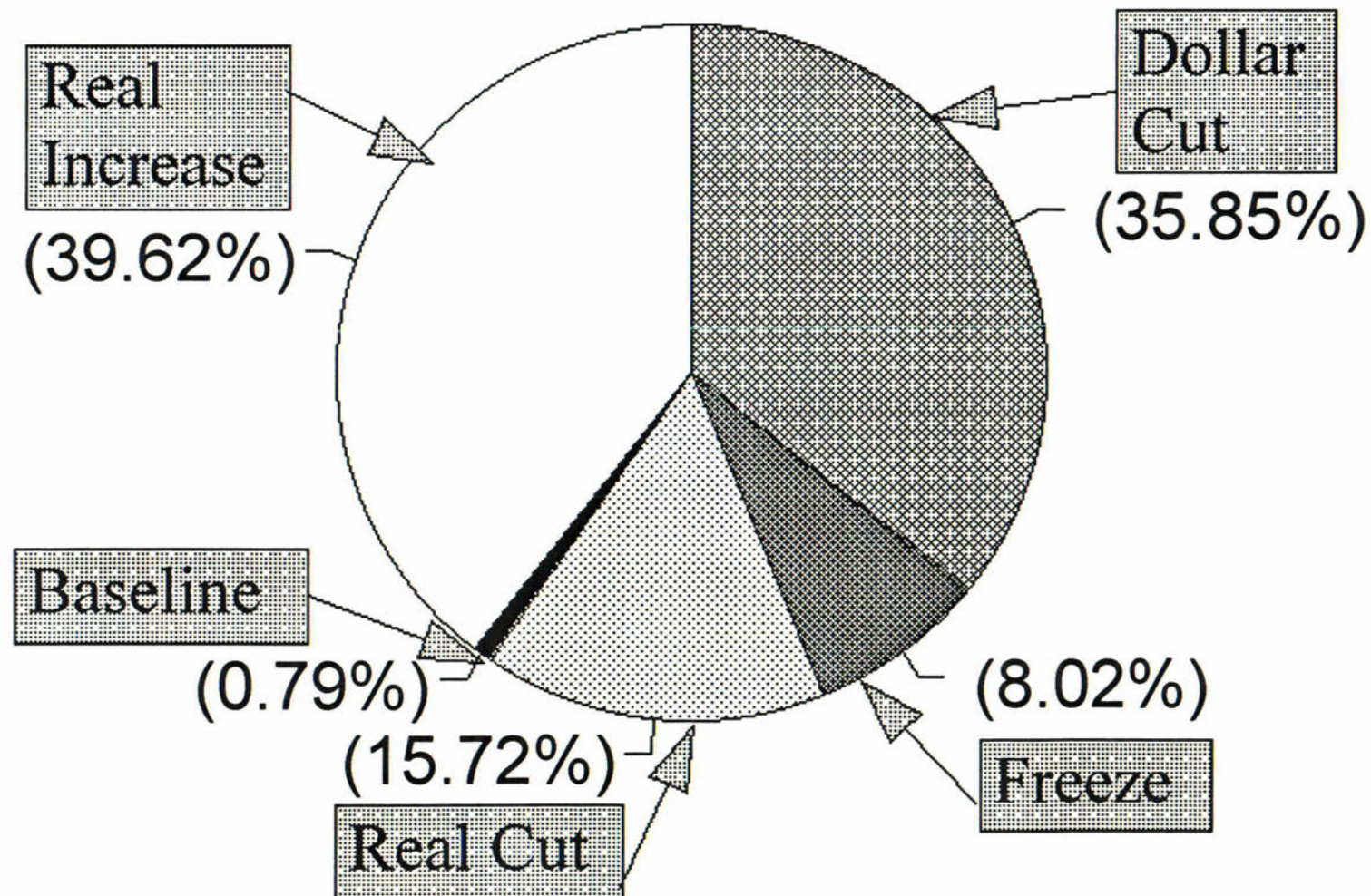


Sources of FY 1995 Deficit Reduction

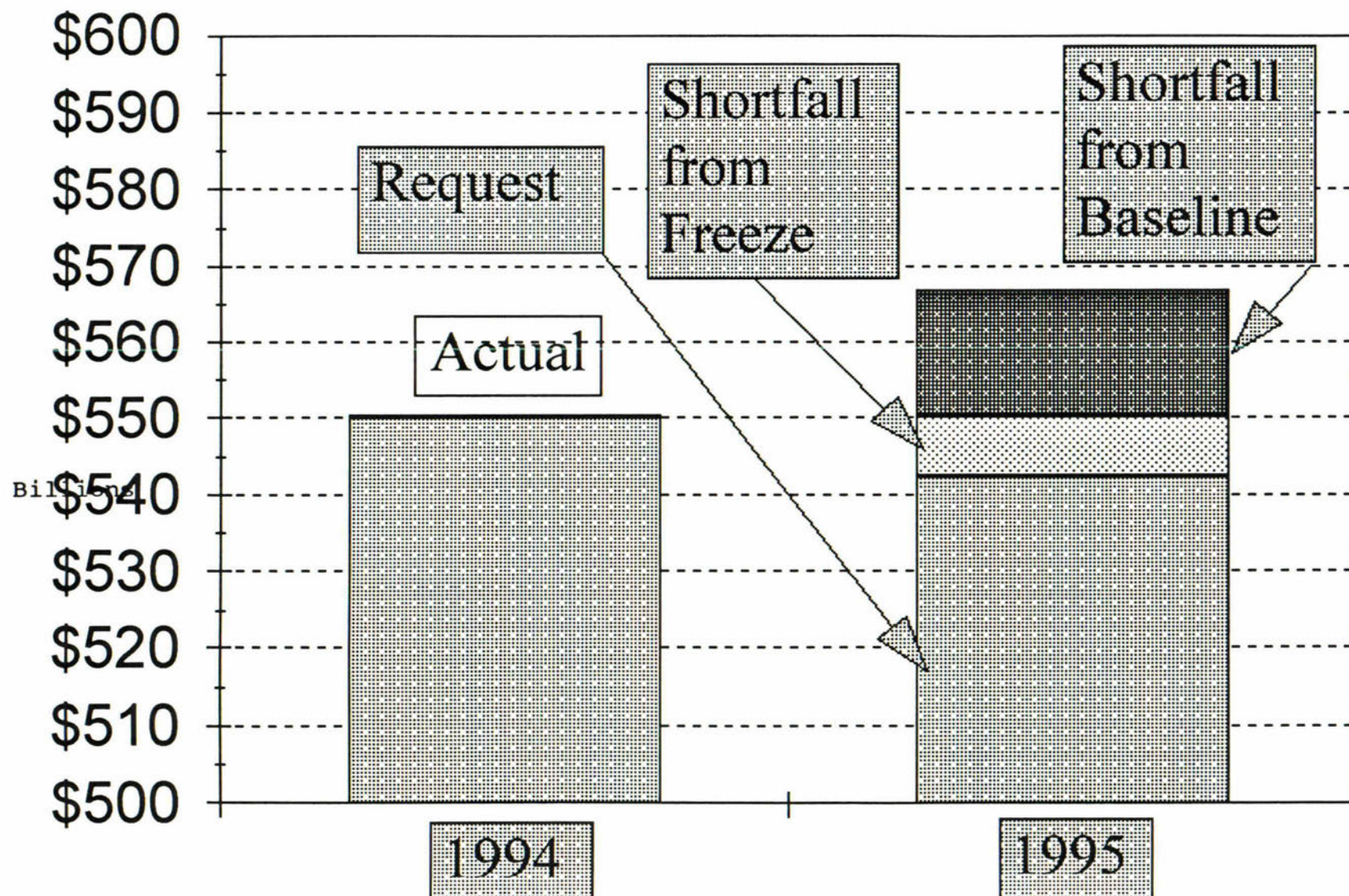
Total: \$125.7 Billion



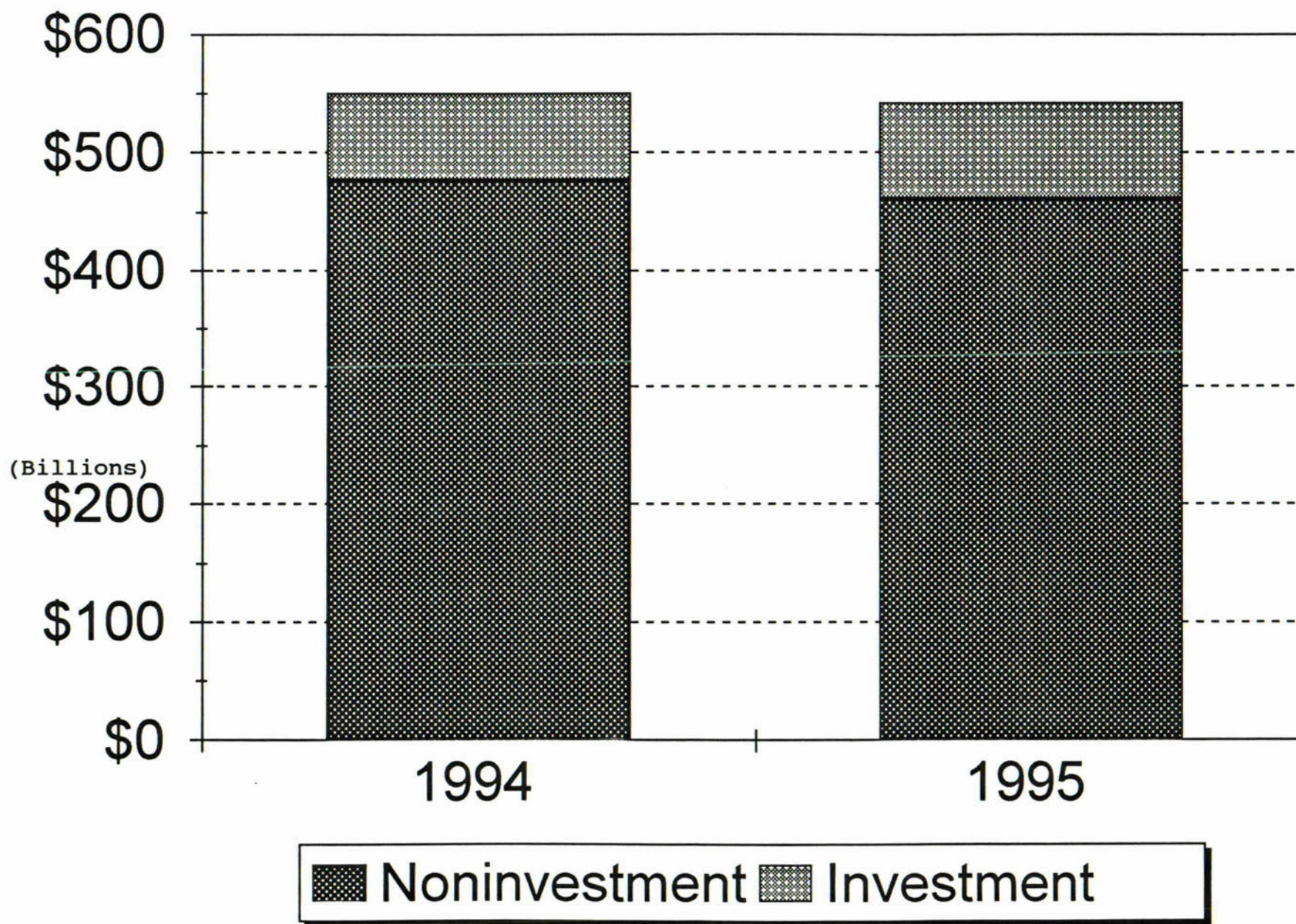
Most Budget Accounts Are Cut



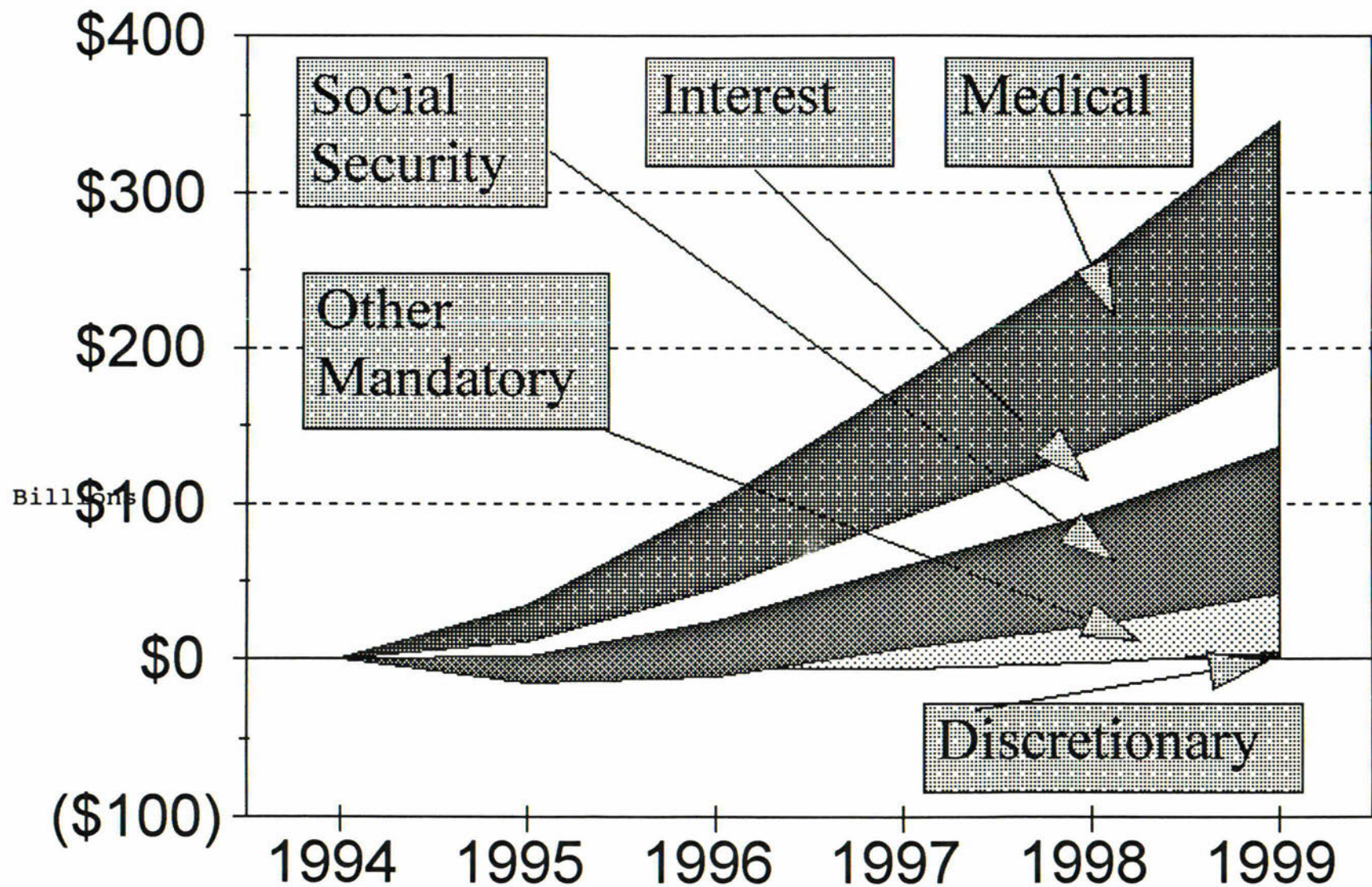
Discretionary Spending is Cut



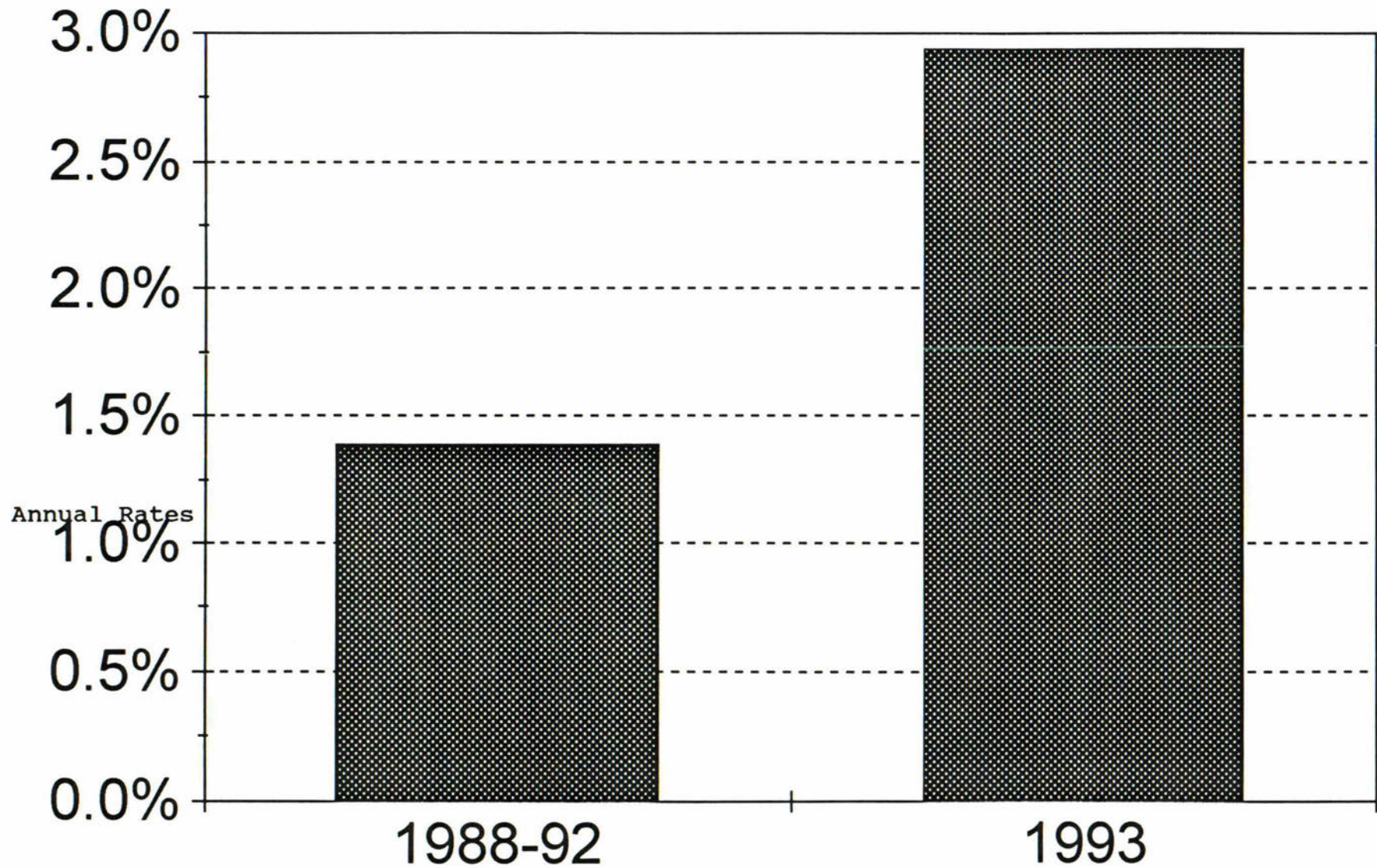
Investments Grow; Other Programs Cut



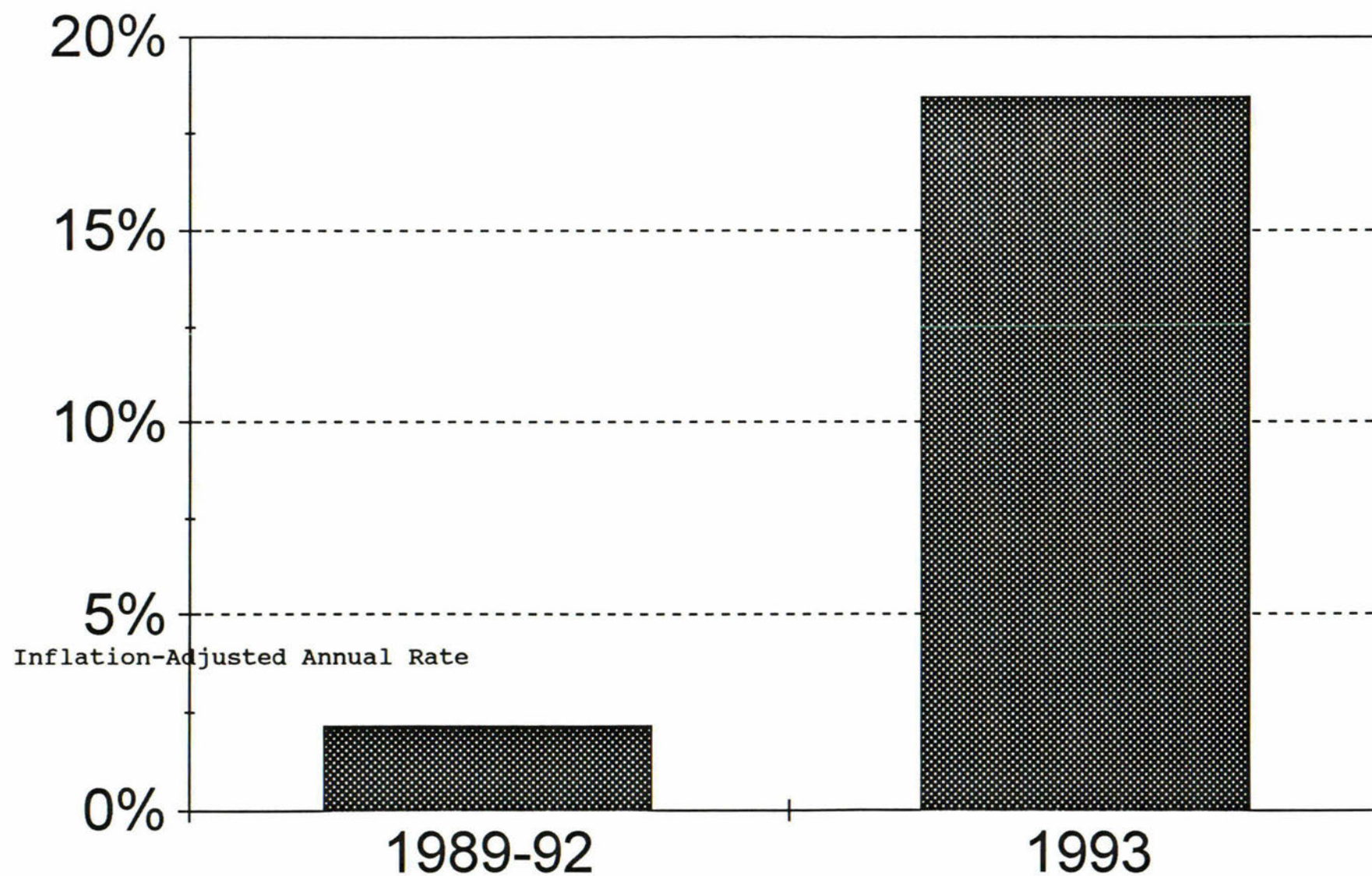
Sources of Spending Growth



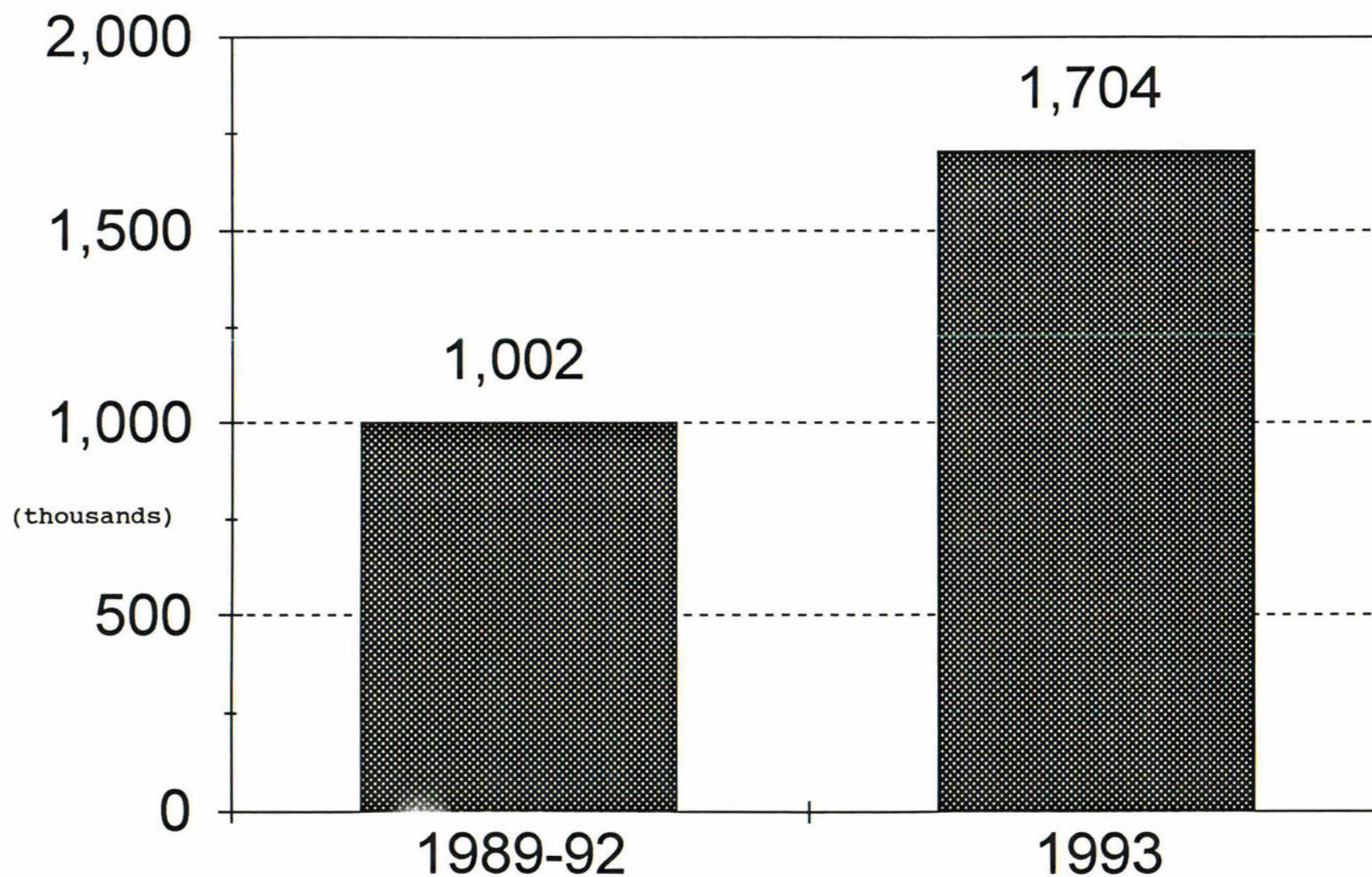
Real Economic Growth



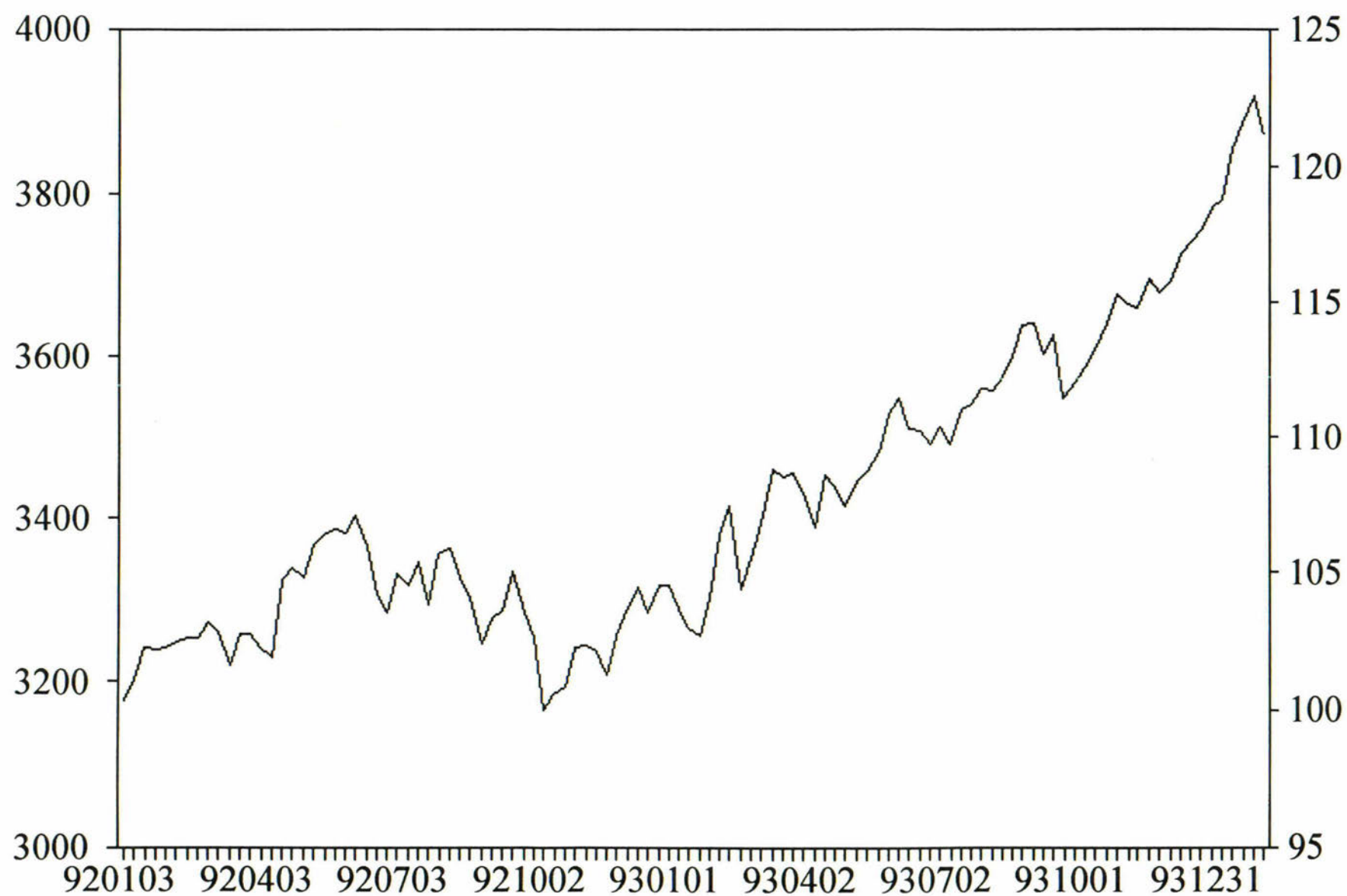
Business Fixed Investment in Equipment



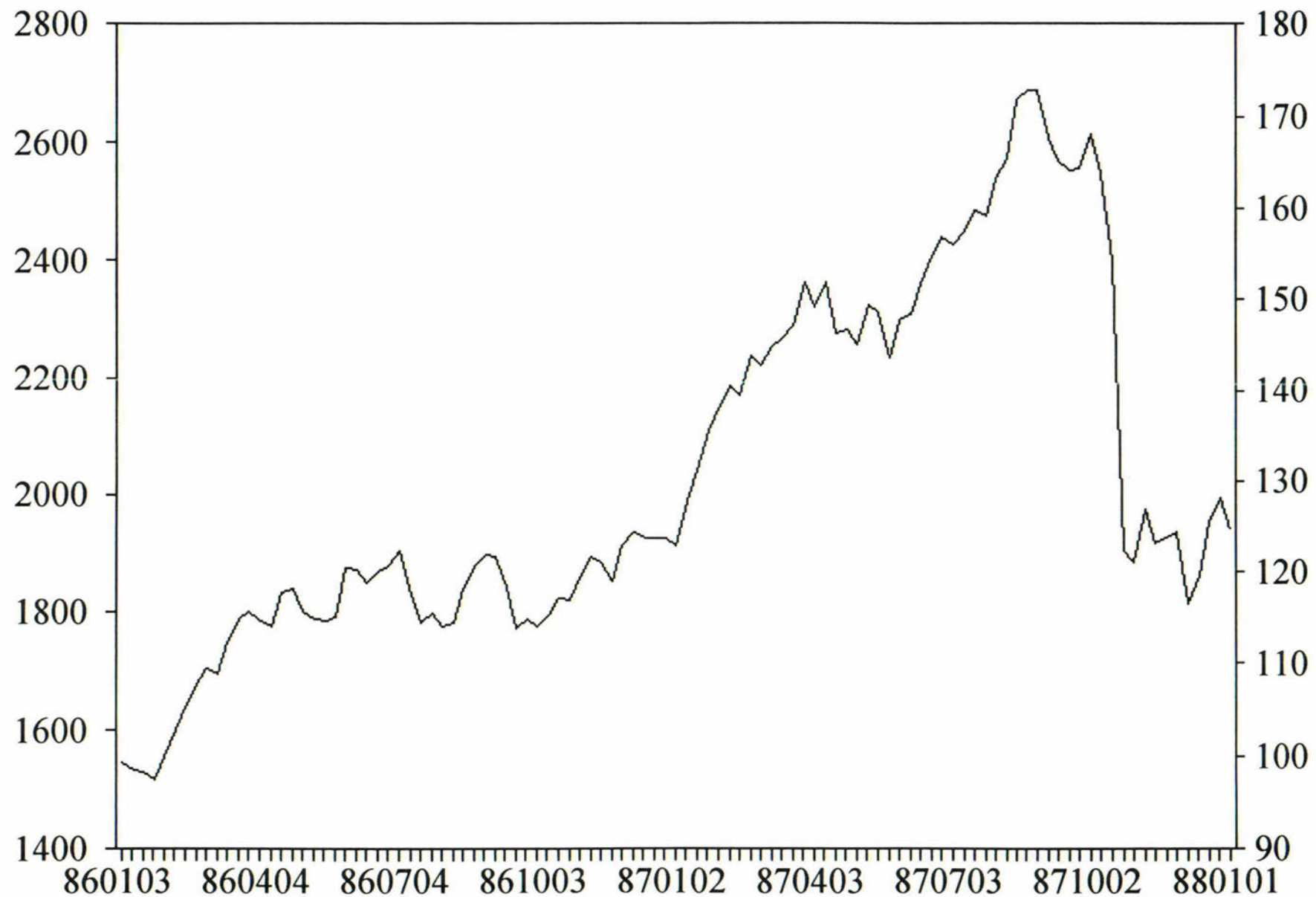
Private Sector-Job Creation



Dow-Jones Industrial Average, 1992-94



Dow-Jones Industrial Average, 1986-87



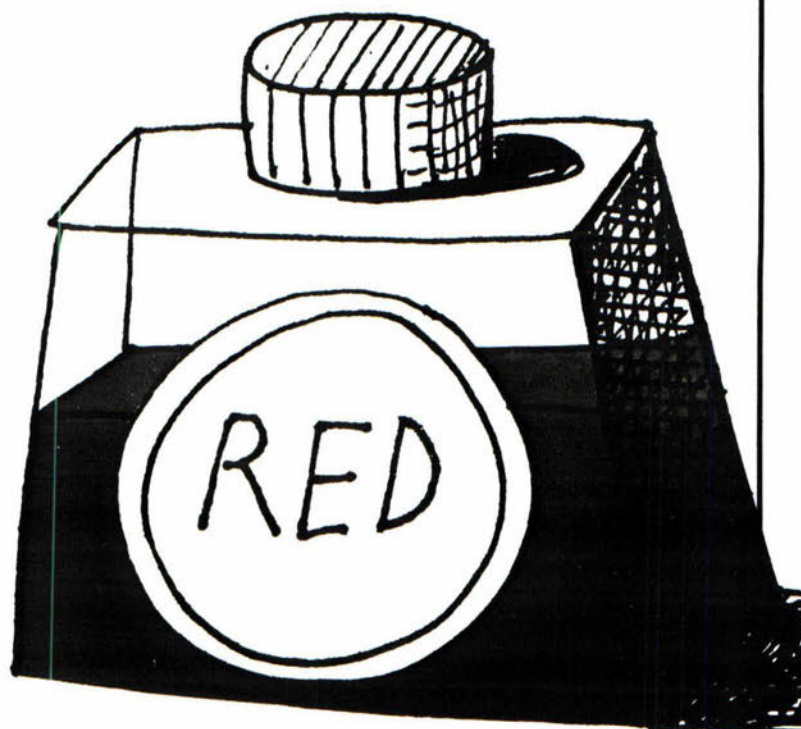
A reprint of

FACING UP

WHY THE MIDDLE CLASS
MUST BE CLINTON'S NEXT TARGET

BY PETER G. PETERSON

FROM THE OCTOBER, 1993 ISSUE



Peter G. Peterson is the chairman of The Blackstone Group, a private investment bank. Earlier in his career Peterson served as the U.S. Secretary of Commerce and as chairman and CEO of Lehman Brothers and Bell & Howell. Peterson's article in this issue is based on ideas elaborated in his book *Facing up: How to rescue the Economy from Crushing Debt and Restore the American Dream*, to be published in November by Simon & Schuster.

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Illustrations by J. C. Suarès

The cause of our huge budget deficits is not government waste or welfare programs for the poor—it's the out-of-control spending on welfare programs (called "entitlements") for the middle and upper classes. President Clinton's plan barely makes a dent in this spending

FACING UP

BY PETER G. PETERSON

EARLY ON IN HIS PRESIDENTIAL CAMPAIGN BILL CLINTON TALKED ABOUT THE need for Americans to pull together and "sacrifice." Later, in a State of the Union address remarkable for its candor, he spoke to a raptly attentive nation about how our ballooning federal deficits cloud our economic future. That was a subject George Bush had found worthy of mention only once in his 5,000-word State of the Union address the year before. The budget plan that Bill Clinton then delivered to Congress not only used real numbers instead of rosy scenarios; it

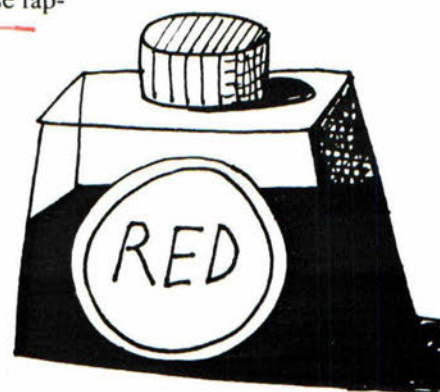
shattered some paralyzing dogmas. The nonsense that we could put our fiscal house in order without new taxes was laid to rest. Especially commendable was the President's opening the door to energy taxes, which not only raise revenues but also represent a means to curb a particularly toxic kind of consumption. Even Social Security, our ultimate sacred cow, was put on the budget-cutting table—if only at the table's edge. After years of empty "Morning in America" and "Don't Worry, Be Happy" rhetoric, all of this was welcome—even intoxicating—to us deficit hawks.

But in the end the actual sacrifice called for under the Clinton plan is so mild and selective that it can hardly be said to address our long-term economic challenges. The President's new taxes on the "rich" turned out to spare almost entirely a much enlarged but fiscally misnamed middle class, excluding all but the top one percent of U.S. tax filers. Despite all the talk of draconian sacrifice, the Clinton plan's proposed energy tax amounted to little more than a flea bite. As for entitlements, the thing that mattered most, the President barely managed to crimp their growth. From 1993 to 2004 federal benefit spending under the original Clinton plan, which, in its handling of entitlements and its overall budget savings, differs only in detail from what Congress approved, would have soared by some \$730 billion—as compared with \$790 billion under the Congressional Budget Office's business-as-usual baseline scenario.

Without much broader sacrifice—and a presidential vision that truly explains its purpose and inspires us to consume less today for a better tomorrow—we will never cure America's economic ills.

The Clinton plan doesn't come close to balancing the budget, even in the near term. According to the numbers developed by the White House itself, if the President's entire original budget package had been passed and implemented, by 1997 the federal deficit would have declined by only \$140 billion from what it otherwise would have been. That would put it at \$206 billion, or 2.7 percent of gross domestic product—just a smidgen under where it was (3.0 percent of GDP) in 1989 before the recession began. If 2.7 percent of GDP doesn't seem like a lot, consider that in 1992 a deficit that size would have soaked up about half of U.S. net private savings. And consider also that about three quarters of the spending cuts that the President has proposed for 1994 to 1998—modest as they are—are only to take place after the 1996 election, which, of course, raises the risk that they will not materialize at all.

After 1997 the federal deficit will once again begin to rise rapidly. Under the impact of continued growth in entitlement spending, by 2004 it will have climbed to about \$465 billion, or 4.6 percent of GDP. As the Baby Boom generation begins to reach retirement age in the years that follow, a General Accounting Office study indi-



cates, the deficit could then soar to an unthinkable 21 percent of GNP in the year 2020, when today's toddlers are starting to raise their own families.

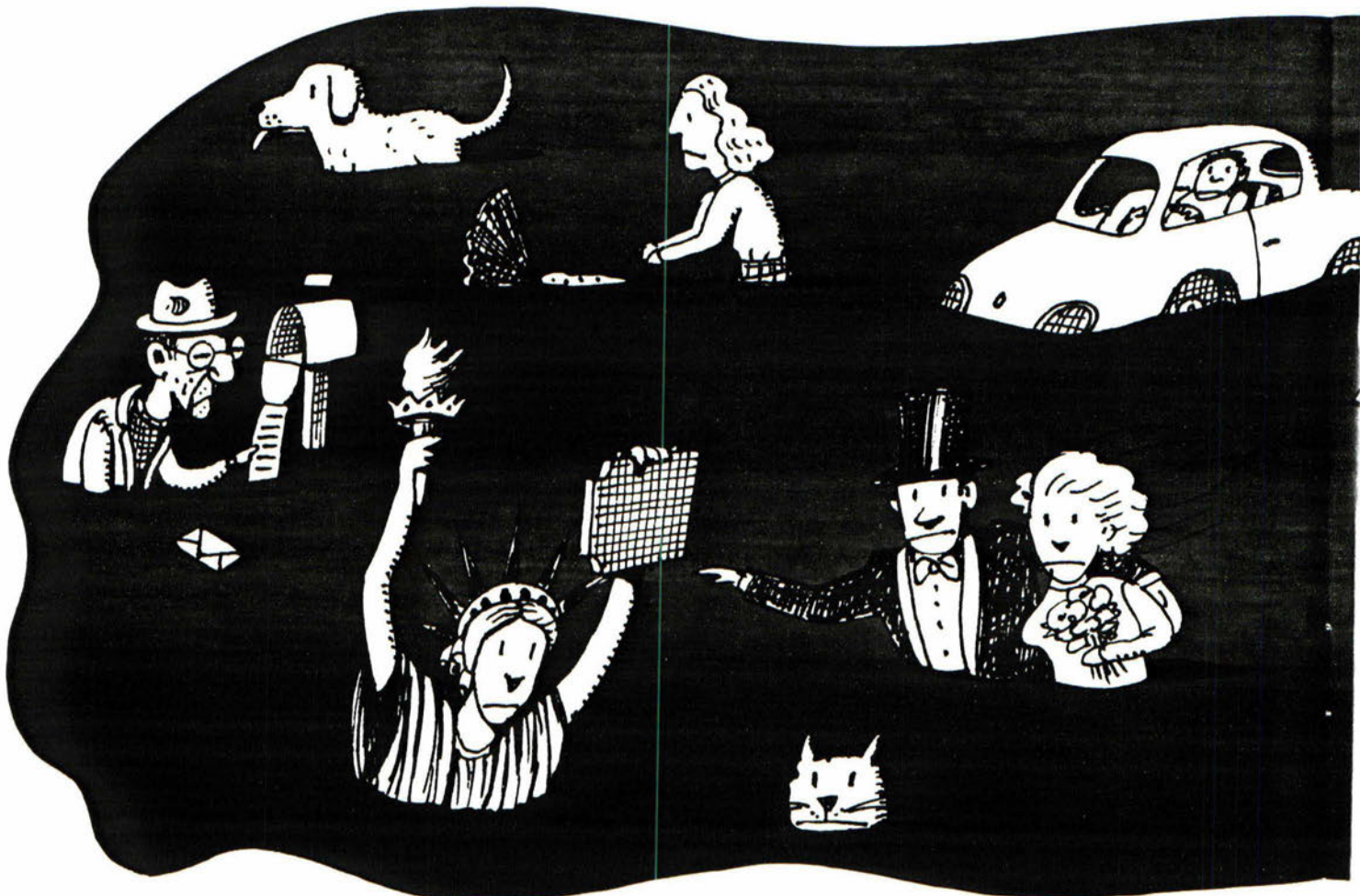
Economists disagree on many things, but almost none would disagree that it is essential not to let our public debt grow faster than the economy. Yet under the Clinton plan public debt is on track to grow far faster than the economy. Today public debt is already at a higher level—55 percent of GDP—than it has been at any other time since the mid-1950s, when we were still paying off the costs of the Second World War. Because the Clinton budget plan leaves on the table a full two thirds of deficits previously projected for 1993–2004, public debt will grow to about 65 percent of GDP by the end of that period. And along with the debt, needless to say, federal interest costs will soar.

Considering how ravenously a large deficit consumes national savings—and Clinton has spoken eloquently about this—and how important the availability of savings is to making the future-oriented investments that Clinton says he wants (and that America surely needs), how can we possibly justify short-term tweaking of the

deficit in lieu of radical surgery to balance the budget?

I have asked the Clinton people this question. One answer they offer is that the volcanic eruption of red ink projected for after 1997 will never occur, owing to steps they will take to control that most intractable force driving our deficits—exploding health-care costs.

The President is certainly right to go after health care. This is where much of deficit reduction must occur. But as to whether Bill Clinton will find his hoped-for health-care savings, I am more than a bit skeptical. As Charles Schultze, a former chairman of the Council of Economic Advisers, put it, "God couldn't design a program" that will achieve net savings in health care in the near term. The President, after all, is proposing that we spend *more* on health care—according to some, as much as \$100 billion to \$150 billion annually in new public and private benefits, much of it picked up by the federal government. In the longer term achieving real savings elsewhere in health care will require real sacrifices—including, ultimately, selective rationing of high-cost, low-benefit medical technologies and services. But the Administration isn't preparing the American people for such sacrifices.



Until it does, it won't be able to come up with enough health-care savings to offset the cost of the benefit expansions we are now talking about, much less contribute to overall deficit reduction.

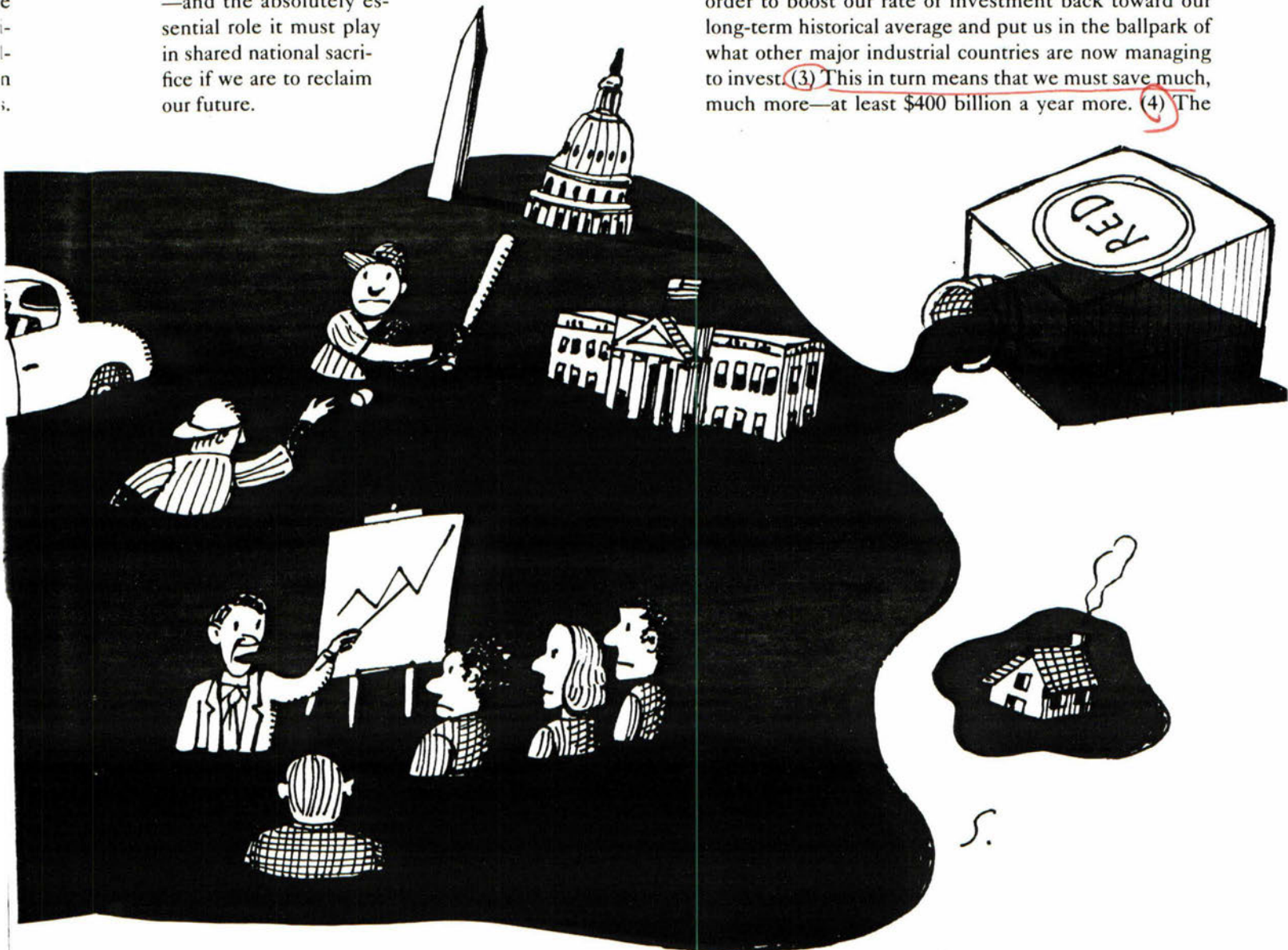
Bill Clinton warned of an economic Armageddon if we fail to change course—but then all he was able to give us to cure our economy's ills was a few teaspoons of syrupy medicine.

What happened? The President, according to senior aides, kept asking, "What is *politically* feasible? I do not want this to be another budget that is D.O.A." In the end his political advisers told him he couldn't ask for sacrifice where he had to—from the great American middle class. Let me now speak the unpopular truths that I am sure the President knows but believes are too politically dangerous to act upon. Let me turn to the problem of the great American middle class—and the absolutely essential role it must play in shared national sacrifice if we are to reclaim our future.

The Brutal Truth

IF YOU LISTEN CAREFULLY TO MOST ECONOMISTS and policy experts today, a consensus emerges about the magnitude of America's economic challenges and what sorts of reforms will be necessary to overcome them.

In particular, most would agree with the following: (1) To get American living standards rising again, we must increase productivity growth. (2) To boost productivity we must invest more—much, much more—not just in machines but in research and development, in infrastructure, and in people. Making the new investments we need if we are again to know the kind of rising living standards we remember from the 1950s and 1960s will require a lot of money. Many, myself included, think that at least \$400 billion a year in new investments is needed in order to boost our rate of investment back toward our long-term historical average and put us in the ballpark of what other major industrial countries are now managing to invest. (3) This in turn means that we must save much, much more—at least \$400 billion a year more. (4) The



surest and fastest way to increase our savings is to reduce and eventually eliminate the federal deficit, which is really just a form of negative public savings. (5) To reduce the deficit and keep it down we must make major cuts in consumption spending, and in particular in entitlements. But this, alas, requires us to confront a brutal question: If we are to save more by consuming less, whose consumption growth do we propose to cut?

It's at this point that agreement on what needs to be done, while not exactly breaking down, comes face to face with a truth that remains politically inexpressible. That truth is that the problem is all of us. *Most Americans—emphatically including the middle class—will have to give something up, at least temporarily, to get back our American Dream.*

We all remember the slogan that came out of the Clinton campaign: "It's the economy, stupid." Well, when it comes to the budget, the watchword ought to be "It's entitlements, stupid." From Social Security and Medicare to the vast tax favors for home-mortgage interest and employer-paid health insurance (policy wonks call these benefitlike subsidies in our tax code "tax expenditures"), consumption-oriented spending dominates the budget today. And the explosive growth of these entitlements will continue to rob our future. The budget arithmetic is inescapable: we just can't get the spending cuts we need from anywhere but entitlements. As big as it is, even defense spending isn't big enough. We could shut down the Pentagon tomorrow and still not balance the budget. Nor can we count on saving much on our huge interest bill unless we first reduce other types of spending. Interest on the national debt is something that we must pay to avoid a devastating financial panic—and it keeps growing as our national debt grows, just as it would fall if we began to attack the deficit. The rest of what government does represents just pennies out of the overall budget dollar.

The Cost of Entitlements

LET'S DEFINE SOME KEY TERMS AND LOOK AT some key facts about entitlements. "Entitlements" are any public-sector payments, received by a person or a household, that do not represent contractual compensation for goods or services. This definition obviously excludes large portions of the federal budget, from defense procurement to interest on the national debt to purchases designed for America's collective benefit (such as highway construction). But it includes nearly everything else—most notably such dominating fixtures of the American political landscape as Social Security, Medicare, Medicaid, food stamps, unemployment compensation, veterans' benefits, and farm aid, to say nothing of our lavish federal pension systems.

The most striking single fact about entitlements is their vast cost. Over the course of fiscal year 1993 the U.S. Treasury will have mailed out benefit checks (directly to

individuals or to state agencies and insurance companies that administer benefits) totaling some \$800 billion, or about one eighth of our nation's GDP. That amounts to more than half (53.5 percent) of the entire federal budget—or about \$6 million every minute of every working day, flowing to one out of two American households. These figures, moreover, include only direct outlays from the federal budget. The numbers would be even larger if we included tax expenditures. If we count them and add the cost of administering entitlement programs—as many economists argue we should in order to get the full picture—federal entitlements now amount to more than \$1 trillion annually and flow to well over three quarters of all U.S. households.

Ten Myths About Entitlements

MYTHS ABOUT ENTITLEMENTS ARE EVERYWHERE. They are used—and abused—in the political dialogue in ways that seem to make reasoned debate and reasonable reforms impossible. Let's look at ten of the most common myths.

1. *Most federal social spending goes to the poor.*

It is important to remember what entitlements have done to reduce poverty. Before the New Deal millions of Americans had no means of support in the event of unemployment, disability, unexpected retirement, or the death of a parent or spouse. Vast numbers of children grew up in destitute families. At great cost to society and the economy, millions of workers could fall into poverty and never recover. In 1937 President Franklin D. Roosevelt could say, "I see one third of a nation ill-housed, ill-clad, ill-nourished." Today entitlements prevent some 20 million Americans (half of them elderly) from falling into poverty.

This is clearly all to the good. However, keeping people out of poverty is not the purpose toward which most entitlement spending is directed. In reality, only about one out of eight federal dollars of social spending serves to lift poor families above the poverty line. Only about one out of four federal benefit dollars even flows through a program that uses financial need as a criterion for eligibility. Counting both direct benefits and the value of entitlements conveyed through the tax code, the aggregate amounts received by people above the national median income are simply staggering. In 1991 nearly half of all entitlements went to households with incomes over \$30,000. One quarter went to households with incomes over \$50,000.

2. *Entitlement spending helps to equalize incomes by giving more to the poor than to the rich.*

Few axioms of American political life find such uncritical acceptance as the belief that social-welfare programs effect a dramatic redistribution of wealth in favor of low-income households. It apparently makes little difference that most experts, liberal and conservative alike, have

never subscribed to this axiom—and that recent data repudiate it altogether.

Back in the sixties the Nobel laureate economist Milton Friedman used to shock audiences by asserting that Social Security was actually a regressive program—since the program's mildly progressive benefit formula compensated neither for its regressive payroll tax nor for the fact that the poor pay taxes over more years (since they tend to start working at a younger age) and receive benefits over fewer years (since they tend also to die at a younger age). Most economists found Friedman's analysis at least plausible; no one has yet disproved it. More recently the celebrated political scientist Mancur Olson looked over the panoply of American entitlement programs and concluded:

Most of the redistribution of government is *not* from upper-income and middle-income people to low-income people. Most of the redistribution of income in fact is from middle-income people to other middle-income people, or from the whole of society to particular groups of rich people, or from one group to another where the groups are distinguished not by one being poor and the other being rich, but only by the fact that some groups are organized and some are not.

Income data from the Congressional Budget Office tend to bear out Olson's critique. Total federal benefits to the affluent are at least as substantial as those to the needy. Among Social Security beneficiaries, for instance, households with incomes of \$100,000 or more receive, on average, checks that are twice as large as those of households with incomes of less than \$10,000. Even when we add in the cash and in-kind benefits disbursed by all of the other federal sources for which we have income data—including "means-tested" welfare and food stamps—we find that households in the top bracket (\$100,000 and up) received an average of about \$5,700 in 1991, slightly more than the average of \$5,600 received by households in the bottom bracket (under \$10,000).

But direct federal payments are not the only way in which the federal government distributes benefits. We also have to take tax expenditures into account. These loopholes, designed to favor certain households and bearing no relationship to ability to pay, are the fiscal and economic equivalent of a government check. Most tax expenditures are unquestionably regressive: many poor households cannot qualify for them—and even when they do, what they receive is smaller, relative to their income, than what the affluent get. This year, for example, the Congress's Joint Committee on Taxation estimates that the average value of the home-mortgage interest deduction for taxpayers with incomes over \$100,000 is \$3,453 and that the same deduction is worth an average of only \$478 for taxpayers in the \$20,000 to \$30,000 bracket. Even these figures include only those who qualified for the benefit. They exclude many low-income families, including renters and those who opted for the standard deduction, who do not qualify.

When we add together all the direct-benefit outlays and all the tax expenditures, an unambiguous picture emerges. On average, a household with an income under \$10,000 collected roughly \$5,700 in 1991. On average, a household with an income over \$100,000 collected \$9,300. This distribution of benefits by income became more—not less—skewed during the 1980s. Clearly, it has nothing to do with economic equality. Let's phrase the issue a bit more bluntly. If the federal government's purpose were to straighten out the national income distribution, it would do a better job if it dispensed with all the programmatic rules and simply scattered all the money by airplane over every population center, to be gathered at random by passers-by.

3. *Social Security and Medicare are an earned right: beneficiaries are only getting back what they paid in.*

Here the case is open and shut. Most currently retired Americans receive Social Security benefits that are two to five times greater than the actuarial value of prior contributions, by both employer and employee. The payback for the Medicare Hospital Insurance program is five to twenty times greater. A typical middle-income couple who retired in 1981 have already received back, with interest, not only the total actuarial value of their previous Social Security and Medicare taxes but also *the total value of their lifetime federal income taxes.*

And these calculations of actuarial value are conservative. They assume that employer contributions "belong" to the beneficiary and that the public must guarantee a "market" interest rate on all contributions, no matter what the condition of the economy or the wages of those who are taxed to make good on this claim. In fact, the Social Security Administration keeps no direct record of how much each person contributes. It just keeps records of each person's wage history, to which a politically determined formula is applied when that person retires.

The politically potent and disingenuous language adopted by the Social Security Administration has contributed to the earned-right myth. The system is described as an "insurance" program, although it is nothing of the sort. References are made to contributors' "accounts," when no such accounts exist.

My father, helped along by years of such misleading nomenclature, went to his grave thinking that he was simply getting back his money, by which he meant what he had put into his "account" over the years. Since by this logic the benefits belonged to him, any proposal to take any of them away was both unjust and immoral. In truth, it was as though the government had a moral obligation to provide a windfall forever. He could only wonder why his otherwise well-educated son thought differently. I could never persuade him. It would have depressed him to find out that in fact there was no Social Security savings account in Washington with George Peterson's name on it.

Nor would I have wanted to depress him further with other unpleasant facts about entitlements. My father was

immensely supportive of my wife's work in behalf of poor children at the Children's Television Workshop. He would have been distressed to learn that in 1986, the last year of his life, the nation was told that it could not afford to fund fully the much-admired Head Start program. Yet merely the *increases* in Social Security's cost-of-living adjustments that year would have fully funded Head Start. Had he known the facts, I am confident he would have been happy to give up his sliver of the huge entitlement pie for such a worthy cause.

4. *The elderly, as a group, are poorer than young Americans.*

In reality, the 1990 official poverty rate among the over-sixty-five population was 12 percent, as compared with 21 percent among children. When we include the value of all noncash benefits as income, the poverty rate for the elderly is six percent, as against 15 percent for children. On this latter basis poor children outnumber the poor elderly in America by more than five to one. In no other major industrial nation is the poverty rate for children (using identical definitions) anywhere near what it is in the United States.

Children are the truly needy in our society, but they certainly don't get most of the public money. In 1990 of all direct federal benefits 63 percent went to the 13 percent of all Americans over age sixty-five, while nine percent went to the 26 percent of all Americans under age eighteen. On a per capita basis, and including all federal outlays that might be called "child benefits," from education to immunization, the ratio of average benefits received was eleven to one: \$13,890 to each elderly person and \$1,271 to each child. Even adding in everything spent by state and local governments (on schools, for instance), the ratio still favors the elderly by at least three to one.

Some argue that entitlements for the elderly merely substitute for transfers of wealth that the young would otherwise make to their parents. That might be true if these programs weren't so lavish. Before Social Security and Medicare, young families did sacrifice for older parents—if and when Mom and Pop were in need. Yet because today's retirees are, as a whole, wealthier than the young, adults aged twenty-five to thirty-four now report receiving from their parents twenty times more support than they give to them; even for adults thirty-five to forty-four, the ratio is five to one. Social Security and Medicare, far from embodying traditional family values, have turned them on their head.

5. *Social Security is building up a huge surplus that will be available to pay for benefits promised to Baby Boomers.*

It is true that Social Security receipts from payroll withholding taxes currently paid into the retirement part of the Social Security system (not the health-care or Medicare part) are higher than Social Security expenditures, and will probably remain so until the Baby Boomers start retiring in large numbers. But this surplus is temporary. What is more, the funds are not being saved or invested. Instead they are being used to help offset each year's overall federal budget deficit. Thus these surpluses are

transformed into debts held by the Social Security trust funds. Future taxpayers will become liable for the principal and interest.

Let's peer into the future to see what the real financial status of our old-age benefit programs is. In assessing their solvency actuaries tally up what are known as unfunded liabilities—the amounts (in this year's discounted dollars) by which future benefits promised to today's adults exceed all their future payroll taxes plus the assets currently held in all the government's relevant "trust funds." The federal government's unfunded liabilities for just four programs—Social Security, Medicare, and federal civil-service and military retirement—come to about \$14 trillion. That's a sum several times larger than the national debt, and one equivalent to roughly \$140,000 for every household. This is a system in surplus?

6. *Today's younger Americans will eventually receive the same health and pension benefits they are providing today's retirees.*

Recently the Senate Finance Committee held a hearing on likely paybacks to various generations. No expert disagreed on the trend (an unusual fact in itself): the earliest beneficiaries got by far the best deal, and the deal has been getting worse for each successive generation. By some calculations some upper-income single males retiring this year may get less out of Social Security than they put in.

Moreover, financing even the reduced returns that are promised to tomorrow's retirees is unlikely to be economically or politically sustainable as America ages. The Social Security Administration projects that, depending on demographic and economic trends, the cost of Social Security and Medicare will by 2040 rise to between 38 percent and 53 percent of payroll—unless we cut benefits. I believe the only real question is when, not whether, we will change course. We can make modest, fair-share sacrifices now. Or we can make wrenching changes later, amid economic crisis and, as Paul Tsongas would say, intergenerational war. The choice is not just economic but also moral. I can imagine few ethical principles more important than fairness toward our children.

7. *Retirement benefits are an "inviolable contract" between the generations.*

No, Virginia, there is no sacred contract, at least not according to the U.S. Supreme Court, which has repeatedly ruled that no covered worker retains any rights, contractual or otherwise, over taxes paid into the Social Security system. Perhaps I may be permitted a layman's less lofty legal opinion. As I recall (from a college course in commercial law), one fundamental requirement of a valid contract is a "meeting of the minds" of the parties to the contract: between those who pay and those who receive. But no such meeting of the minds exists. I am not aware that anyone has consulted my grandson, Peter Cary, now aged three, about the staggering tax rates that our current entitlement "contracts" will require him to pay when he enters the work force.

Simply repeating "inviolable contract," "mandatory," "nondiscretionary," "uncontrollable" payments, or some other disingenuous mantra does not change certain truths. What Congress mindlessly gives can be taken away. A fundamental reality is that the current system is not sustainable. If Social Security (or Medicare) is a contract, it is an unenforceable one.

8. *Tax breaks for health insurance primarily benefit people who otherwise could not afford proper health care.*

Maybe this one isn't really a myth, but the regressivity of our subsidies to privately paid health care is too shocking not to mention. In 1994 exempting employer-paid health insurance from taxes will cost the U.S. Treasury about \$75 billion. Needless to say, of the 35 million or so Americans without health insurance, who receive zero benefits from this huge tax break, most are poor or low-income citizens. Among households that do have insurance, those with the highest incomes and the most generous insurance plans receive several times as much from this federal tax subsidy as those with low incomes and a cost-conscious HMO.

9. *The federal government's major housing entitlement, the home-mortgage interest deduction, promotes homeownership and stimulates the economy.*

In 1994 the cost of the home-mortgage interest deduction in lost revenues to the federal Treasury will be \$46 billion, 80 percent of which will go directly to households with incomes over \$50,000. The main economic effect of the home-mortgage deduction is to inflate the price (and size) of homes, while diverting investment away from more productive sectors of the economy.

Our global competitors, who hear us publicly rail about our investment-starved economy and the stagnation of our productivity, politely ask what conceivable connection this tax subsidy for the relatively well off has with enhancing productivity. Officials in Canada regularly chide me about the fact that Canada has the same rate of homeownership as the United States without the benefit of this tax subsidy.

Why, then, do we have it? The answer, of course, does not lie in any real economic imperative. The subsidy exists because we all think we deserve it. What's more, it props up one of our most powerful special interests: the real-estate lobby.

10. *The only reason that Ronald Reagan could not keep his promise to shrink the size of government was the huge rise in defense spending.*

Judging by the cheers of his supporters and the jeers of his critics, we might suppose that President Ronald Reagan cut everything but defense. And judging by the similar partisan bickering over the policies of his successor, George Bush, we might suppose that the "welfare state" was the victim of further slashing and hacking for another four years after Reagan stepped down.

But the reality is very different: the cost of all direct federal benefits today (\$807 billion in fiscal year 1993) is considerably greater than the entire federal budget that ex-

isted when Reagan first took office (\$696 billion in fiscal year 1981). In fact, adjusted for inflation, federal benefits soared by 54 percent from 1981 to 1993—while all other domestic spending showed zero real growth, and defense, the one area where everyone supposed the Reagan and Bush Administrations had gone hog-wild, showed real growth of only 15 percent.

Contrary to popular impressions, the advent of the Reagan-Bush era did not signal a decisive shift in entitlement policy. With the exception of the 1983 Social Security amendments (designed by a bipartisan commission), both Presidents left non-means-tested outlays and tax expenditures—that is, most entitlements—on autopilot. Thus the Reagan-Bush years only reaffirmed that these vast middle- and upper-class entitlements were politically "uncontrollable"—a weasel word behind which Congress and the President can hide their unwillingness to act, since together they can control any spending they want.

The Middle Class: The Third Rail of American Politics

THE MIDDLE CLASS IS AT THE HEART OF OUR budget problem—and must be at the heart of the solution. Taken together, the major benefit programs for which we have income data on recipients—spending roughly 80 percent of total federal benefit dollars, and including everything from Social Security and Medicare to AFDC and food stamps—deliver 99 percent of their benefits (\$529 billion in 1991) to the 99 percent of American households with incomes under \$200,000. This is the upper boundary of what President Clinton has for political convenience defined as the "middle class." (The income-tax increases proposed by the Clinton Administration begin at \$140,000 of taxable income, the number most people have heard quoted. But that's really equivalent to about \$200,000 of adjusted gross income from all sources.)

Yet 43 percent of such benefit dollars (\$227 billion in 1991) go to households that cannot possibly be considered poor: those with incomes between \$30,000 and \$200,000. And note that the absolute dollar figure surely understates the total, since it reflects only 80 percent of all benefit dollars. What about the remaining 20 percent? We cannot be sure. Some of it flows through programs such as Medicaid, which mostly benefit lower-income households; some, too, flows through programs such as student loans, farm aid, and veterans' health care, which disproportionately benefit upper-income households. All told, it would be safe to assume that total federal benefit outlays reaching the \$30,000-to-\$200,000 income bracket amounted to at least \$265 billion in 1991.

And what about our ocean of so-called tax expenditures—the subtle subsidies that help the wealthy borrow huge sums for home mortgages and take unlimited health-care deductions? More than two thirds go to tax

filers with incomes between \$30,000 and \$200,000. Just seven percent go to the Americans whom the President calls "rich."

The top-earning one percent of Americans, it's true, receive 13 percent of all income in the United States. Going after the rich to help balance the budget is fine—as far as it goes. Unlike some of my Wall Street colleagues, I see absolutely nothing wrong with imposing higher tax burdens on the wealthiest in our society. But it does not require any arcane knowledge of fiscal arithmetic to see that even with the substantial tax increases proposed by the Clinton plan, trying to balance the budget is quite literally impossible on such a narrow stretch of income territory. In fact, to meet this goal by the year 2000 by taxing the "rich," we would need to tax away *all* the taxable income of everyone with more than \$175,000 of adjusted gross income. Or, if we would prefer a less draconian approach, we could merely double the income taxes of "affluent" tax filers—but we would need to include everyone down to about \$50,000 of income. Even this kinder and gentler approach would amount to something more like expropriation—hardly consistent with either free markets or democracy.

As for direct entitlement benefits, here too not much help is available from the rich. The maximum entitlement savings obtainable from the one percent of households enjoying incomes of more than \$200,000 are unfortunately limited to the benefits that go to them—about \$5 billion if we took away *all* their benefits (something that even Bill Clinton, with his laser beam on the rich, has never dreamed of suggesting).

But if we are willing to ask for even modest sacrifices from all Americans with incomes above about \$30,000, the picture changes entirely. Suddenly we're talking about a whopping 73 percent of national household income. We're also talking about a stunning 74 percent of all tax expenditures and 43 percent of major federal entitlement benefits, which, taken together—and including our estimate for all benefits—amounted to \$372 billion in 1991. That's a sum we simply cannot afford to ignore if we are at all serious about putting our fiscal house in order.

Twelve years ago, when Ronald Reagan ascended to the White House, I hoped that his politically candid talk about cutting the budget deficit would lead to politically courageous action. But instead we found a convenient scapegoat. The "poor," we learned, were bankrupting America. Just eliminate the "waste, fraud, and abuse" in our welfare system—all those mink-wearing welfare queens driving Cadillacs and buying vodka at taxpayers' expense—and a balanced budget would be in reach. The premise, of course, was wrong from the beginning. Despite cuts in programs for the poorest Americans during the Reagan years, the deficit kept exploding.

When Bill Clinton ascended to the White House, I was once again hopeful that the President would seize the moment and make the tough choices needed to cut the

deficit and boost savings and investment. But we seem to be caught up in another form of scapegoating. This time it's not the poor who are to blame; it's the rich who are not paying their way.

To be sure, President Clinton will get further with his scapegoat than President Reagan did with his. But both ways of dodging tough choices veer away from the heart of the problem. We are all implicated in our budget deficits, our entitlement ethos, and the overall consumption bias in our economy. And all of us, most particularly the broad middle class that is the backbone of America, must now be part of the solution.

Let's pause for a moment to ask ourselves, what in reality is the "middle class"? Ask any American if he or she is "middle class," and the answer will almost always be yes. The truly poor will admit to being "lower middle class," and the rich will go along with "upper middle class," but few will forthrightly call themselves "poor" or "rich." This is a characteristically American self-perception, and it reflects our desire to live in a basically egalitarian society. But in recent years it has allowed nonpoor Americans to believe that they deserve universal federal entitlements—much of them windfalls—such as Social Security and Medicare, which are often disingenuously called "insurance," and which people mistakenly think of as the payback on their contributions to "their accounts."

Next, ask any group of Americans to specify the annual income that defines "middle class" and you'll hear responses ranging from, say, \$20,000 all the way up to \$200,000—if we include the Clinton Administration's definition. But there are more precise and realistic definitions. If nontaxable entitlement benefits and other tax-exempt income are included with adjusted gross income reported to the IRS, the median family in the United States had a total adjusted gross income of \$31,700 in 1993. If "middle class" is then narrowly defined as comprising half of all American families equally distributed around that \$31,700 family, the statistical middle-class income turns out to range from \$14,040 to \$55,880.

This exposition regularly startles those who are new to it. A family with \$60,000 of income invariably thinks of itself as "just getting by," but it actually stands in the top quarter of families. A two-earner family with an income of \$120,000 may think of itself as just middle class. In fact that two-earner family stands in the top five percent of American families. By the time we reach those with incomes in excess of \$200,000—the only households targeted for significant sacrifices by the Clinton Administration's proposals—we are left with a mere statistical sliver of the population: roughly one percent.

Middle-class Americans today, it seems, suffer from what might be called a "reverse Lake Wobegon" syndrome. As Garrison Keillor fans know, Lake Wobegon is a wonderful fictional place where all the children are above average. When it comes to incomes, however, most middle-class Americans, trying hard to make ends meet,

assume they must be below average.

Middle-class Americans today feel hard pressed and beleaguered—and they are. Nobody could possibly argue that even a well-above-the-median \$50,000 a year in household income will put one on easy street. It's hard to make it on a typical middle-class income today—when paychecks barely keep up with the cost of homes, of college educations, and even of necessities.

Working hard and trying to follow the rules, middle-class Americans have adopted a kind of siege mentality in the face of evaporating expectations about future income growth. The middle class is already making a *de facto* and unplanned sacrifice in terms of the loss of upward mobility. But an organized, planned, and temporary additional sacrifice can reverse that trend. Only if we all give up something to reinvest in our future will we be able to rekindle the rise in U.S. living standards. If we all just hunker down to protect what we feel we're entitled to, we will condemn ourselves to a future that grows bleaker each year. Evaporating and diminished expectations are not what America is about. The willingness of middle-class citizens to sacrifice a little today for a better tomorrow is, however, exactly what America *used* to be about and ought to be about once again.

In spite of the recent stagnation of its living standards, the American middle class is still the world's richest middle class, consuming far more than any of its counterparts in Europe or Japan—and paying far lower taxes than most. Indeed, Americans may think themselves overtaxed, but we pay some 10 to 20 percent less of our national income in taxes than do the citizens of most other industrialized countries. The actual economic room for sacrifice exists; what we are missing is the public understanding and the political will to recognize such sacrifices as being in our long-term best interests.

We can't, of course, call on the middle class alone to sacrifice. The rich must pay their fuller and fairer share. Many of the same people who argue that the middle class is too beleaguered to contribute to solving our economic problems stand by silently as the \$30,000-a-year middle-class worker pays ever-increasing payroll taxes (which in many cases come to more than his or her income taxes) to subsidize the entitlement benefits of retirees who are getting ten times their contributions in Medicare payments (tax-free) and who may be earning \$100,000 or more a year in retirement. This is unconscionable.

Relearning Our Endowment Ethic

THESE THINGS ARE CERTAIN: WE CAN'T DO IT without the middle class. And we can't do it without going at entitlements head on.

Bill Clinton's decision to skirt entitlements and to spare the middle class from all but token sacrifice may have seemed a politically expedient course for the short term, just as it has to the past several Administrations. (According to the economist Benjamin Friedman,

74 percent of the burden of what deficit reduction the Clinton plan does achieve through higher taxes or benefit cuts will be borne by the small share of U.S. families earning more than \$100,000.) But it has meant that his only feasible program is one that has no hope of balancing the budget—or even coming close.

Bad economics may end up being bad politics as well. It is a matter of debate whether the American public is actually ready for real change and tough choices. And avoiding excessively rapid spending cuts or large tax increases in the midst of a creeping recovery was an understandable concern—though for all too many years it has never been the right moment in the business cycle or the political-election cycle for decisive action on the long-term economic predicament that by now also harms our short-term economic prospects. Any responsible budget plan must be phased in gradually if we are to avoid too bumpy a ride. But I believe that a clear goal of budget balance—and a commitment to meeting it by the end of the decade—would ultimately go over better with both the markets and the public than the course Clinton has chosen. Indeed, if one accepts Richard Nixon's dictum that the economy that matters most is the one that prevails three months before the next election, the President's current approach is a dangerous one.

By not asking the public to swallow the bitter pills at the outset, Clinton risks being forced to ask the public—and especially the middle class—to swallow them later, closer to the 1996 election. At that point, having denied the middle class its promised tax cut—and having created the impression that Americans are already making the needed sacrifices when they're not—Clinton may find the public wondering at the need for further sacrifice. Moreover, the lift given to the bond market in 1993 by the early promise of deficit reduction may by 1996 have reversed itself. With health care and other entitlements still spiraling out of sight, and with private credit demands likely rising as we and the rest of the world fully emerge from recession, the United States could once again see soaring interest rates right around election time. As 1996 approaches, Bill Clinton not only inevitably faces a second major budget-cutting exercise but also runs the distinct risk of being tagged the Biggest Borrowing President in history—and he won't even have the excuse of having presided over a divided government. It's easy to imagine a 1996 Republican campaign advertisement along these lines: "Bill Clinton raised your taxes, still borrowed a billion dollars a day, built a bunch of bridges to nowhere—and this time you know who to blame."

My view is that everybody except the poor and near-poor must be part of the solution to America's economic problems. But as we move through the various strata of the middle middle class and upper-middle middle class, and on into the upper middle class, the sacrifices called for in the form of higher taxes or curtailed entitlement benefits should get much larger. By the time we reach the genuine upper class, we should have increased the

tax bite significantly and cut deeply into tax subsidies and windfall entitlement benefits.

To help restore fiscal and moral responsibility to our entitlement system, the budget plan I propose in my book *Facing Up: How to Rescue the Economy From Crushing Debt and Restore the American Dream* therefore includes an "affluence test," or a graduated entitlement-benefit reduction. This affluence test (along the lines of the comprehensive means-testing idea discussed by Neil Howe and Phillip Longman in "The Next New Deal," in this magazine in April of 1992) would apply to all federal benefits, both cash and in-kind. No sacrifice would be required of households with incomes below the U.S. median (generously assumed to be \$35,000 by 1995, when the test's phase-in would begin). For families with above-median incomes, a portion of total entitlement benefits would be withheld on a steeply progressive basis. Under the test, households would lose 7.5 percent of all benefits that cause their incomes to exceed \$35,000, plus five percent at the margin for each additional \$10,000 in income. For most types of entitlement benefits, the maximum benefit-reduction rate would be 85 percent, applicable to household incomes greater than \$185,000.

If this proposal doesn't silence those who rail that entitlement reform is inevitably regressive and must ravage the poor, it should at least give them pause. For families who are earning between \$30,000 and \$40,000, are receiving benefits, and are subject to the test, the sacrifice called for would average just \$260 a year—or one percent of their benefits. Moreover, most who would have to sacrifice are retired and have lower expenses than working-age adults with similar incomes. For families earning between \$50,000 and \$75,000, the sacrifice would rise to an average of \$2,310, or 12 percent of benefits; for families with incomes over \$200,000 it would average \$15,345, or 72 percent of benefits.

All told, the budget savings made possible by the affluence test are enormous: at least \$93 billion in 2004, on the basis of a conservative calculation that takes into account only the 80 percent of entitlement benefits for which we currently have detailed data on recipient income. Affluence testing alone, however, does not add up to complete entitlement reform. Among other measures, we will also need to cap our open-ended tax subsidies for retirement, housing, and health care, accelerate the scheduled rise in Social Security retirement ages, and trim the largesse of our federal pension systems.

All of these reforms involve structural spending cuts that will save significant money in the 1990s and much more beyond. In a business-as-usual budget scenario, entitlement costs could be closing in on a quarter of GDP by 2040. Under my plan we would already be saving about 1.9 percent of GDP in entitlement spending by

2004; by 2040 we would be saving 5.3 percent of GDP, or some \$690 billion in today's dollars—more than twice what we now spend on the Pentagon. That's what I mean by structural spending cuts.

We must invent a new entitlement system that will not just pay us affordable benefits when we need them but will also encourage us to save more for the future, care better for our own children and parents, and take more responsibility for our own health. As America itself grows old, perhaps the most vital changes in our entitlement system will be those that encourage a positive new vision of aging. Entitlements for the elderly must promote an active, economically self-sufficient lifestyle for elders who are able. We will no longer be able to afford a system that equates the last third or more of one's adult life with a publicly subsidized vacation.

Getting our entitlements system back on a sound footing is the key to both a balanced budget and a renewed rise in U.S. living standards in the next century. But of course, putting our fiscal house in order will require much, much more. There is still room for trimming in the small discretionary domestic corner of the federal budget. I also believe that in this post-Cold War world we can spend substantially less on defense, and I endorse the President's proposed cuts. To balance the budget by the year 2000, and at the same time spend more on worthy public goals, from more-generous targeted assistance to the poor to productivity-enhancing investments in human capital, research and development, and infrastructure, we will also need to raise new revenues above and beyond the tax increases President Clinton has already proposed. Along with a broad-based progressive consumption tax, I recommend higher "sin" taxes and a fifty-cent-a-gallon federal gasoline tax phased in over five years, in order to target a particularly profligate type of consumption. But in the end, unless we are willing to touch the third rail of American politics and rein in the growth in middle- and upper-class entitlements, our goal will elude us.

The worst aspect of our entitlement addiction is how it subtly fixes our attention on how much we are going to get—and how it obscures any thought of what we have received from others and what we wish to pass on in our turn. In this sense our entitlement ethos pervades not just our public benefit programs but our entire approach to deficit-financed consumption. It is time for America to begin unlearning its entitlement ethic and begin relearning its endowment ethic. At some point we must decide how much we are willing to give up today in order to save for and invest in a tomorrow of rising living standards for ourselves and, of course, our children. The alternative—a future without an American Dream—is no alternative at all. □

THE WHITE HOUSE

WASHINGTON

October 11, 1993

MEETING WITH YOUR PRINCIPAL ECONOMIC AND POLITICAL ADVISERS

DATE: October 12, 1993
LOCATION: Cabinet Room
TIME: 9:30-10:30 a.m.
FROM: Robert E. Rubin

I. PURPOSE/BACKGROUND

You will meet with your principal economic and political advisers to discuss the October package, including the NPR cuts, the Kerrey Commission and the Balanced Budget Amendment.

II. PARTICIPANTS

The President	David Gergen
The Vice President	George Stephanopoulos
Secretary Bentsen	Howard Paster
Secretary Brown	Jack Quinn
Secretary Reich	Roger Altman
Robert Rubin	Alice Rivlin
Mack McLarty	Bo Cutter
Laura Tyson	Gene Sperling
Leon Panetta	John Podesta
Carol Rasco	
Tony Lake	

III. PRESS PLAN

No press coverage.

IV. SEQUENCE OF EVENTS

Discussion of October package, Balanced Budget, and Kerrey Commission.

V. REMARKS

None required.

October 11, 1993

MEMORANDUM FOR THE PRESIDENT

FROM: LEON PANETTA AND BOB RUBIN

SUBJECT: Fall Budget Issues to be Discussed with Democratic Leadership:

Attached are three separate memos on the main issues that we will need to discuss with the Democratic Leadership:

- Balanced Budget Amendment to the Constitution;
- Budget Savings Commission; and
- October Savings Package

The NEC, your inside political advisers, and in some stances the Vice President and Mack McLarty have had several meetings on these issues, which will be the topics for the meeting planned at 9:30 a.m. in the Cabinet Room on Tuesday, October 12th. (The NEC, as used herein, refers to the core members, to wit, Secretaries Bentsen, Reich and Brown, Director Panetta, CEA Chair Tyson, DPC Assistant Rasco and NEC Assistant Rubin, along with appropriate deputies.)

BALANCED BUDGET AMENDMENT

- A. **ISSUE FOR DECISION:** We must soon choose whether to support the Simon-Stenholm Balanced Budget Amendment to the Constitution, which is likely to come before the Congress in November. It would:
- Require that the budget be balanced each year, beginning either in FY 1999 or two years after ratification by three-fourths of the States;
 - Require a 60 percent roll-call vote of the full Membership (as opposed to those present and voting) of both Houses, to allow a budget deficit or any increase in the National debt limit;
 - Allow a revenue increase only through a majority roll-call vote of the full Membership of both Houses; and
 - Permit a majority vote waiver during military conflict.
- B. **ARGUMENTS IN FAVOR**
1. ***Need for Discipline of Budget Balance:*** Some argue that budget balance is the right target from an economic standpoint. But even others who see nothing sacred about a deficit of precisely zero believe that there is no real discipline without some precise target, and believe that zero is the number with the most appeal.
 2. ***Forces Tough Choices:*** Even though a Balanced Budget does not itself call for making the tough choices, it serves as a self-imposed club that will force Congress into a context where they will have no choice but to make tough choices. Some argue that the Constitution, more than any law, would motivate the Congress to make the difficult choices necessary to balance the budget. The difficulty of enactment of the FY 1994 Reconciliation Act, which did not take the budget all the way to balance, is cited as evidence.
 3. ***Maintain Anti-Deficit Image:*** Your opposition to an Amendment that carries a popular message could cloud your reputation for deficit reduction. Some may see opposition to a Constitutional Amendment as a retreat from your earlier deficit reduction effort. This point may be stressed by active deficit reduction spokespersons and groups.

4. ***The Horse is Out of the Barn:*** Some believe that the Amendment is already unstoppable, and that there is no point in expending political capital against it, especially if it may detract from the public gains you made by passing the largest deficit reduction package of all time.

C. **ARGUMENTS AGAINST**

1. ***Exaggerates Economic Cycles:*** When the economy is weak, the deficit goes up, tax revenues fall (because incomes are lower), and spending rises (for unemployment compensation, welfare -- even Social Security for laid-off older workers who cannot find new jobs and so retire early). These are the "automatic stabilizers" that have been credited as preventing the nation from ever falling again into a serious depression. The amendment language calling for "total outlays for any fiscal year not to exceed total receipts for that fiscal year" reflects a legislative intent to have balance during each year, and not just a five-year balanced budget plan. This means that implementing legislation would require constant adjustments to keep the budget in balance.

Although the draft Amendment allows a 60 percent roll-call-vote waiver, it is not likely that Congress will feel compelled to break their constitutional obligation without strong proof that the economy is already in decline. Members of Congress could posture as being tough against the rising deficit and make things worse. Furthermore, we typically realize that the economy is turning down only after the fact; by that time, we may already have made things worse by trying to comply with a balanced budget requirement.

Balancing the annual budget means freezing the national debt at its current level in absolute terms, not simply reducing it relative to GDP. That's an odd goal in an economy which is getting bigger and bigger in dollar terms year after year. Consumer debt, business debt, mortgage debt, etc. all grow over time in a growing economy. Why should government debt be different? Twenty-five years ago, the national debt held by private investors was \$150 billion, which was about 18% of GDP. If we still had that much debt outstanding, it would be just 2.4% of GDP. We might well want the debt-to-GDP ratio to fall, rather than remain constant at its current level. But that does not require a balanced budget.

2. ***Reducing Two Deficits:*** This proposal would nearly eliminate any chance of any meaningful additional investments over the next several years. The Simon-Stenholm Balanced Budget Amendment calls for a balanced budget in the later of two years after the passage of the bill or FY1999. With our current economic plan, we would need an additional \$223 billion in deficit reduction in that one year alone. It would not seem politically or economically tenable to simply follow our current path to FY1998, and then look for a whole set of new policies that lower the deficit by \$223 billion in FY1999 alone. The implementing legislation required under the Amendment would almost certainly require the President to come forth with a substantial amount of new

deficit reduction on top of our current plan, in the order of \$500-\$700 billion more between FY1995 and FY1999. Any notion that passing the Simon Balanced Budget Amendment would take us off the hook for several years would seem unlikely. In a scenario in which the Administration and Congress would be under severe pressure to cut Social Security and Medicare benefits for the middle class and raise middle class taxes, the chances of channeling savings to new investments, would be severely impaired.

Furthermore, this would put the Administration in a position where the President is compelled to put forth Social Security cuts and middle-class tax increases, and Congress has the option to reject them with a 60% vote.

An example of a plan to get this degree of deficit reduction is the recent Concord Coalition proposal. They ask for only \$10 billion in new investments, while calling for a 50 cent gas tax, an additional \$20 billion per year in sin taxes, means testing of all entitlement programs including Social Security and Medicare (affecting 42% of Americans who receive those benefits), an increase in the Social Security Retirement age, and major reductions in overall Medicare benefits. Yet, these savings do not assume the passage of our health care plan. If these amounts of savings had to be found on top of health care, even tougher measures would have to be passed.

3. ***Commitment to Health Care:*** Since large middle-class taxes will be highly unpopular as a means to balance the budget, there will be an effort to get everything possible out of entitlement savings. This will make health care quite vulnerable in two ways. One, with the passage of a balanced budget amendment, it will be difficult to re-allocate \$238 billion in Medicare and Medicaid savings to health care, and two, if most entitlement savings are dedicated to the balanced budget amendment, it will be highly difficult to add new entitlements such as prescription drugs and long-term care in the foreseeable future.
4. ***No Distinction Between Investment and Consumption:*** A \$1 of reduction in excessive health care spending is treated exactly the same as a \$1 reduction in the best investment in technology, defense conversion or Head Start. When cuts have to be made, in fact, we know that it is far easier to cut new programs that have not been implemented -- and thus have no established constituency -- than to cut existing programs where there are jobs, expectations and entrenched political interests that will protect the status quo.
5. ***Gimmicks Cannot Replace Leadership:*** A Constitutional Amendment has always been viewed as a "gimmick" to allow leaders to hide from the tough choices that must be made to reduce the deficit. Presidents who had to face deficits in the past (Jackson, Wilson, Truman, etc.) did not have a Constitutional Amendment to do what was right.

6. ***A Proposal to Have Budget Policies That Were Fair To The Middle Class:*** There is no conceivable proposal to balance the budget by FY1999 without serious cuts in Social Security, Medicare and middle-class tax increases, as well as cut-backs on plans to help those who are most disadvantaged.
7. ***Degrades the Constitution:*** The Constitution defines the rights of citizens and the role of government. It does not dictate economic policy. To so use the Constitution would throw difficult issues into the Federal courts. Several noted conservative jurists see this danger; former Judge Robert Bork has called such an Amendment "a vain hope or a dismal prospect."
8. ***Minority Rule:*** The supermajority requirements in the Amendment would allow a politically motivated or economically unsophisticated minority (perhaps a united minority party?) to prevent any President from moving his economic program.

IV: RECOMMENDATION:

1. Policy Decision: The NEC unanimously and decisively opposes the Simon Balanced Budget Amendment for the reasons mentioned above. Your policy advisers, such as George Stephanopoulos and others, also concurred in these judgments. David Gergen stated that he had supported a balanced budget amendment prior to taking his current position. He feels it has merit as a tool to force Congress to make tough choices that they have been unwilling to make. David did not recommend, however, that you support this balanced budget amendment now, in light of the severe choices that would have to be made to achieve the balance.

2. Political Decisions: If you concur in the decision to oppose the balanced budget amendment, there are remaining decisions that have to be made.

Intensity of Opposition: There was some political concern that an active fight against the balanced budget amendment will create a false impression that you are not intense in your efforts to control the deficit. Others felt that it was better politically for you to make a principled fight against the amendment, than to risk alienating all sides by passive opposition. In any case, Senator Simon appears so close to the necessary two-thirds majority, and passage would have such onerous effects, that the NEC and most of your in-house political advisers strongly recommend that you wage a strong fight to defeat the bill in the Senate.

Message and Strategy: The main decision seems to be what our message and strategy should be for opposing the amendment. Some argued that this could be used as a vehicle to re-state your overall vision on the need to address both the budget and investment deficits to create economic growth. Your political advisers seemed to believe that this might not be the best context for talking about the economic virtues of public investment. Most (including George S. and David G.) seemed to believe that the best strategy would be to stress your opposition based on the negative policies to

the middle class that would have to be taken in order to balance the budget by FY1999, and challenge people to show you how they would specifically achieve this balance without such unpopular policies. For example, you could state that you oppose this balanced budget because it would devastate health care, require large increases in middle-class taxes and significant cuts in Social Security benefits, and that you challenge anyone to show you differently.

Alternatives: Another issue to be considered is what other budget discipline alternatives are there that would give members of Congress something to vote for if they were going to oppose the balanced budget plan. Options could include some form of capital balanced budget, macroeconomic sensitive entitlement cap, or enhanced rescission. The first two might be too complicated, politically and substantively, to construct at this point, and you need to consult with your Congressional advisors about the viability of the third option.

II. BIPARTISAN COMMISSION ON BUDGET SAVINGS

The majority of the NEC and your in-house political advisers believe there are possible risks from such a Commission. Therefore, we believe we should carefully consider what structural elements might best minimize these risks and preserve Presidential flexibility to the greatest degree possible.

A. Discussions Held with Congressional Leadership

Extensive discussions have been held with Majority Leader Mitchell, Speaker Foley, Majority Leader Gephardt and Minority Leader Michel, as well as Pete Domenici, Bob Kerrey, John Danforth and others on the possibility of a bipartisan commission on budget savings. The general consensus of many of these members of Congress is that such an effort could be helpful in focusing on the issues related to additional savings in entitlement programs. We also need to consider how much such a Commission's mandate should review tax and revenue issues, if at all.

Attached is a brief description of a proposed Bipartisan Commission on Budget Savings (Attachment #1).

B. Issues Related to Commission

Discussions have been held about the Commission with a number of senior White House staff members. Those discussions have identified a number of key issues related to the Commission, regarding minimizing risk and preserving the Administration's flexibility, including:

(1) the role of the Administration -- how closely should the Administration be identified with the Commission? Some key questions:

-- Should members of the Administration be appointed to the Commission?

-- Should the Commission report to the President or to the NEC or to some other Administration group appointed by you, which could serve as a forum for review before transmission to the President?

(2) impact on 1995 Budget -- Senator Kerrey has supported a December 1, 1993 reporting date for the Commission, so that the Commission's report could be considered in the 1995 Budget. Such a report would come late in the process. Moreover, we can't know at this time if we would want to include its recommendations. Key question:

-- Should the Commission's report be available in time to consider including it in the 1995 Budget, or should it report after the Budget and/or after the budget resolution?

(3) role of Congressional leadership -- Senator Mitchell has expressed interest in serving on the Commission, while Speaker Foley seems somewhat reluctant to serve. Key question:

-- Do you want to have the Congressional leadership on the Commission to enhance control of the Commission, recognizing that this might make the Commission's work even more difficult to reject than it would otherwise be?

(4) majority vote or supermajority vote -- Senator Kerrey supports a requirement for a majority vote for Commission recommendations. However, this would make it easier for Republicans to stonewall and avoid responsibility for any decisions by the Commission. A supermajority requirement would ensure that recommendations had broad political support, but would also increase the possibility that the Commission would deadlock or revert to simple solutions, such as caps. Key question:

-- Should the Commission be required to have a supermajority to make recommendations, or is a simple majority sufficient?

(5) type of recommendations -- some concern has been expressed that the Commission would push for entitlement caps, rather than specific programmatic policy changes. Key question:

-- Should the Commission be required to make specific recommendations on a programmatic basis?

(6) taxes -- Senator Kerrey and Senator Danforth believe the Commission should look at taxes along with entitlement and mandatory programs. Key questions:

-- Do you agree that the charter of the Commission should include tax issues?

-- If so, should the Commission be required to consider the impact on progressivity of any tax recommendations?

C. Bringing the Issue to Closure Within the Next Two Weeks

1. Meet with Democratic Leadership

In appropriate meetings with Majority Leader Mitchell, Speaker Foley and Majority Leader Gephardt, we should discuss establishing such a commission, the political and legislative risks associated with such an effort, and how to control those risks. You might not want to be at those meetings yourself, unless needed at the end.

III. ELEMENTS OF OCTOBER PACKAGE FROM NPR

As you know, the Administration is planning to send to the Congress a package of deficit reduction proposals later this month. This package, which we hope will total at least \$9 to \$12 billion over five years, plus procurement reform estimated to be scoreable between \$2.0 to \$5.0 billion, will consist of ideas generated by Vice President Gore's National Performance Review and by rescissions of FY 1994 appropriations bills. The Vice President, the National Economic Council, and your in-house political advisers have had preliminary discussions about the NPR savings options, and have reached a unanimous recommendation except for one item mentioned below. The results of those discussions are presented here.

1. Procurement and Personnel Reform

Discussions are currently underway between the Administration and the House and Senate Government Affairs Committees on a procurement package to be introduced in the next few weeks. We will be asking the Congressional Budget Office to score the package once final agreement is reached.

The Administration has sent to the Congress a "buyout" proposal (this will also be included in the October package) offering Voluntary Separation Incentive Payments of as much as \$25,000 to selected workers who leave government service. In the House the bill has been introduced as H.R. 3218. Hearings on the bill in the House have been scheduled, and it is our hope that the measure will pass the Congress before adjournment.

2. Rescissions

OMB has begun the process of identifying potential rescission items for inclusion in the October package and we will need to discuss these with you within the next ten days.

3. Savings

Together with the Vice President, the NEC and your in-house political advisers have reviewed the NPR and identified almost forty proposals based on good public policy which we believe should be presented to the Congress. Below, under section A are examples of several items which were included without much disagreement or discussion, which would total approximately \$7 billion over five-years.

Under Section B, are a number of additional NPR proposals which are more controversial and problematic, of which you need to be aware and which should be discussed with the leadership. While there is a unanimous recommendation on all of these issues (except the highway demonstration projects), we want to make sure you are fully apprised of the arguments for and against each policy choice so that you feel comfortable with each decision.

A. Examples of Less-Controversial Items Recommended for the October Package:

- ending the wool and mohair programs
- eliminating Federal support for the honey program
- reorganizing the Department of Agriculture
- streamlining HUD operations
- increasing Department of Justice debt collection
- closing VA supply depots
- selling the Alaska Power Administration
- reforming the Federal Helium program
- streamlining the VA benefits claims process
- allowing HCFA contracting out

While some of the proposals in the Base Package will be opposed by some members of Congress, we believe they are defensible, and we recommend that they be included in the October package.

B. Recommendations for Your Special Attention:

● **Reduce Essential Air Service Subsidies:** This proposal would prohibit subsidies to airports in small communities which are within 70 miles of hub airports; 28 airports would lose subsidies. The House and Senate have already endorsed cuts in this program, and we believe it would be appropriate for the Administration to propose this relatively modest change.

● **Streamline Army Corps of Engineers:** Secretary Aspin is currently reviewing an Army Corps of Engineers streamlining plan proposed by the Bush Administration. Any such plan would be highly controversial with members of Congress who would lose Corps offices or headquarters in their districts. Rather than submit a specific plan in the October package, we could propose legislation directing the Corps to develop and implement a plan which would achieve a set amount of savings.

● **Power Marketing:** This proposal would require the Bonneville Power Administration based in the state of Washington to buy out its debt to the Federal government. Any debt buy-out proposal is likely to result in increased rates for consumers in the Northwest, and will be strongly opposed in the Congress. We are continuing to explore ways of achieving scoreable savings in this program without raising rates.

● **Social Security Disability Claims:** This proposal requires intensive review of disability claims by the Social Security Administration with the goal of removing beneficiaries from the rolls who are no longer disabled. While there is clearly fraud

and abuse in the Social Security Disability rolls, it is a controversial proposal because the Reagan Administration did this in a crude fashion that was seen as leading to publicized stories of unjust removal of truly disabled people. We recommend exploring ways of increasing the review of beneficiaries without adopting the full NPR proposal. This would require new funding and personnel.

● **Highway Demonstration Projects:** The NPR proposed eliminating all highway demonstration projects. There is not a consensus in the NEC on this issue. Some of your advisors propose that we cut the number of projects cut by targeting those which have been appropriated without being authorized. This would still allow for \$600 million in deficit reduction. Yet, even this more limited cut is seen as inadvisable by some of your in-house political advisers. This is a matter we need to discuss.

4. House and Senate Procedure

In the House of Representatives the October package will be distributed to the appropriate committees. After committee consideration, the various elements will be packaged by the Rules Committee for a vote on the House floor. In the Senate, one committee – the committee with the preponderance of the legislation under its jurisdiction – will be asked to consider the package. Issues not in this lead committee's jurisdiction will be considered as amendments to the bill reported by the lead committee once that measure reaches the Senate floor. It is hoped that the October package will pass the Congress before adjournment.

5. Distribution of Savings

We are looking at proposing an October package that would total \$13–15 billion, assuming that approximately \$3 billion is scored for procurement. At the close of the last meeting of the Vice President and the NEC, there was a tentative agreement that:

- 1) a \$13.5 billion package be proposed, in which \$10 billion would be for deficit reduction and \$3.5 billion in discretionary spending savings would be for funding the crime package, so that the NPR savings would ensure that this initiative was funded under the tight caps, and
- 2) that we would insist on preserving the \$3.5 billion for crime, even if items in the deficit reduction package were stricken.

The following are the highlights of a draft of an executive order creating a "Bipartisan Commission on Budget Savings."

Establishment

- o The Commission would be made up of 30 members to be appointed by the President. Ten members would be Senators and ten would come from the House of Representatives. The Democratic and Republican parties would be equally represented. Ten other members would be individuals who have experience and expertise in the areas to be considered by the Commission. An additional option is to appoint the House Speaker and Minority Leader and the Senate Majority and Minority leaders to the Commission as non-voting ex-officio members, bringing total membership up to 34. A further option would be to include the House Majority Leader, bringing the membership to 35 (an odd number), although there would then be 11 members from the House, compared to 10 from the Senate.
- o The President would designate a Chairperson and Vice-chairperson from among the members of the Commission.

Function

- o The Commission would recommend potential long-term budget savings measures in entitlement programs and the tax system by December 1, 1993.
- o Majority vote would decide which recommendations to include in the report. The report would include dissenting views of any member upon request.
- o The Commission could hold hearings.

Administration

- o The Commission would be able to request information to support its work from executive departments and independent entities and the Commission chairperson could request the detailing of personnel to the Commission.
- o Members of the Commission would serve without compensation, however travel expenses and a per diem could be provided private citizens on the Commission.
- o A Federal department would be designated to provide the Commission with administrative services, funds, facilities and other support services.
- o The Commission would disband 30 days after submitting its report to the President.

THE WHITE HOUSE

WASHINGTON

93 DEC 21 P 2: 35
December 21, 1993

MEMORANDUM FOR SECRETARY BENTSEN

SECRETARY BROWN
SECRETARY REICH
LEON PANETTA
LAURA TYSON
CAROL RASCO
TONY LAKE

FROM: ROBERT E. RUBIN *ER*
SUBJECT: 1994 Agenda

The President, a couple of weeks ago, returned the attached summary memo on our low-budget impact economic ideas, with a note that he wanted a meeting on this. In view of his December schedule, that meeting won't be held until January.

Meanwhile, it seemed like a good idea to meet to see which of those initiatives had enough support to begin work now, and to decide who should do what.

In addition, we could talk about our agenda for 1994 -- what we think the economic team should be focusing on. Some items would be determined by events already scheduled or likely to happen, e.g., the March G-7 jobs conference, the need to combat the balanced budget amendment, the economic component of the Western Hemisphere Conference, the automobile initiative, and the 1996 budget process. Others would be ideas for initiatives by us, e.g., an analysis of the concept of regional economic strategies, for which CEA is already preparing a framing discussion document, or a more fully developed inner-city strategy. Obviously, many of the things on our agenda will be handled jointly with an appropriate other policy council.

Finally, we could review the list of existing working groups, and see if any should be deleted.

Sylvia Mathews will prepare an agenda for this meeting. You might refer thoughts for that agenda to me or to her, and she also will be in touch with your chief of staff on this.

I would guess that this undertaking will require several meetings, but we'll know better after our first meeting. Hopefully, this process will help us plan better for what we know is coming, continue coordinating effectively, and stimulate creativity.

This memo is also being given to the President and Vice President, to see if they have any items they would like to put on our agenda.

Attachment

cc: Mack McLarty, David Gergen & George Stephanopoulos

Needed: A Budget Policy

By HERBERT STEIN

We are entering a new federal budget cycle, as the administration works on the budget it will submit in January. This will initiate another round of discussion in Congress and among the public. It will be an opportunity for the administration and the rest of us to raise the level of thinking about what the standards, objectives and procedures for dealing with a budget of \$1½ trillion should be. Certainly the administration should be able by then to approach the subject in a more mature way than it did when it presented a budget just after entering office.

We used to have a standard: a balanced budget. Then for a while we seemed to have a standard that the budget deficit should be big enough to keep the economy at full employment. At times I thought we were approaching a standard that seemed to incorporate the best of both these ideas—the standard of balancing the budget as it would be at full employment. That is all gone with the wind.

Past Practice

I do not think one will find anywhere a statement of what our present policy is, but one might deduce something like this from the practice of the past dozen years:

The American people do not insist that the budget be balanced. They do, however, like to think that they and their representatives in the government are on the side of balancing the budget. So our representatives follow a policy that is sufficient to make their constituents believe they are for balancing the budget, or at least substantially reducing the deficit, while imposing the least possible visible pain in the form of higher taxes or lower government benefits.

Out of this we get five-year deficit-reducing programs—Gramm-Rudman I, and Gramm-Rudman II, and the 1990 Budget Package and the 1993 Budget Package. But these programs do not contain any commitment to specific revenue or expenditure decisions that would yield the promised result. About halfway through the five-year period it becomes apparent that the budget is far off the promised path. Then our representatives do the whole thing over, assuring voters that they really are on the side of the balanced budget. We will probably be ready for another dose by the end of 1995.

This may not be the worst of all possible policies. It does, of course, leave deficits that almost everyone thinks are too big. But, contrary to many fears, the deficits did not prevent recovery from the deep recession of 1981-82 and apparently are not preventing recovery from the mild recession of 1990. They did not prevent a consid-

erable reduction of the inflation rate. And the public seems to be satisfied, or at least not so dissatisfied as to turn out of office the governments that behave like that.

But I do not believe this is a good way to arrive at the size of the deficit. It leaves us constantly in the position of failing to achieve what we constantly say is a high-priority objective—namely to balance the budget or greatly reduce the deficit. That persistent failure and hypocrisy cannot be good for the national morale. The present mode of behavior about the budget provides no basis for confidence that we will not yet run into deficits of a size and duration that will be seriously damaging to the economy. And even if the present policy does conform to the public's preferences, no one can deny

Board of Contributors

Simply to reject the budget-balancing amendment is not enough. We should also recognize the risks of our lack of a standard and try to formulate something better.

that the public's preferences on this subject are terribly ill-informed.

Decisions about the deficit are made without any attempt even to describe what the consequences of the decisions might be. For example, earlier this year President Clinton proposed a \$500 billion deficit reduction package. He never explained why it was \$500 billion rather than \$250 billion or \$750 billion. He never tried to tell us what the benefits of a \$500 billion package might be and what the costs of the tax increases and expenditure cuts needed to bring about the \$500 billion deficit reduction might be. Nor did he try to tell us why he thought that the benefits would equal or exceed the costs.

I do not think such questions were ever raised in Congress. Five hundred billion dollars seems to be accepted as the size in which deficit reduction packages come these days—big enough to look serious but not so big as to seem outlandish. If it is true that the American people at least tolerate what is going on, it is also true that they don't have the faintest idea of the consequences—and neither do most of their decision-makers in the government.

There are people who will say that we can and should establish a policy of continuously balancing the budget. A proposal for a constitutional amendment to enforce that will come up again, for the umpteenth time, next year.

The arguments against the balanced budget amendment are clear and strong:

1. Requiring the budget to be balanced each year would be destabilizing to the budget and possibly also to the economy.

2. Even requiring the budget to be balanced in the long run may be inconsistent with other national objectives.

3. There are many definitions of "the budget," and no one knows which is the one that should be balanced, if any.

4. The discipline sought through a balanced budget amendment can be evaded by extrabudgetary devices, like mandates, that can affect the allocation of output and the distribution of income much as budgetary expenditures and revenues do.

5. How the requirement of a balanced budget would be enforced on the president and Congress is unclear.

6. Many issues that should be decided in the political process would be forced into the courts.

7. Anyway, the whole thing is a big cop-out by politicians who want to be known as budget-balancers but do not want to do the specific things that are required to balance the budget.

But—when all that is said one still has to ask the old question. Compared to what? Do those who, like the president and me, oppose the amendment have a better alternative?

The earlier postwar standards, whether fine-tuning or full-employment balance, were aimed at the concern of an earlier period, which was mainly for the stability of the economy. Now we know that the budget deficit or surplus has other objectives to serve. Today we need a standard that reflects our present concern with the growth of the national income and its allocation among uses and persons, of this generation and future ones.

Four years ago I wrote a book, "Governing the \$5 Trillion Economy," in which I tried to describe a way of thinking and a procedure that would yield a budget deficit or surplus reflecting explicit consideration of real costs and benefits, and without a prior assumption that the optimum size of the deficit is zero. Other economists, including Laurence Kotlikoff of Boston University and Robert Eisner of Northwestern, also have developed more functional standards of budget policy, al-

though their proposals differ from mine.

My purpose here is not to plug my proposals for a budgetary standard, or anyone else's. My point is that simply to reject the budget-balancing amendment is not enough. We should also recognize the risks of our present standard, or lack of a standard, and try to formulate something better.

Sometimes when I have tried to direct the attention of people to the need for a budgetary standard they have replied, "Oh, yes, that's very interesting, but we know what the main problem is, which is to reduce the deficit, and we don't want to distract attention from that by bringing up longer-run and more general considerations." The fact is, however, that we are not balancing the budget or reducing the deficit very much. The notion of balance first and standard later is mistaken. Balancing the budget is a flag that everyone feels obliged to salute but no one feels obliged to follow. Probably we will not make headway toward balancing the budget, if that is the desirable goal, until we can show how that is required by some general policy whose practical utility we can understand and explain.

A Functional Standard

The idea of establishing a functional standard of budget policy is obviously not high on the national agenda. One cannot expect the administration to push it. Administrations do not like sophisticated budget standards that can serve only to limit their freedom of action. President Reagan and President Bush did support the balanced budget amendment, but I think that was less a limit they expected to live with than a way to get gold stars with a fraction of the voters while fastening blame for deficits on Congress.

If the way we think about deficits and determine their size is to be substantially changed, the initiative will probably have to come from outside the government. That would not be unusual. Much of the impetus for reform of federal budgeting in the past has come from the private sector, starting with the drive for an executive budget more than 80 years ago. We may yet get tired of our five-year budget packages that start without principle and end without result, and also of our biennial wrestle with that attractive nuisance, the balanced budget amendment, and get down to serious thought about how to make budgetary decisions that serve today's real national objectives.

A former chairman of the president's Council of Economic Advisers, Mr. Stein is an American Enterprise Institute fellow.

THE WALL STREET JOURNAL MONDAY, NOVEMBER 29, 1993

THE PRESIDENT HAS SEEN
12.9.93

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THE PRESIDENT HAS SEEN 12/3

December 2, 1993

MEMORANDUM TO THE PRESIDENT

From: Gene Sperling

Subject: 11 Signs of Recovery

Below are 11 statistics that Alan Blinder, Ev Ehrlich, Joe Minarik, Sylvia Mathews and myself believe best express the good news in the economy. While we still must stress that our problems and solutions are long-term and that people are still hurting, there is no denying that we are now experiencing consistent signs of a firm recovery. (The unemployment number will be out tomorrow.) Certainly an area where we need improvement is exports, yet that reflects both why we are taking the trade steps that we are and the need for strong world economic growth.

1. PERSONAL INCOME IS UP: Today, it was announced that personal income is up 6% up over the last month; non-farm personal income has risen 9 months in a row.

2. PRIVATE SECTOR JOBS IN NINE MONTHS SURPASS THE LAST FOUR YEARS: There has been 1.27 million private sector jobs created over the last nine months -- more than 250,000 private sector jobs than were created during the previous four years.

3. HISTORIC LOW INTEREST RATES:

10 Year Rates: One year ago, 10 year interest rates were at 6.94; today they are over a full point lower at 5.82.

30 year rates: One year ago, 30 year rates were at 7.57. Today, they are over a full point lower at 6.28.

Mortgage Rates: Are down a full point from last year to near 7% -- a 25 year low.

4-7. LOW INTEREST RATES DUE TO THE SUCCESS OF OUR DEFICIT REDUCTION PLAN IS SPURRING AN INVESTMENT-RECOVERY:

4. HOUSING: Housing Starts now 13% in the last 3 months. Single family starts are at highest level in over 6 years. Construction spending is up 10% over the previous years spurred by 25 years low mortgage rates. Existing home sales were at the highest in 14 years.

5. DURABLE GOODS: Durable goods order highest ever and up 9% over year over year.

6. BUSINESS INVESTMENT: Business spending on equipment is up 15% over the last year.

7. AUTO SALES: Auto sales are up 13% in the last 12 months.

8. MANUFACTURING: National Association of Purchasing Management's index in November rose to 55.7% a strong sign of expansion in manufacturing.

9. CONSUMER CONFIDENCE IS PICKING UP: The Conference Board's Consumer confidence was up by a sharp 18% in November.

10. INFLATION IS AT HISTORIC LOWS: Core Inflation for the last 12 months were the lowest in 20 years -- to a time of price controls. Core PPI the last 12 months lowest since starting collecting the data in 1974.

11. RETAIL SALES: We have had seven straight months of increases in retail sales -- up 6% over the last year.

JP

THE WHITE HOUSE
WASHINGTON

DATE: 11/29/93

NOTE FOR:

BOB RUBIN

The President has reviewed the attached, and it is forwarded to you
for your:

Information ☐

Action ☒

Thank you.

JOHN D. PODESTA
Assistant to the President
and Staff Secretary
(x2702)

cc:

THE WHITE HOUSE
WASHINGTON

November 24, 1993

11:23 P5:23

MEMORANDUM FOR THE PRESIDENT

FROM:

ROBERT E. RUBIN

SUBJECT:

Reich Memo on Meeting with Business Leaders in the Wake
of NAFTA

*agree in reservation
but need a bus alliance*

As always, Bob Reich's thoughts are a valuable contribution; however, on this particular suggestion, I disagree with him.

The business community has enormous respect for your efforts on NAFTA, but, based on a lot of recent conversations, I do not think the NAFTA effort will gain us much on our other policy efforts. That doesn't mean you aren't in a better position to try -- I think you are -- but suggestions of assessments, as in Bob's memo, could have an adverse impact on business attitudes towards us.

Last week, I met with Hillary to discuss a possible business strategy on health care, based on my recent conversations, and I will be following up with her in a memo this week.

✓ Bob Reich thinks this is an idea of sufficient merit for discussion and I agree. He also says that the training piece is less than most medium and large companies already do.

agree with your
reservation but need
a business alliance.

U.S. DEPARTMENT OF LABOR

SECRETARY OF LABOR
WASHINGTON, D.C.

NOV 22 1993

22 29:12

MEMORANDUM FOR THE PRESIDENT

FROM: Labor Secretary Robert B. Reich *RB*
VIA: Bob Rubin
Mark Gearan
David Gergen
George Stephanopoulos
SUBJECT: The Jobs Agenda: Meeting With Business Leaders in
Wake of NAFTA

While the NAFTA cauldron still bubbles, it would be useful, I think, for you to summon to the White House business leaders who supported NAFTA (the USA-NAFTA coalition) and ask them to "sign up" for the Administration's jobs agenda. I attach a possible outline.

The Unfinished Jobs agenda After NAFTA

1. You leaders of American business helped me explain to the American people why NAFTA will mean more jobs, and better-paying jobs in America, and for that I thank you.
 2. The debate over NAFTA revealed something we all know: Although NAFTA and other market-opening agreements will create more and better jobs for Americans, many working Americans are reluctant to embrace such new opportunities because they are worried about their jobs. Average wages of non-supervisory workers have been dropping since 1976, and (adjusted for inflation) are back to where they were in the late 1960s. Meanwhile, jobs are less secure than ever, and average duration of unemployment is longer.
 3. Exports will help create more jobs; and export jobs tend to pay better (17 percent) than non-export jobs because they often demand more skills. But in order for American workers to be able to take full advantage of these new global opportunities, they need to be well-trained.
 4. I need your support for my upcoming initiative to turn our old unemployment system into a re-employment system -- giving Americans the counseling, information, and job retraining they need to get new and better jobs.
 5. Your support and involvement was critical in getting NAFTA passed. It will be no less critical to the second part of the jobs agenda -- upgrading the skills of all Americans. I call on you to take a pledge to:
 - Provide jobs this summer to disadvantaged young people, in numbers equaling at least half of one percent of your total payroll employment. Stay in contact with those young people until they finish high school.
 - Hire youth apprentices directly from high school, in numbers equaling at least one quarter of one percent of your total payroll employment.
 - Upgrade the skills of all your workers. Devote at least 1.5 percent of your payrolls to worker training.
 - Work with your suppliers to get them to devote at least 1.5 percent of their payrolls to skill training as well.
- I will be celebrating American companies which have taken this pledge.

THE WHITE HOUSE
WASHINGTON

November 24, 1993

11:25:10

MEMORANDUM FOR THE PRESIDENT

FROM: ROBERT E. RUBIN *in for REN*

SUBJECT: December Speech

I agree with Bob Reich that it would be very useful for you to make a speech reflecting on the past year and the Administration's overall economic strategy and our successful efforts to implement that strategy during your first year.

Bob Reich's idea of a jobs emphasis is important, but as one consequence of a strategy to create economic growth, not as something separate from economic growth.

THE WHITE HOUSE

WASHINGTON

November 19, 1993

Seattle

Dear Mr. Speaker:

I write to express my strong opposition to the Penny-Kasich amendment to H.R. 3400.

Over the past year, we have taken bold and serious steps to bring down the federal budget deficit and regain control of our economic destiny. We can be proud of the \$500 billion in deficit reduction -- including \$255 billion in spending cuts -- that we accomplished for fiscal years 1994 through 1998. The hard freeze on discretionary budget authority and outlays is the most significant step that has ever been taken to control discretionary spending. Likewise, my executive order establishing targets for mandatory spending (along with the specific mandatory savings contained in the reconciliation bill) is the first real step that has been taken to control unforeseen increases in entitlement programs. Furthermore, we have introduced the most detailed plan ever to provide universal health coverage and control the rise in health care spending -- which is the main culprit in driving up the budget deficit.

With specific regard to fiscal year 1994, we have already achieved, in the budget and appropriations process, savings of some \$12 billion from the 1994 cap on budget authority. That is a major accomplishment. I have also sent to the Congress a 6-year \$9 billion package of additional spending reductions and a \$2 billion fiscal year 1994 rescission bill. I am also supporting efforts to increase these savings as contained in H.R. 3400. The primary changes will be:

(1) increasing the rescission proposal to \$2.6 billion in fiscal year 1994; and (2) a specific requirement to implement the National Performance Review (NPR) proposal to eliminate 252,000 positions from the federal work force. These and other actions will bring the total savings in the package to \$25-\$30 billion, as likely to be scored by the Congressional Budget Office.

In addition to these spending cuts, my Administration is working with the Congress on major reforms in the procurement process to be based on the principles established in the Vice President's NPR. If the legislation follows those principles, we anticipate that the procurement measure will save another \$22 billion over 6 years on top of the \$25 billion-\$30 billion in spending cuts described above.

The Penny-Kasich amendment to this savings package includes many meritorious spending cuts. Indeed, many of them have been proposed by my Administration to finance health care reform and meet the unprecedented spending caps in the recently passed economic plan. As they have included several of our cuts in their package, we will include several of these cuts in either our package or our FY 1995 budget proposal. Yet, despite these areas of common ground, I strongly believe that the amendment should not be passed for the reasons set forth below:

Health Care Reform. In the aftermath of the \$500 billion deficit reduction plan, the largest trouble spot in the federal budget is the spiraling cost of health care. The best single hope for reducing the long-term structural deficit is passage of fundamental health care reform to bring these costs under control. Yet, Penny-Kasich claims over \$40 billion of the potential Medicare savings needed for any serious health care plan. Therefore, it hurts, not helps, our effort to bring the federal deficit down. Denying these savings to health care reform would reduce the flexibility needed for any plan, and fracture the growing consensus for universal coverage and cost containment. The fact that the authors have chosen to modify their proposal by increasing the magnitude of the health care cuts is particularly disturbing.

A Substantial Budget Gap Will Be Created: Our economic plan already requires an unprecedented 5-year "hard" freeze on discretionary spending that will require serious cuts in nearly every part of the budget. This strict spending constraint already puts severe limits on spending, and will require serious cuts in nearly every part of the budget. Indeed, we already need to find over \$50 billion in additional discretionary savings to meet our deficit reduction targets and protect needed investments in fighting crime, defense conversion, infrastructure, training and education and other investments that most Americans believe are essential to economic growth. The original Penny-Kasich proposal would mandate an additional \$53 billion reduction of the discretionary spending caps. Because at least \$20 billion of its specific spending cuts are already included in my plan, Penny-Kasich leaves a \$70 billion gap between the deficit reduction mandate and the savings that are specified. Efforts to close this gap could harm important national priorities.

Defense. We are already undertaking a measured reduction in defense spending, carefully designed to protect our security needs. As defense makes up roughly half of total discretionary spending, the need to close a \$70 billion discretionary spending gap would create pressure for arbitrary defense cuts in force structure, force modernization, training and readiness, base cleanup, and defense conversion that could threaten our national security. Secretary of Defense Aspin and General John Shalikashvili, the Chairman of the Joint Chiefs of Staff, believe that the amendment "duplicates DoD reductions already taken to the current budget levels ... [and] would require cuts to personnel strength that would seriously degrade the support necessary to maintain readiness." In their letter to Congress, the Secretary and General went on to state, that the amendment and that while "[w]e appreciate the enormous pressures that deficit reduction goals have placed on federal spending,... we do not believe this Congress is willing to allow our military forces to become the hollow shells that existed in the late 1970s."

Bipartisan Commission on Entitlement Reform. As you know, I have issued an executive order establishing a bipartisan commission to consider further entitlement reform. I believe that such detailed and deliberate consideration is the better way to address the difficult issues in our complex entitlement programs.

Economic Growth and the Timing of Deficit Reduction. We have already enacted the largest deficit reduction package in our nation's history. While our economy still has a long way to go, the benefits of all of our actions are beginning to show. In the first 9 months of our Administration, the economy has created 200,000 more private sector jobs than were created over the last 4 years. The economic plan has led to historic lows in interest rates and mortgage rates, which are fueling an investment-led recovery while allowing millions of American families to refinance their homes or find better opportunities to buy their first home. Over 90 percent of small businesses are already eligible for new or additional tax cuts due to our economic plan. And starting January 1, 1994, over 15 million American households with full-time workers will receive new or additional tax cuts so that those who work full-time will not have to live in poverty.

While we still must do more to get our economy working for all Americans, recent economic indicators suggest -- and my Secretary of the Treasury and Chair of the Council of Economic Advisers agree -- that our plan provided the right dose of deficit reduction. We should give that plan time to work and not take risks with our now fledgling recovery.

Together, we have made major strides in bringing down the deficit while still taking the steps we need to ensure national security and economic growth. Many of the ideas contained in the Penny-Kasich legislation can help move us in that direction, but for the reasons listed above, the amendment as a whole is flawed and must be rejected.

Sincerely,

A handwritten signature in black ink, reading "Bill Clinton". The signature is fluid and cursive, with a long horizontal line extending from the end of the name.

The Honorable Thomas S. Foley
Speaker of the
House of Representatives
Washington, D.C. 20515

November 18, 1993

Dear Speaker:

I write to express my strong opposition to the Penny-Kasich amendment.

Over the past year, we have taken bold and serious steps to bring down the federal deficit and regain control of our economic destiny. We have passed the largest deficit reduction in history, called for a reduction of over 250,000 workers in the existing federal workforce, put forth a sweeping National Performance review, prepared a commission to investigate further entitlement reform, and introduced the most detailed and comprehensive plan ever to provide universal health coverage while controlling the rise in health care spending that has been the main culprit in driving up the federal deficit.

The Penny-Kasich amendment includes many meritorious ideas for spending cuts that are needed to finance health care reform and meet the unprecedented spending caps passed in the recently passed economic plan. Indeed, many of the spending cuts called for in Penny-Kasich are cuts which have been proposed by my Administration. Despite the merit of these component parts, the amendment is counterproductive to economic growth and deficit reduction in at least three respects, and should therefore not be enacted into law.

Health-care reform. In the aftermath of the \$500 billion deficit reduction plan recently passed, the largest and most profound trouble spot in the Federal budget is the spiraling cost of federal health care spending. The best single hope for reducing the long-term structural deficit is passage of a fundamental health-care reform legislation that can bring these spiraling costs under control. Yet, because the Penny-Kasich legislation claims over \$40 billion of the potential Medicare savings needed for *any* serious health care plan, the Penny-Kasich proposal hurts, not helps, our effort to bring down the federal deficit. Denying the use of these savings for health care reform, will reduce the flexibility every plan needs for passage and fracture the growing consensus in the nation for taking the bold steps necessary for universal coverage and unprecedented cost containment. The fact that the authors have chosen to modify their proposal by *increasing* the magnitude of the health care cuts is particularly disturbing.

Economic Growth and the Timing of Deficit Reduction. The recently passed deficit reduction package is already having a positive effect on our economy. Passage of the plan has led to lower interest rates, enhanced financial stability, and the start of an investment-led recovery, whereby we are spurring ~~our~~ today by right now increasing our investments in tomorrow. Indeed, while we still must do more to get our economy working for all Americans, the economic news of the past few weeks has been most encouraging. That is why I strongly support the views of my Secretary of Treasury and Chair of the Council of Economic Advisors, who have both stated that it makes little sense to run the risk of slowing this fledgling recovery by adding a substantial dose of deficit reduction before we have even

given our current economic growth plan a true chance to work. As we learned painfully during the last few years, slow growth is one of the greatest enemies of deficit reduction, and we cannot take risks with the emerging economic growth we are experiencing.

The Plan Leaves A Substantial Gap in the Budget: Our economic plan already requires a five-year freeze on discretionary spending which will call for serious spending cuts in nearly every major area in the federal budget. Indeed, these reductions are severe enough that we must find over \$50 billion in additional discretionary savings in order to meet our deficit reduction targets and still protect needed investments in fighting crime, defense conversion, infrastructure, training and education. The original Penny-Kasich proposal would mandate an additional \$53 billion reduction of the discretionary spending caps, before we have even shown the American people that we can responsibly meet our current deficit targets without choices that would be destructive to our national and economic security. Since the specific spending cuts in the Penny-Kasich proposal include at least \$20 billion that is already included in my Administration's proposals -- their plan leaves at least a \$70 billion gap between the deficit reduction that is mandated and the new savings that are specified. A plan that leaves such a large gap creates dangers that it will lead to arbitrary cuts in the military budget and reduction in investments crucial to economic growth that will threaten, not strengthen our national security and economic security.

With all respect for the good intentions of the sponsors of the bill, I believe their plan will be counterproductive to the efforts for reducing the structural deficit, while creating jobs and long-term economic growth that all of us want, and I urge all members of Congress to reject their plan.

Sincerely

WJC

THE WHITE HOUSE

WASHINGTON

November 5, 1993

Dear Mr. Speaker:

I write to express my firm opposition to the proposed balanced budget amendment to the Constitution of the United States (S.J. Res. 41 and H.J. Res. 103). While I am deeply committed to bringing down our Nation's deficit, this proposed balanced budget amendment would not serve that end. It would promote political gridlock and would endanger our economic recovery.

The Administration fought hard to pass a historic deficit reduction plan because we believe that deficit reduction is an essential component of a national economic growth strategy. As you know, I worked tirelessly with the Congress to gain passage of the largest deficit reduction package in the Nation's history. This legislation includes a "hard freeze" on all discretionary spending, a virtually unprecedented constraint on Federal spending. Through the National Performance Review, a new rescission package, and a major proposal to limit the growth of Medicare and Medicaid through comprehensive health care reform, we are taking continuing steps to keep the deficit on a downward path. I have also long supported such procedural innovations as enhanced rescission authority or a line-item veto and would consider workable budget proposals that distinguish between consumption and investment. The Bipartisan Commission on Entitlement Reform will come forward with suggestions on controlling entitlement costs and other serious budget reforms. Thoughtful, specific reforms are better policy than a rigid Constitutional amendment.

The balanced budget amendment is, in the first place, bad economics. As you know, the Federal deficit depends not just on Congressional decisions, but also on the state of the economy. In particular, the deficit increases automatically

whenever the economy weakens. If we try to break this automatic linkage by a Constitutional amendment, we will have to raise taxes and cut expenditures whenever the economy is weak. That not only risks turning minor downturns into serious recessions, but would make recovery from recession far more difficult. Let's be clear: This is not a matter of abstract economic theory. Contractionary fiscal policy in the 1930s helped turn an economic slowdown into a Great Depression. A balanced budget amendment could threaten the livelihoods of millions of Americans. I cannot put them in such peril.

Moreover, at presently anticipated growth rates, the deficit reduction required by this amendment could be harmful to average hard-working American families. Supporters of this amendment must be straight with the American people. Given the current outlook for the FY 1999 budget, the amendment would require some combination of the following: huge increases in taxes on working families; massive reductions in Social Security benefits for middle class Americans; and major cuts in Medicare and Medicaid that would make it impossible to pass meaningful health reform legislation. This latter result would be particularly ironic and counterproductive because comprehensive health reform is our best hope not only for providing health security for all Americans, but also for bringing down the long-term structural deficit. The fact that these consequences will not be clear to most Americans for a few years does not relieve us of the responsibility of facing them today.

We must reject the temptation to use any budget gimmicks to hide from the specific choices that are needed for long-term economic renewal. The amendment by itself would not reduce the deficit by a single penny. The only way we can continue to make progress on bringing down the deficit while investing more in our future is to continue the process of making tough and specific policy choices. If we avoid such straightforward debate now, the likely outcome will be accounting subterfuge and gimmicks when the easy promise of a balanced budget amendment runs up against difficult political realities. A gridlocked Congress would encourage members to look for an easy way out -- for example, by moving more Federal programs off budget or by imposing more unfunded mandates on the States. Ironically, the amendment might encourage less rather than more fiscal responsibility.

The amendment's potential impact on our constitutional system is as troublesome as its effect on the economy. The proposed amendments are so vague and complex that budgets quickly could be thrown into the courts to be written by appointed judges with life tenure, rather than the people's elected officials in the Congress. Surely, we can do better than this.

Finally, I believe that economic and budgetary decisions should distinguish between investment and consumption. Those who manage a family budget know that there is a fundamental difference between spending money on a lavish meal, and paying the mortgage on a home that is an investment in one's future economic security. Under this balanced budget amendment, there is no distinction between cutting a dollar in waste and a dollar in a valuable investment in technology that could make us a richer and more competitive Nation in the future. That is unacceptable to me. We need to find ways to reduce the deficit and increase investment in ways that enhance not undermine the economic security and potential of our people and their communities. We must bring down the budget deficit at the same time we make progress on bringing down the investment deficit through investments in those who helped us win the cold war, through more resources to fight drugs and crime, and by giving all Americans the opportunity for quality education and training throughout their lifetimes.

I remain firmly committed to the goal of deficit reduction. But I am just as firmly opposed to this balanced budget amendment, because it would simply delay honest debate over the hard choices needed for long-term economic growth and could imperil the economic stability of the Nation and our fledgling recovery.

Sincerely,

A handwritten signature in black ink, appearing to read "Bill Clinton". The signature is fluid and cursive, with a long horizontal stroke at the end.

The Honorable Thomas S. Foley
Speaker of the
House of Representatives
Washington, D.C. 20515



EXECUTIVE OFFICE OF THE PRESIDENT
COUNCIL OF ECONOMIC ADVISERS
WASHINGTON, D.C. 20500

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THE CHAIRMAN

October 12, 1993

MEMORANDUM FOR THE PRESIDENT

FROM: LAURA D. TYSON JDT
ALAN S. BLINDER AJ

SUBJECT: Further Reflections on the Balanced Budget
Amendment

In our discussion of the balanced budget amendment at today's meeting, you reasoned that balanced budget requirements at the state level were sometimes beneficial because they forced state governments to make tough choices among spending priorities and to raise taxes to fund necessary investments. This is true. But, despite that, state and local expenditures have grown as fast or faster than federal expenditures over the last decade or two.

In evaluating the wisdom of a balanced budget amendment at the federal level, moreover, it is important to keep in mind some critical differences between the responsibilities of the federal government and those of state governments.

First and foremost, the federal government is responsible for the macroeconomic health of the nation. Indeed, the Full Employment Act of 1946--the same piece of legislation that established the Council of Economic Advisers--explicitly charges the federal government with this mission. By forcing fiscal contractions around the time of economic slumps, a balanced-budget amendment would imperil macroeconomic stability in a way that no state balanced-budget requirement can.

Second, the federal government's responsibility for the nation's macroeconomic well-being spills over our borders in that world macroeconomic stability depends, in part, on U. S. policies. Just as we are now complaining that German monetary and Japanese fiscal policies are drags on the world economy, a rapid move toward budget balance in the U. S. would imperil world economic growth.

Third, the federal government is responsible for upholding the integrity of the U. S. Constitution. Many thoughtful observers view a balanced-budget amendment as constitutional graffiti--and a potential source of serious constitutional crises.

Fourth, and finally, the proposed balanced-budget amendment is unlike the balanced-budget requirements of states in that it makes no distinction between capital and operating budgets. By federal definitions, states do "deficit financing" all the time.

We realize that the politics of this issue are difficult and that, in all likelihood, "you cannot beat something with nothing." But the economics here are so overwhelming that we urge you in the strongest possible terms to oppose the amendment.

We have attached a copy of an editorial by Alan Blinder criticizing last year's version of the balanced budget amendment. His arguments apply equally well to this year's version.

Attachment:a/s

DID YOU HEAR THE ONE ABOUT THE BALANCED BUDGET?

BY ALAN S. BLINDER



The latest yuk from Congress is called the balanced-budget amendment. It could wind up making slumps deeper and recoveries more difficult—and that's no joke

It would be comical if it weren't so serious. Yes, fans, the folks who brought you a \$269 billion deficit in fiscal year 1991 and are pushing \$400 billion in 1992 now are poised to pass a constitutional amendment mandating a balanced federal budget. Unless this legalistic lunacy is stopped, it may pass both houses of Congress in a month or two and be sent to the state legislatures for ratification. Since many states are eager to ratify, this abomination could become law in record time.

But why call it an abomination? Isn't the deficit too high? And hasn't the U.S. political mechanism shown itself incapable of dealing with it? The answers are yes and yes, but the constitutional cure is worse than the budgetary cold.

Let me start with the problem that is at once the most obvious and the most serious. As everyone should know by now, recessions swell budget deficits by reducing tax receipts and raising expenditures on items such as unemployment insurance. Under a balanced-budget amendment, Congress would be required to raise taxes, cut discretionary expenditures, or do both whenever the economy weakened—thereby aggravating slumps and making recoveries harder to sustain.

The House version at least limits outlays to estimated receipts rather than actual receipts, so a recession that takes us by surprise would not require a contractionary fiscal response. But the Senate version is based on actual receipts and has no such virtue.

DRACONIAN MEASURES. The recent recession provides a sobering example of how things might work out in practice. In January, 1991, the Administration projected a \$318 billion deficit for the fiscal year ended Sept. 30, 1991. Had the balanced-budget amendment been in effect, Congress would have had to pass spending cuts and tax hikes totaling much more than \$318 billion, because such draconian fiscal measures would surely have deepened the recession and depressed tax receipts further. What was a relatively mild, though long-lasting, contraction might have developed into a whopper. Why inflict this on ourselves?

Supporters note that the balanced-budget requirement could be overridden by a three-fifths vote of both chambers of Congress, with the House version also providing for a waiver in case of declared war. So the amendment could be waived when compliance would be most harmful. That's comforting. But why write into the Constitution something that we routinely expect to suspend?

The problems do not end there. Budget balance is a shibboleth, supported by no sensible economic principle—especially not when gross

domestic product, private debt, and business debt keep growing year after year. And the myopic focus on the federal deficit, to the exclusion of state and local deficits, is curious when the federal government sends the states about \$150 billion in aid each year.

Even if we somehow decided that a deficit of zero is the right target, the current federal accounting system is hardly the best way to keep score. To cite just two examples, it draws no distinction between current operating expenses and capital expenditures—which are routinely separated in state and local budgets. And it fails to recognize that inflation, by reducing the real value of the outstanding national debt, automatically yields *tacit* revenue to the government. Shall we enshrine neolithic accounting practices in the Constitution? Or shall we amend the Constitution each time accounting practices change?

SPENDING LIMIT. Other objections are procedural and constitutional. Under a balanced-budget amendment, Congress might *mandate* actions by others rather than *spend* money itself. More items would surely be moved off-budget. The price, in both cases, would be less oversight and political accountability.

Then, we must remember that America is the most litigious society on earth. Just imagine the lawsuits that would be filed alleging that Congress had violated the amendment in letter or spirit. The prospect of economic policy being made by judges, rather than by Congress, may appeal to some. But it is certainly not the way that powers are assigned by the Constitution.

Supporters claim that most states live with balanced-budget requirements now. Leaving aside the humorous notion that the states are models of fiscal rectitude, this assertion is quite wrong. State governments balance their operating budgets but finance capital expenditures by issuing debt.

The closest thing to a valid argument in favor of the amendment is that forcing Congress to finance all expenditures by taxation would limit spending—an outcome with evident appeal on the political right. But is it true? The fact that state and local spending has grown faster than federal spending for decades should give pause. And there is surely a more straightforward approach with fewer undesirable side effects: Pass a law limiting the growth of spending.

They say you can't beat something with nothing. So, I conclude with my own substitute amendment, combining the two worst constitutional ideas of the 1980s: Let's amend the Constitution to require children to pray for a balanced budget in the schools.

ALAN S. BLINDER IS THE GORDON S. RENTSCHLER MEMORIAL PROFESSOR OF ECONOMICS AT PRINCETON AND THE AUTHOR OF *GROWING TOGETHER*

THE WHITE HOUSE

WASHINGTON

SEP 29 12:57

September 29, 1993

MEMORANDUM FOR THE PRESIDENT

FROM: ROBERT E. RUBIN *for the President*

SUBJECT: **Fall Budget Issues**

As you know, we now face many serious choices concerning a rescission package, NPR savings, unemployment, NAFTA, comprehensive training, welfare reform and the crime bill. In moving forward on these individual decisions, it was the feeling of your advisers that we needed to have some broader direction of how much we wanted to emphasize deficit reduction as opposed to investments in allocating (increasingly) scarce resources.

Last Friday, the Vice President, along with the members of your core economic team and key White House staff (Mack, George, Howard Paster, Carol Rasco, an NSC representative and others) met and had a lively debate on this issue. While there was disagreement over tactics, there was unanimous consent on what our overall direction should be: everyone believed that the Reconciliation plan passed in August satisfactorily met our deficit reduction goals for our current five-year budget period, although over the long-run, more deficit reduction may be needed. Therefore, it was also unanimous that it is now time to turn our energies toward finding savings to fund the investments that make up the second track of the economic growth agenda set forth during the campaign and during your Presidency.

The driving force in this conclusion is that the Administration has a whole panoply of proposed investments that are critical, and, even with great budgetary imagination and discipline, vastly inadequate prospective funding. Also, from a macro-economic perspective, the additional benefit on interest rates and interest rate-generated activity, from further deficit reduction, would either be outweighed by the contractionary impact or not be consequential enough to justify sacrificing important investments. Clearly, such a course would require an extremely well thought out communications and Congressional strategy, to provide absolute assurance to the markets that there will be not a dime of backtracking on our existing deficit reduction commitment, to get full credit for the deficit reduction accomplishment, and to generate understanding and support for the objective of public investment.

There was also strong agreement that the Administration's desire to focus all of our energies on investments was constrained by some degree of commitment to come forth with at least a proposal for additional cuts for deficit reduction.

Therefore we see three fundamental questions that you must resolve:

One, should this Administration, as your economic team and advisers recommend, have a policy preference for locking in our current deficit reduction commitment, but now targeting new and additional savings to investment priorities?

Two, if you agree or disagree with the above recommendation, what is our best strategy for presenting the October package and NPR savings in a way that meets our political commitments while maximizing our investments?

Three, in light of the exceedingly scarce resources we have this year in terms of both time and funds, what should our priorities be, in terms of investment choices and timing, in in terms of various issues, including crime, dislocated workers training and NAFTA?

ISSUE ONE: Additional Deficit Reduction versus Investment Funding -- As discussed above, your economic team and advisers believe, on policy grounds, that we should focus solely on new investments, while recognizing some political constraints to show some effort to find new cuts for deficit reduction.

ISSUE TWO: Strategy for Maximizing Investments -- While there was agreement on our goal of focusing on new investments, there was considerable and lively disagreement over what was the best strategy to attain that goal.

The first question we must be clear on, in terms of our best tactical strategy, is what we are committed to propose for additional deficit reduction -- beyond the rescission --- in October. In reference to an October package, we must determine what you feel your deficit reduction commitment or political requirement is, if anything other than rescission for amounts not used under the 1994 caps. The BA underage will be about \$14 billion. There will be no outlays underage.

During our discussion, there seemed to be agreement that there must be some additional deficit reduction proposed. Even here, there was some disagreement as to whether you send in the most politically difficult or non-scorable NPR proposals targeted to deficit reduction and save the most scorable and achievable savings for deficit reduction, or whether you put your best savings proposals forward to fund investments. Thus, besides considering how much savings should be put into an October deficit reduction package, we also have to consider what types of specific savings we want to target for deficit reduction as opposed to investments.

For the purpose of discussion, we assumed that at a minimum, we must propose a \$10 billion, five-year commitment for deficit reduction above the rescission. The options would be the same in substance, although the number would be different, whatever the level of your commitment. With this assumption in mind, below are listed the three main alternative possibilities, each of which has some advocates and some opponents. As you will see, within each of the main three proposals are some variations as well.

1. Stand-Alone, \$10 Billion NPR for Deficit Reduction Strategy

This strategy is designed to put a modest deficit reduction package alone on the table, as a means of satisfying our additional deficit reduction obligation and creating a context for us to move toward using additional savings for investments. Advocates say either this will pass as is and fulfill the deficit reduction requirement, or the legislation will fail because Congress will not want to take on the difficult NPR decisions; but that, either way, the commitment will have been fulfilled and additional cuts can then be put forth to fund investments. Opponents say the legislation will be amended, to include additional NPR savings, also directed toward deficit reduction, and so nothing will be gained in terms of holding back cuts for investments. It was also argued that a \$10 billion package is too small relative to the NPR initiative, and so will undercut its credibility.

Some advocates say that we should submit the \$10 billion now, for deficit reduction, and save the rest for funding investments in the FY95 budget. This separation provides the best chance of preserving the rest of NPR for funding investments, and that initiatives like displaced workers can be submitted now with the funding being identified in the FY95 budget. (Whether or not that meets NAFTA-related political needs is another question).

There is also a question of what should be included in the deficit reduction package. Some would say, put the most politically difficult proposals in this package, and save the most achievable and most scorable ones for crime or worker training; and if they want deficit reduction bad enough, they will pass it. Others would say, we should put the best scorable NPR proposals in the deficit reduction package to make sure that it passes. Others would say, stress procurement reform, which may be passable and popular but not scorable.

2. Submit a \$24 billion NPR package, with a 50/50 split for deficit reduction and investments

This strategy would involve calling for one larger package and then aggressively setting forth the full case for now turning from deficit reduction to investment. Advocates say use of a larger number preserves the credibility of NPR, fulfills your deficit reduction commitment, and would result in investments because Congress has

had somewhat of a mood swing and would be more receptive towards a message of cut and invest. Advocates feel that Congress may well amend a \$10 billion package to create a larger one, all for deficit reduction, so that you are better off facing the issue up front, with a larger package and a call for a 50/50 split. Opponents also feel that \$10 billion undermines the credibility of NPR.

Opponents say that the larger number will be used as a commitment to deficit reduction, in the same way that some Republicans are asking that the caps be lowered to \$108 billion. In other words, opponents say that any NPR package, no matter how you stipulate use, will be stripped of investment and put solely towards deficit reduction, thereby, in this instance, foregoing the investment potential for the full \$24 billion.

3. Two-Step Strategy: Announce A \$10 billion Package for Deficit Reduction and a Separate Package of Savings for Investments

Advocates say that announcing a deficit reduction package and a separate package for identified investments that are popular will create a better context for now turning from deficit reduction to investment. Advocates say that this creates more of a perception of turning the page, and also allows appearance of closer linkage of the NPR cut as the funding for popular legislation, i.e., would facilitate the strategy of leading with popular legislation and treating the cuts as a funding mechanism. Thus, the advocates say, the two-step approach has a higher probability of working. Advocates also say this will preserve the integrity of NPR, since the initial presentation will refer to both pieces. Opponents say Congress will view the two steps as one, and will treat this the same way as the single, larger package.

Some advocates of this position believe the key lies not in saying that a portion goes to deficit reduction and a portion goes to investments, but rather in proposing, in addition to a deficit reduction package, specific investments that people want and then simply using NPR savings or other cuts as the financing mechanism. These advocates point to health care, where we simply led with a major investment, so that the savings were from the start presented in the context of funding health care and not deficit reduction. Thus, from this model, you would simply propose crime legislation or worker retraining and show how you would pay for it.

Another variation of this view would be to submit \$10 billion now, for deficit reduction, and submit the otherwise non-scorable procurement cuts in the October package, with a stated intent to use them for investment as the outlay reductions are actually realized. Advocates are concerned that, if this intent is not stated and accomplished, Congress might designate the cuts for deficit reduction, as realized.

ISSUE III. Priorities and Time-Sensitive Decisions -- There are also questions as to how to handle other matters that need to be faced within the context of turning the page, e.g., a commission following up on the reconciliation legislation, an entitlements conference, and a balanced budget amendment.

- A. Whether or not you agree with this framework, as Leon Panetta's comprehensive memo of September 20th (attached hereto) makes absolutely clear, no matter what you do, proposed initiatives substantially exceed available funding, and you will need to decide on priorities. Some of those decisions need to be made now; others can wait until somewhat later. You could also greatly improve the outlook for achieving investments by identifying substantial low-priority programs to eliminate.
- B. No matter what you decide on any of the questions in this memo, three problems should be mentioned:
 - 1. The NPR cuts may be too difficult for Congress, so whatever you submit is defeated. That may satisfy your commitment to seek further deficit reduction in an October package, but our funding problem for investments is exacerbated.
 - 2. Defeat of a deficit package may leave some in Congress feeling that the attempted reduction is still there as an objective.
 - 3. A Republican effort may be made to take the whole \$108 billion NPR, and link it legislatively to cap reduction.
- C. No matter what you decide on any of the questions in this memo, two very complicated questions must be resolved very quickly: (1) funding required to replace NAFTA tariffs foregone, and (2) displaced worker issues, e.g., funding for a comprehensive dislocated worker program and, absent a good answer here or timing problems, whether or not to have a temporary NAFTA-specific program which would be folded into the comprehensive program.
- D. A point related to paragraph C above is that the popularity of investments put forth could influence the probability of success of any of these tactics, but popularity and immediate need may conflict in some instances. Moreover, the investment priorities must be given a common framework, such as dealing with the different critical investment needs for growth and jobs, rather than appearing to be an unrelated potpourri.
- E. Whatever number you choose for NPR will obviously be far short of the \$108 billion promised, which needs to be addressed as a communications issue. One possible reconciliation is to say that the rest is being saved for future budgets.

- F. You may want to consider making it clear that you might veto a package whose deficit reduction exceeded your direction.

To conclude, this is a neutral memo framing issues of great importance, upon which your advisers have conflicting views, and provides the framework for an orderly and well organized discussion with you later today.

THE WHITE HOUSE
WASHINGTON

September 10, 1993

MEMORANDUM FOR NEC MEMBERS

FROM: ALICE RIVLIN AND GENE SPERLING

SUBJECT: NEC MEETING TODAY

The attached is for the NEC meeting at 3:30 today. Please review before the meeting, if possible.

DRAFT

September 9, 1993

To: NEC Members
From: Alice Rivlin and Gene Sperling
Subject: Priorities Project

The beginning of the FY95 budget process is an opportune moment for the President to rethink, reconsider and review his policy priorities. When deciding to run for President, then Governor Clinton went through an elaborate process of discussion and analysis in deciding what would be his top policy priorities during the campaign. The priorities chosen at that time reflected years of analyses and experience of the then Governor, as well as campaign commitments. After the election, these priorities guided the investment component of the President's economic plan and Administration's proposals for reconciliation and FY 1994 appropriations.

After nine months in office, the President and the members of his Administration have an opportunity for taking stock and reevaluating policy priorities. The Administration team now has a great deal more information about the effectiveness of programs and the receptiveness of Congress and the voters to particular initiatives. The tightness of the discretionary caps in FY95 and beyond, and the increasing focus on controlling entitlement spending, makes it imperative that the President think very carefully about where he wants to direct the efforts and resources of his Administration to maximize real accomplishments.

Setting priorities must involve a process that interweaves 1) big picture reflection of the President's goals; 2) a hard-nosed sense of what is achievable policy-wise; 3) an understanding of how priorities -- both achieved and sought -- reflect on message and how the President is viewed by the public in terms of who and what he stands for. 4) a pragmatic sense of what is achievable legislatively; 5) an analysis of the budgetary constraints 6) an estimate of what is can be accomplished by the power of Presidential persuasion.

We propose that the President--and all of us--move from big issues of priorities to the actual FY95 budget decisions in three steps:

1. **Legacy Notebooks:** The first step should be an opportunity for the President and all of us to step back and consider what should be the President's legacy -- what are the positive things for the country he would feel most good about accomplishing -- and how that should drive both budgetary and non-budgetary decisions.
2. **Reassessment of Priorities and Preview of FY 1995 Decisions:** This step would lay out background information (with opportunity for discussion if the President desires) designed to answer questions like these: how well did we do in Congress in funding investments? What is the latest view within the Administration and outside about the

effectiveness of the programs we chose to emphasize and about the public's perception of that effectiveness? What shifts in resource allocation actually occurred in FY 1993 and FY 1994: more for children? more for infrastructure? more for technology and science? Less for what? What are the big choices that will have to be faced to meet the discretionary spending caps in FY 1995? What is happening to entitlement spending and what are the options for controlling it?

3. Options and Decisions on the FY 1995 Budget. The final step would be to lay out for the President the issues raised by the agencies' FY 1995 budget decisions and the major decisions he has to make to come to closure on the FY 1995 budget submission to Congress.

STEP ONE: THE PRESIDENTIAL LEGACY NOTEBOOK

Rationale: A worthwhile exercise for the President, his staff and his advisors is to consider what the President's legacy should be. This question forces the President to ask himself, if he cannot get everything he done he would like, what is the handful of things, that he would most like to accomplish for the nation during his tenure in the White House. Part of that question has already been answered, by his stress on health care. Yet, among his other major priorities — children, schools, training, college, technology, defense conversion, 100,000 cops, infrastructure, AIDS, urban economic empowerment, welfare reform, environmental infrastructure — it is hard to know which we most want to stress.

The legacy project does not mean giving up on any of these priorities, but it can focus attention and resources more clearly.

We envision two legacy notebooks:

1. General Legacy Notebook: We would collect for the President several three page memos from members of the NEC, Cabinet, White House staff and outside advisors whom the President respects. We will consult with people who know the President well as to whose comments outside of government he might be most interested in. In order to allow maximum participation, while also keeping the pages the President must read a reasonable amount, we might wish to require that all papers be signed by two or three people. If, for example, three people collaborated on each paper, 60 people could participate, while keeping the notebook to sixty pages.

The memo for the Legacy Notebook One would ask three things.

A. In a future summary of "Accomplishments of Late 20th Century Presidents," what would you most want said about Bill Clinton? (limit of three items)

B. If you had \$10 billion to spend at the margin in the next budget, how would you spend it and why? What would you reduce to find the additional money?

C. What Presidential priorities or legacy can be achieved without any (or minor) budgetary impact?

2. Cabinet Legacy Notebook:

The second legacy notebook would be from the Cabinet. They would be asked the same questions for their area of responsibility. Thus, the Secretary of HUD would be asked to say what the legacy should be in his Department, how he would spend an additional \$1 billion, where he would get it, and what are the non-budgetary priorities.

The notebooks would serve as not only for a first step for the President to reflect on his legacy and priorities, but as a vehicle for the NEC and White House staff to consider these issues together. After the completion of the Notebook, we would use the papers to set-off a series of NEC discussions. We might do this prior to sending the President the notebook, or while the President is doing a first read.

Second Step: Reassessing Priorities and Preview of FY 1995 Decisions

This priority project would not serve the President well if we created a process that allowed the President to ponder priorities, but did not also inform the President about the policy and political feasibility for bringing about fundamental change in the major policy areas. The second stage should therefore provide a process for 1) answering the President's inquiries to the two Legacy Notebooks, 2) be a process to bring the President up to date on the academic studies, literature, state and local success stories; 3) Reports on public opinion on various policy initiatives; 4) Congressional analysis -- to be given in oral presentation by Pastors' office; 5) OMB analysis of budget trends in entitlements and recent changes in discretionary spending by department and major "cross-cuts" or priority areas. (See attached cross-cut table.)

This step would also involve a notebook for the President, presenting budget trends with supplementary information organized by cross-cuts. For example, if the cross-cut area was "science and technology," there would be a brief memo that sought to bring the President up to speed on what was the current thinking on technology policy, the breakthroughs, the major areas of disputes. OMB, cabinet officers, and NEC members could have the opportunity to comment on different areas. Congressional relations might prepare Congressional viability analysis on major areas, to be given through a verbal presentation to the NEC and later to the President.

There is no way that this process can be perfect or complete or give the President all perspectives. Yet, it can accomplish the following:

- 1) It can ensure that the President is up-to date on major policy and academic arguments concerning major investments, as well as new and successful state and local examples.

2) It can ensure that the President is aware of major disagreements concerning the viability of certain investments.

3) It will give him a context to study and compare what experts in the field think are imperative policy issues and where viable policy responses exist.

Step Three: Budget Decisions

The first two steps would take place in September, October and early November, during the period that OMB was reviewing the agency budget submissions for FY 1995 in detail (see steps 1-4 on attached OMB budget preparation schedule). OMB would then present the budget decisions to the NEC/DPC and the President.

Presentations would be organized by cross-cut as well as by agency. An analysis by appropriations subcommittee would also be useful as final decisions were being made.

Attachments:

OMB Budget Preparation Schedule
Cross-cut table shell

September 8, 1993

**OMB SCHEDULE FOR
1995 BUDGET PREPARATION**

<u>Event</u>	<u>Date</u>
1. ISSUE PLANNING GUIDANCE TO MAJOR AGENCIES.....	9/3/93
2. ENTITLEMENTS PAPER.....	COMPLETED BY 9/30
A paper will be prepared by OMB staff (primarily BRD and EP, with assistance from program divisions) that is intended to provide: a report on the status of the entitlement caps; materials for an October legislative savings bill; the basis for a November conference on entitlements; the basis for the 1995 budget proposals. The paper will first report on the status of major entitlements, including current trends and risks. This will be followed by some discussion of strategies and options.	
3. SUBMISSIONS OF MAJOR AGENCIES DUE TO OMB.....	10/1
The budget requests of major agencies are due to OMB. Because of the tight fall schedule, submission delays or major noncompliance with 1995 budget guidance could significantly complicate the review schedule.	
4. DIRECTOR'S REVIEWS.....	11/1 to 11/24
OMB staff will develop summary material by agency, function, appropriations bill, and crosscutting category outlining major elements of the agency requests. The requests will be compared to the discretionary and entitlement caps and other budget limits. After consulting with agency staff on the composition of the request, OMB PADs will make recommendations to the Director in a series of meetings.	
5. PRESIDENT/NEC/DPC REVIEWS OF MAJOR ISSUES.....	11/15 to 12/17
All major budget issues will be presented to the President. OMB will develop an agenda for these meetings, working with the NEC and DPC. Funding for the President's investment initiatives will be highlighted, and as with Director's reviews, the agency requests will be reviewed for compliance with the Budget Enforcement Act and other restraints. The President's decisions will be communicated to the agencies as soon as they are final.	

6. ECONOMIC ASSUMPTIONS RELEASED TO AGENCIES.....12/3

The detailed information in the agency requests is based on mid-session review economic assumptions. These assumptions will be revised for the 1995 budget. For internal decisionmaking, OMB will make adjustments to recognize the approximate effects of alternative economic assumptions on the budget. For production of budget information for public release, agencies need as much lead time as feasible to translate revised economic assumptions into the thousands of data records that will support the public budget document. The work traditionally begins about the same time final decisions are being made on the budget elements.

7. DRAFTING OF BUDGET DOCUMENT -- DEVELOPMENT OF
DETAILED DATA BASE FOR PUBLIC CONSUMPTION..... COMPLETED
BY MID-
JANUARY

Budget decisions will be translated into a newly redesigned four-volume budget. The budget will be a combination of the broad justification of the February Vision document and the detailed materials from the more technical April document. The budget sections outlining the Administration's program will be circulated and cleared for public release beginning shortly after decisions are made.

At the same time, agencies will be developing the detailed data base supporting the budget. OMB staff will review the data for consistency with Presidential decisions, and compliance with BEA discretionary caps, pay-as-you-go limits and the entitlement caps. The data that supports the production process is far more detailed than the information used for internal decisionmaking.

8. PRODUCTION OF BUDGET DOCUMENT..... TRANS-
MITTAL ON
2/7/94

Once the work of drafting the text is completed and the thousands of elements of data are "locked", the materials will be turned over to the Government Printing Office for final printing and transmittal to the Congress and the Public.

FY 1995 BUDGET PLANNING by Cross Cutting Categories

plans.mil
8/9/93

Objectives

Economic Growth

- o R&D, Technology & Science - Peroff
- o Infrastructure Investment - Schwartz
- o Human Capital (Education & Training) - Selfridge
- o Business Development - Ryder
- o Rural & Urban Development & Investment - Ryder
- o Adjusting to Economic Change - Meyers
- o Export Promotion - DuSault

Promoting Individual Independence & Responsibility

- o Welfare Related Programs - Selfridge
- o Individual Empowerment Programs - Selfridge
- o Investing in Children - Selfridge
- o Drug-Free and Safe Communities - Schwartz
- o Homelessness & Social Services - Ryder
- o Consumer Protection - Selfridge

Environment and Natural Resources Management

- o Federal Land Management - Cogswell
- o Infrastructure and Resource Enhancement - Cogswell
- o R&D & Technology - Peroff
- o Pollution Prevention & Regulation - Cogswell
- o Facility/Site Cleanup - Peroff

Health - Kleinberg

National Security

- o Defense - Gessaman
- o Peacekeeping - Gessaman
- o Developmental Assistance - DuSault

Other (to be arrayed by function) - Dams

Memorandum: Separate Papers to be prepared by DPC on Native Americans, Homeless, and Immigration.

THE WHITE HOUSE

WASHINGTON

June 29, 1993

MEMORANDUM FOR THE PRESIDENT

FROM: ROBERT E. RUBIN *RLN*

SUBJECT: Secretary Reich Memorandum Regarding U.S.
Leadership on Structural Unemployment and Labor
Market Policies in G-7 Nations

Bob Reich asked me to pass on to you the attached memorandum. I agree with Bob's recommendations, although I would allow each country to designate three representatives rather than specify the Ministers of Labor, Education and Technology. In two of the governments that I knew reasonably well before I came here, the most appropriate representatives would have included individuals who were not occupants of those three Ministries, and I think the same is true of our government today.

I would also add that my own instinct is that there may well be another dimension of historic importance to the unemployment problem, to wit a disconnect between GDP growth and employment due to technology, new ways of organizing workforces and globalization. Quite a few members of your economic team don't feel there is a new phenomenon, but all agree that if there is, appropriate additional policy prescriptions are not at all clear.

Finally, the world is currently in a negative economic cycle, which is likely to last at least through the better part of 1994. Laura Tyson and I were discussing this just this morning, and we both agreed that whatever you do can at best have relatively little impact on hastening the return of more favorable cyclical conditions, although we should certainly pursue macro-economic coordination. The Administration's economic programs, including investments, deficit reduction, regulatory review, trade, and micro-economic measures, can, on the other hand, have a significant impact over the long run. We also agreed that difficult conditions give rise to quick fixes, like President Ford's famous WINS buttons, which are unsound and counterproductive.

Attachment

U.S. DEPARTMENT OF LABOR

SECRETARY OF LABOR
WASHINGTON, D.C.

JUN 29 1993

MEMORANDUM TO THE PRESIDENT

FROM: LABOR SECRETARY ROBERT B. REICH *bsr*

SUBJECT: U.S. LEADERSHIP ON STRUCTURAL UNEMPLOYMENT AND LABOR
MARKET POLICIES IN G-7 NATIONS

PROPOSAL

You should propose that the G-7 establish a Commission on Structural Unemployment. The Commission would seek to achieve a "new consensus" on the dimensions and causes of structural unemployment in G-7 nations, and on the preferred means for dealing with the problem. The consensus would reject protectionism and rigid labor-market policies in favor of worker adjustment and education and training policies.

The Commission would be chaired by the United States, and would involve ministers from labor, education, and technology within each of the G-7. The Commission would present an interim report to the G-7 leaders within six months and a final report in one year, containing specific recommendations for how the G-7 together can reduce structural unemployment and enhance the incomes of their citizens.

THE PROBLEM: HIGH AND PERSISTENT UNEMPLOYMENT IN G-7 NATIONS

Structural unemployment is becoming an increasingly important problem in the G-7.

While the U.S. recession officially ended over two years ago and while employment growth has picked up in recent months, unemployment and underemployment remain high; the current U.S. unemployment rate of 6.9% is higher than the 5.8% rate at the supposed trough of the recession in March 1992. The number of Americans who are unemployed, involuntarily underemployed, or too discouraged to continue looking for work remains over 16 million. Much of the unemployment and underemployment appears to be structural, as indicated by the fact that an unprecedented 80 percent of U.S. workers who have been laid off this year are not expected to be called back to their old jobs. The pace of permanent worker dislocation appears to be increasing.

The current unemployment situation is even bleaker in most other G-7 nations. In fact, overall unemployment in the G-7 is higher today than at any time in the past 40 years. European industrialized economies are the most seriously affected. Eleven

percent of the labor force in the nations of the European Community is unemployed; unemployment has averaged 9.9 percent for the past decade. European unemployment is largely a structural problem: nearly half of those unemployed in the European Community have been without work for over a year. These European economies appear to be on a dangerous trajectory where the unemployment rate increases dramatically in recessions but fails to decline substantially in recoveries. Canada has also experienced an upward unemployment trajectory with double digit unemployment rates for the last three years.

Japan continues to have the lowest unemployment rate in the G-7 (still below 3 percent), but it has a substantial number of discouraged workers. Japan's structural unemployment also is hidden in a highly-inefficient distribution and retail sector, whose ranks continue to grow.

THE CAUSES

The unemployment problem facing G-7 nations partially reflects cyclical unemployment arising from a weak macroeconomic situation. But even with a complete macroeconomic recovery, it is likely that unemployment will remain stubbornly high in Europe, and that even in the United States dislocated and disadvantaged workers will continue to have difficulty finding new jobs.

The structural unemployment problem in the G-7 reflects not so much increases in productivity (which historically, always have created more jobs rather than fewer) as it does a shift in relative labor demand against less-educated workers and those doing routine tasks and toward workers with problem solving skills. In most G-7 nations, structural unemployment has taken its greatest toll on manual workers and non-college workers.

- o Challenged by global competition and labor-saving technologies, American, European, and Japanese companies have been forced to move beyond high-volume, standardized mass production, and focus instead on products and services tailored to the individual needs of customers: specialized materials, customized computer chips, specialized banking and insurance services.

- o Increased globalization and skill-biased technological change have raised the knowledge content of goods in which advanced industrial nations have a comparative advantage.

THE FALSE CHOICES

If properly managed, this shift in demand can lead to rapidly-growing economies that produce high-wage, high-skill jobs. But the economic policies undertaken in Europe and the United States in the 1980s created a Hobbesian choice between job quality and job growth, and invited protectionism.

o The continental European pattern of explicit government intervention in the wage setting process and inflexible employment security and protection rules succeeded in the 1980s in preventing the gap between high-wage and low-wage workers from widening, but ran into severe economic difficulties by not directly addressing profound changes in the demand for skills. Such policies maintained wages and job security for the employed, but they greatly burdened new job creation especially in small and medium-sized businesses. Largely because of inflexible wage structures and restrictions on the ability of firms to redeploy and change their work forces in response to a changing world economy, employment growth has stagnated in these nations and unemployment continues to grow. Only substantial public sector employment expansion prevented even worse unemployment problems in many of these countries during the 1970s and 1980s. In fact, there has been almost no net private sector employment growth in the European Community over the last twenty years.

o The U.S. and British pattern treats labor like other commodities and allows earnings and working conditions to decline as demand for unskilled work has declined. The result has been substantial increases in wage inequality. In the United States, non-college workers' real earnings have substantially declined. Both nations have allowed wages to fall and permitted employers relative freedom to adjust their labor markets to demand shifts. Because of this flexibility, the United States, in particular, has experienced job growth over the last two decades that has been the envy of European nations. Nevertheless, job growth in both the United States and Britain has been punctuated by high unemployment in recessions and increasing problems of structural unemployment for disadvantaged and displaced workers.

o Protectionism. It is perhaps natural in these turbulent times for advanced industrial nations to blame imports from other nations -- especially developing nations whose workers are willing to toil for much lower wages -- or to blame immigrants entering the country. But escaping from global markets through protectionism is not the solution. Technology will operate to reduce the demand for less-skilled workers even if the borders are sealed. Open international markets have historically been related to rapid economic growth and expanding employment. World trade is not a zero-sum game. Many of the high-wage jobs of the

future will be associated with exports and jobs that service the export industry. Export sector and related jobs pay substantially higher wages than jobs in the rest of the economy. Economic expansion in the rest of the world strongly stimulates U.S. exports and creates high-wage jobs in the United States. Protectionism is a third false choice that will have little impact on job creation but will certainly harm the efficiency of the economy and the growth of incomes.

THE PREFERRED CHOICE

o Macroeconomic Policy

The first and most obvious policy priority to reduce unemployment is to ensure that the G-7 economies enjoy a swift and complete recovery from the recession of 1990-92. The sharp proposed reduction in the U.S. budget deficit should remove a significant source of uncertainty about the stability of the world economy and aid such a recovery. A strong commitment to fiscal expansion in Japan and monetary easing in Europe could also help.

o Investments in People and in Flexibility

But once an improved macroeconomic environment is created, policies will be needed to deal with the longer-term problem of structural unemployment. Policies to address structural unemployment must directly address changes in the global economy that have shifted labor demand in the G-7 away from routine tasks and towards problem-solving skills. Such policies require active intervention to improve skills and ease the transition from contracting industries into new jobs in expanding ones. But such policies also require wage flexibility and employer discretion over when to terminate employment.

A complete jobs strategy would operate on five dimensions: the supply of skills, the composition of the demand for skills, the matching of supply and demand, the flexibility to respond to market forces and the overall level of demand for labor.

(1) First, good education, training, and retraining must be available to all citizens, not only the children of the privileged few.

(2) Second, firms must be encouraged to adopt high-performance work practices -- providing on-the-job training to their front-line workers, and giving them significant responsibility.

(3) Third, up-to-date employment information, job-counselling, and job-search assistance must be available to all new entrants to the labor force and all newly unemployed workers.

(4) Fourth, firms should be allowed maximum flexibility in setting wages and terms of employment, above a minimally-decent floor.

(5) Finally, fiscal policy should provide for a balanced expansion in investments in human capital, physical capital, infrastructure, and technology. Such investments are necessary to maintain a strong overall level of job creation and demand for skilled labor.

o Toward a "New Consensus" On Courses and Remedies

This overall strategy requires different policy changes in different G-7 countries. In the United States, the major required changes are increases and improvements in investments in education and training, an effective school-to-work transition, a worker adjustment system, and the capacity for lifelong learning on the job. Japan and many European countries have already put into place some of these workforce investment systems. But other, relatively inflexible labor policies and wage-setting restrictions in these nations hinder both the incentives of the unemployed to find jobs and the incentives of employers for job creation. In Europe, the emphasis should be on reducing restrictions on wage setting and employment adjustment and in improving active labor market policies to quickly move the unemployed into new jobs. Japan can contribute best by improving the world macroeconomic condition. All G-7 countries need to focus on changes in tax and transfer systems to make work pay.

ADVANTAGES OF ASSERTING LEADERSHIP ON THIS ISSUE

G-7 structural unemployment already is fanning the flames of racism and protectionism in several G-7 nations, and must be faced directly. The United States' commitment to open markets, ethnic diversity, internally flexible labor markets, and education and training, places it in an excellent position for G-7 leadership in framing the issue and seeking "positive sum" solutions. You are personally committed to the education and training of nations' workforces and have a great deal of credibility on the issue.

DISADVANTAGES

Structural unemployment is a complex and increasingly emotional issue in many G-7 nations, provoking demagoguery on the left and the right of the political spectrum. Inappropriately managed, the Commission could be a source of embarrassment for some nations, or worse, a platform for irresponsible ideas.

April 23, 1993

93 APR 26 P3:50

MEMORANDUM TO THE PRESIDENT

From: Gene Sperling

Subject: Packaging Ideas

I. INTRODUCTION: In a recent conversation with Bob Rubin and myself, you expressed interest in taking a look at your past speeches going back to 1991 so that we could examine whether we are doing enough to connect our policy proposals with themes and messages that appeal to people and apply to their lives.

The main issue I want to raise is that we are not packaging our specific proposal under general themes, values, or new ideas that resonate with the public. Without such packaging, we seem to be presenting the public only with a list of unconnected -- though usually popular -- legislative proposals. When ideas are packaged together as promoting new ideas and powerful themes, the average person will not remember all of the specifics, but they will remember that you are taking several actions to promote a value they care about. More specifically, there is something about the listing of programs that comes off more as business-as-usual for a Democrat. We also need to remember that much of the power of our investments will come from the sense that we are promoting new ideas -- and programs that are seen as promoting those ideas and themes.

In your speeches you have often had such packaging in terms of themes, but we have perhaps let the proposal specific nature of legislation move us away from this.

II. PAST SPEECHES: Before suggesting ways we might want to package our ideas, I thought it would be useful to review some of your past speeches:

July, 1991 DLC Speech:

An example of a speech that was strong in packaging was your July DLC keynote. That speech took a variety of seemingly unconnected ideas and package each as supporting three basic values/themes -- community, responsibility and opportunity. This speech was excellent in this sense. Its shortcoming of the speech was that it was weak as a economic growth. Yet, the ideas gave the themes substance and helped you further define yourself as a new democrat.

October 23, 1992 Georgetown Speech:

Here you relied on one main element: new covenant and showed that this could apply to everyone in our society. This was excellent for defining yourself, but may be too vague -- alone -- for a legislative proposal.

November 20, 1991: New Covenant for Economic Change:

Four themes:

Empowering Every American:

- education
- Head Start
- Apprenticeship
- National service
- GED
- Training tax
- Earned income tax credit
- Community development banks
- Tax cut

Revolution in Government:

- Quality Management Control
- Investment budget
- Reinvent health care

Revolution in the workplace:

- Linking pay and performance
- CEO Pay
- Transfer jobs abroad
- New enterprise tax
- R&D
- Targeted investment tax credit to small and new business

New strategies on compete and win:

- Fast track for NAFTA
- Darpa

Wharton: April 16, 1991

Four themes

New economy:

Learning economy

Rebuilding America:

- ITC
- R&D
- future budget
- high speed rail
- infrastructure
- Civilian Darpa

New Compact for Economic Growth

Putting People First: June 22, 1991

PUTTING AMERICA TO WORK:

- end wasteful tax breaks
- eliminate deductions
- Rebuild America
- information Highways
- environmental technology
- Defense conversion
- investment in Communities:
- community development banks
- CDBGs
- Community Development Banks
- 100,000 cops
- urban enterprise zones
- Credit crunch and CRA
- private investment
- trade

REWARDING WORK:

- EITC
- Welfare
- Tax cut
- Family and Medical Leave

- Child Support enforcement

LIFETIME LEARNING

- Parents and Children Together,
- WIC and Head Start
- school reform
- safe schools
- Youth opportunity corps
- National apprenticeships
- National Service Trust
- Training

REVOLUTIONIZE GOVERNMENT:

- Staff reduction
- 100,000 less administrators
- line item veto
- revolving door
- campaign finance reform

III. POSSIBLE THEMES AS WE MOVE FORWARD:

As we move forward, we clearly need to keep focusing on more jobs, high-paying jobs and economic growth. Yet, describing our investments proposals in terms of technology, or infrastructure accurately categorize the main components of a comprehensive investment strategy without putting them in a context that reflect values or themes. Our goals therefore must be to find themes that resonate with people and themes we can link to economic growth. Whether we focus on any combination of values like empowering families, responsibility, reinventing government, opportunity or rewarding work, we must draw a tight nexus between them and economic growth and high wage jobs.

WORK AND FAMILY: One of the strong points in putting ideas in terms of work and family is that each of these themes reflect both values and perspectives that people see their lives. People are both workers and family members and they see problems through these perspectives. They see schools, crime and health largely through their eyes as a parent, and they see the economy and health care largely through the perspective of parents and workers. Therefore, there is a strong logic in presenting programs in themes that are variations of "family" and "work."

1. PRO-WORK (REWARDING WORK) AGENDA:

James Carville had mentioned to me that he was trying to describe many of our programs around the notion that they are about being pro-work. We could greatly expand the list of programs that support a pro-work or rewarding work agenda beyond what seems may seem most apparent -- while making the critique that past Administrations have not truly honored work for the average American. Focusing on work brings down the high-level economic issues to the level that people most understand: work or work and family. It speaks to discipline and responsibility and it a message that applies to both the poor and the middle class. We must also try to build into a work theme, the relationship between the values related to rewarding work and an agenda to create a highly-skilled, highly-educated workers and flexible workplaces and economic growth. The things that could be stressed as representing a firm value commitment to honoring work include but are not limited to the following:

1. Stimulus in the face of a jobless recovery: The notion here is that we do not believe that Washington should gamble with the work and jobs of the American people. We went for the stimulus because we want action and we care so deeply about ensuring that people are not out of work or in involuntary part-time jobs any longer than they have to be.
2. Earned income tax credit
3. Welfare reform
4. Summer jobs -- as not just work but a proposal to increase the work ethic
5. Child care as a means to allow parents to work.
6. Community schools -- that allow single parents who want to work to be able to do so and know that their children are being supervised
7. Health care -- lower costs will improve our competitiveness and security will allow people to move toward better jobs.
8. Apprenticeships -- as a school-to-work agenda.
9. Defense conversion: people who have worked hard to win the cold war should be given the chance to work hard to win the economic battle for our future.
10. Training: people who work should not be forgotten simply because they are the victims of change and misfortune. We need to train them to work at higher and higher levels of productivity.

2. EMPOWERING PARENTS:

Our social programs for children are marked as being new Democrat only in the extent that we defend them in terms of economic growth. Yet, this will always seem a bit removed. We need to show that we are committed to investing in children but that we have a new vision of how to do that.

Empowering parents provides that unifying vision. Focusing on parents shows both the potential and the limits of government. It shows the limits because we need to recognize that government doesn't raise kids and it can't solve every problem. But it supports the notion of teaching a person how to fish. Specific interventions have a limited effect, but empowering parents to be their children's teachers and to bring an educational ethic to the home will have a lasting effect every day on every member of that family.

We have several programs that empower parents. And it would be well-received if we spoke of reforming even popular programs like Head Start in terms of bringing in parents and understanding that reforms must come with parents and children working together. Finally, the HIPPO program gives the President and First Lady significant credibility in this area. Empowering parents ideas could include:

1. Parent Education and Family Preservation
2. Family Medical Leave
3. Child Support enforcement
4. WIC
5. Health care -- so that losing your job will not cost your children health care.
6. Crime bill, community police, and safe schools -- all parents want safe neighborhoods where they don't have to worry about their children
7. Better Schools with more parental involvement

3. REINVENTING GOVERNMENT: Clearly this must be a major point to stress that we want to reform -- not expand government. Yet, we need to think of a few principles that reflect a philosophy that goes beyond just cutting -- which people are generally skeptical about and which may be seen as only negative. We need to stress ideas people can easily understand like, one-stop shopping; entrepreneurial spirit, quality and performance review, citizenship input and have tangible reforms so that we can point to how these ideas are apart of everything we are doing.

4. ECONOMIC CHANGE, THE CUTTING EDGE AND TRADE: Our philosophy on trade can be described in terms of our attitudes about a willingness to open markets and encourage change, but a desire to ensure that all of our people benefit from it. The past debate was between those who were for change but did not care how much it hurt the environment and American workers, and those who wanted to protect us from all change by putting up walls. We want a trade policy that helps America win from change; a trade policy where government takes action to promote open trade, but ensures that we take steps to protect the environment and give workers the help to adjust and win from trade. It is an open trade policy that puts people first. And while some will say that our tough tactics appear protectionists, we must explain that the difference is that our goal is not to use such tactics to stop change and keep markets closed, but to open markets and encourage change. That is fundamentally different from the past. NAFTA displays this philosophy.

We can also link our trade policy to our vision of the need for constant innovation and training. As Reich points out, because so many processes are eventually automated and thus capable of being sent to countries with lower labor costs, our comparative advantage lies in developing a flexible economy capable of continually staying on the cutting edge by always moving toward the next frontier of each economic area. In other words, we know that trade will make the economy dynamic and constantly changing and we need to create a high-value added economy that allows us to benefit from it.

5. ECONOMIC INVESTMENT FOR THE 21ST CENTURY: There is much to gain in showing that you are futuristic; that you have a vision for creating a high-wage economy. Therefore, it makes sense to package together programs -- from a variety of different areas -- that capture the imagination of the public as future-looking. Examples include:

1. High speed rail
2. Alternative fuel vehicles
3. New environmental technology
4. Highway bill
5. Manufacturing of the future:
6. Smart cars
7. Information Highway: [The VP's line about imagining a day when a school child could plug into the Library of Congress as easy as they plug in their nintendo]
8. New School and Education Concepts.

6. MUTUAL RESPONSIBILITY: Certainly, no theme has been as successful in defining you as a new Democrat that the theme of responsibility. This may not be as strong for packaging a set of legislative proposals but it is still important for defining your values. The ideas that fit within this theme are:

1. National Service
2. Child Support Enforcement
3. Pregnancy Prevention
4. Welfare Reform
5. Corporate Governance -- millionaire CEO pay.

7. INVEST ACCOUNTS: We need to understand how important the income contingent loan proposal is. This is one attempt to make show a proposal that directly benefits every American family. We must promote and make it understandable and tangible -- such as through telling everyone that they are eligible for an INVEST ACCOUNT.

8. ENTREPRENEURSHIP AND SMALL BUSINESS: We need to stress the value of entrepreneurship. It is hard to get full support of the venture capital community, but we do have two major small business tax credits as a hooks for such a theme.

9. DEFENSE CONVERSION: Most of our technology policies tend to be vulnerable standing alone as technology ideas. They gain their greatest political force when they are part of a defense conversion proposal. It is difficult for many lawmakers -- Democrat or Republican -- to vote against defense conversion when they have people who are being laid off right or bases closing right in their districts.

~~CONFIDENTIAL~~

U.S. DEPARTMENT OF LABOR

SECRETARY OF LABOR
WASHINGTON, D.C.93 JUN 2 P3:42
"IN - 2 1993

MEMORANDUM FOR THE PRESIDENT

FROM: Labor Secretary Robert B. Reich *BSR*

SUBJECT: A Jobs Agenda

The purpose of this memorandum is to review the jobs situation, and suggest a short-term agenda for dealing with it.

Job growth continues to be sluggish

--The unemployment rate has been stalled at 7% since January. This is not a robust job recovery by anyone's measure, and job growth is still far from matching previous recoveries.

--To make matters worse, much of the unemployment is concentrated and highly visible--especially in California, Connecticut, Massachusetts, and Rhode Island, where the 1980s boom was most evident and where defense contractors are actively scaling back; rural pockets of the South, where textile and apparel manufacturers continue to slim down; Washington and portions of Oregon, where lumbering has been limited or where Boeing and its subcontractors have been hurting; much of Ohio and Pennsylvania, where long-term industrial stagnation continues; and large and medium-sized cities, where major corporations continue to cut middle-level management and to reduce manufacturing employment. In our central cities, significant numbers of adult men and youth are without work, but not even counted in the unemployment figures.

--Continuing high rates of unemployment may make it more difficult to cut defense expenditures as quickly as they should be cut, imperil NAFTA (given the mistaken but widely-accepted view that Mexico will take jobs away from Americans), hamper environmental protection (Pacific Northwest timber, for example), and force the Administration into a series of industry bailouts and specialized subsidies.

DETERMINED TO BE AN ADMINISTRATIVE

MARKING INITIALS: *OB* DATE: *8/26/19*
2019-0774-S

Why low interest rates aren't working

--Your resolve to cut the deficit--demonstrated in the Budget Resolution and, now, in reconciliation--is having the desired effect. Interest rates are sufficiently low to allow companies to refinance their debt, or add debt, at very attractive terms.

--Businesses are not adding employees, however, because of their expectations of insufficient demand for their goods and services. Not even low interest rates will spur new employment unless businesses perceive a demand for the output of these workers. The pessimism is fed by a fiscal policy which is now quite contractionary, and will become even more so in 1994, as Laura Tyson and Alan Blinder pointed out in their May 19 memorandum. In addition, several major export markets are in recession.

--You are in danger of having the worst of both worlds--budget austerity, and continued high unemployment. It is the mirror image of Ronald Reagan; he used "military Keynesianism" to engineer a huge jobs recovery, and drove up the deficit. By the time Reagan had to pay the piper, he was long gone. By the time America can enjoy the prosperity which you have engineered, you may be, too.

How to break out of the gloomy cycle

--If all businesses decided to increase their employment, consumers would have more money in their pockets, consumer confidence would increase, demand for goods and services would increase (even without a fiscal stimulus), and the extra employment would be fully justified. So why don't businesses do so? It's rather like the classic "prisoner's dilemma." Although the low interest rates allow businesses to expand, no single business is willing to increase employment because of the general expectation that other businesses won't, and that demand will be inadequate to justify the addition to the payroll.

--Thus, in order to take advantage of this "window" of low interest rates, it's necessary to create positive expectations about demand for goods and services. To do so, the Administration must send a clear signal that it won't allow employment to stagnate. The signal could take several forms:

* Jawbone for "jobs now." You might challenge American business to utilize part of its refinanced debt in order to hire more Americans. The logic is that your Administration is close to fulfilling its part of the deal--crafting the largest deficit-

reduction package in history. Now it's business's turn to take responsibility and begin hiring. You might want to make the challenge specific: You expect that every \$ x drop in the cost of capital since the Budget Resolution should result in the hiring of y additional workers.

* Announce a "jobs now" agenda which doesn't depend on additional deficit financing, and which could be accomplished administratively. The following possibilities are intended to give you an idea of the scope of such an agenda, although you should be warned that I have not thought through any one of them. (You may want to ask the NEC to consider this list, and add to it.)

-- Asking the Department of Defense to accelerate the procurement of labor-intensive goods and services, wherever appropriate; doing the same with the General Services Administration and other major Government procurers.

-- Asking the Department of Commerce to focus its export promotion programs, in the immediate term, on labor-intensive goods and services.

-- Asking the Defense and Commerce Departments to accelerate reform of "COCOM" restrictions against exports of American high-technology products.

-- Asking the U.S. Trade Representative to place highest priority on opening foreign markets to goods and services produced in the United States, as opposed to goods and services produced by U.S. companies abroad. (Mickey, Bob Rubin, Laura, Ron Brown, and I have been working up some guidelines for you on this).

-- Asking the Department of Labor to strengthen the worker protection provisions of immigration programs such as H-1B of the Immigration and Naturalization Act, which now admits up to 65 thousand skilled foreign workers annually to work in the United States for up to six years, with only weak barriers against displacement.

-- Asking the Department of Labor's Bureau of Labor Statistics to analyze which American occupations and skills are in short supply, and report back within 60 days, so that unemployed Americans may have some rough guidance about what they might train for.

-- Asking the Department of Labor to target newly-unemployed workers from contracting industries, who are unlikely ever to regain their old jobs, and help them get the training and job-search assistance they need.

-- Asking the Departments of Commerce and Labor, and the Small Business Administration, to coordinate economic development and job training, focussing on regions hardest hit by cuts in defense and industrial contraction.

-- Asking the Treasury Department to make available loan guarantees to the airline industry for orders for new aircraft made within the next six months (at least 75 percent of the value of the aircraft should derive from the United States).

-- Asking all departments and agencies which subsidize research and development (AARPA, NSF, NIH, NIST, etc.) to accelerate their funding of labor-intensive research projects (as opposed to capital-intensive projects).

* Be clear that if these steps are inadequate, you will do whatever is necessary to get jobs for Americans. Deficit reduction is a means to creating more and better jobs, not an end in itself.

THE WHITE HOUSE

WASHINGTON

April 28, 1993

MEMORANDUM FOR THE PRESIDENT

FROM: ROBERT E. RUBIN 

SUBJECT: Investment Priorities

Attached are drafts of three different investment priorities lists which were put together by Gene Sperling, Leon Panetta and Bruce Reed. We began, but did not finish, discussing this list at the end of our Monday meeting on preserving as much of our 1994 investment program as possible. The economic and legislative people need your comments and thoughts on this document as soon as possible, hopefully by Thursday.

Also, you should know that the Joint Tax Committee estimated the revenue shortfall to be around \$7.0 billion, rather than the previously estimated \$3.6 billion, so that we have much less to work with if we lose the temporary ITC which costs \$9.5 billion.

Attachment

TABLE 1

PRIORITIES LONG LIST

Transportation:	
Federal-aid highway program	402
Smart cars/smart highways (part of Federal-aid highway obligations)	(70)
Mass transit formula capital grants	23
High-speed rail and MAGLEV	<u>27</u>
	382
Environment:	
Drinking water state revolving funds (EPA)	24
Watershed Resource Restoration (EPA)	15
Weather Service Modernization (EPA)	84
Environmental Technology (EPA)	14
Clean water state revolving funds (EPA)	54
Environmental restoration and waste management (DOE)	8
Natural resource protection and environmental infrastructure (Interior and USDA)	<u>167</u>
	366
Energy:	
Alternative fuels vehicles	18
Advanced Neutron Source	11
Energy conservation and renewable energy programs (Energy Policy Act)	48
Natural gas research and development: Emphasize utilization	<u>5</u>
	82
Community Development and Defense Conversion:	
Community development banks	45
Technology & Business Reinvestment & Defense Conversion:	
NASA short-haul aircraft research	3
Federal Coordinating Council for Science, Engineering & Technology (research initiatives)	100
Crosscutting high performance computing (NSF, NIH, NASA, and NIST)	53
National Inst of Standards and Technology growth	56
Information highways (Commerce)	6
National Science Foundation	100
Civilian Aviation	<u>36</u>
	354
Housing:	
100% vouchers (100,000 units)	7
Preservation and restoration of assisted housing	37
Urban Partnership Against Crime	<u>6</u>
	50
Lifelong Learning:	
WIC (Special supplemental food program for women, infants, & children)	318
Head Start	932
Education Reform and Initiatives	206
National Service	98
Dislocated Worker Assistance Act	60
Youth Apprenticeship	32
Worker profiling	6
Jobs Corp 50-50	<u>11</u>
	1663
Rewarding Work:	
Crime Initiative, including community Policing, Criminal Records Upgrades & Police Corps	210

Health Care:	
AIDS, women's health, immunizations, NIH research, other public health initiatives	346
AIDS - Ryan White Act	60
Substance abuse prevention and treatment	46
Food safety initiative (USDA) and emergency food assistance	<u>54</u>
	506
Investments in the PAYGO Side:	
Earned Income Tax Credit	
Enterprise Zones	
Food Stamps	
Immunization	
Parenting and Family Preservation	
High Speed Rail Bonds	

TABLE 2
INVESTMENT PROPOSALS

THIS IS WHAT
WAS LEFT OUT
OF THE LONG LIST

REBUILD AMERICA - INFRASTRUCTURE	
Transportation:	11
Alcohol-related highway safety and other transportation capital	5
Airport improvement program	24
Air traffic control modernization	5
Public land highways and Indian reservation roads	45
Subtotal, Transportation	
Environment:	
Safety of dams on Indian reservations (Interior)	4
Water resources development (Corps of Engineers)	77
Forests for the Future (USDA)	24
Green programs (EPA)	5
Tree planting initiative (USDA)	33
National research initiative grants (USDA)	2
Forestry research initiative (USDA)	16
Subtotal, Environment	161
Rural Development Initiative:	
Rural water and waste water loans and grants (USDA)	6
Business and community initiative (USDA)	105
Subtotal, Rural Development Initiative	111
Energy:	
Energy efficiency in Federal buildings	49
Increase weatherization grants (DOE)	18
Close-out costs for DOE reactors	18
Fusion energy research	9
Subtotal, Energy	94
Community Development and Defense Conversion:	
Community development block grant (CDBG)	4
Economic Development Administration for defense reinvestment and transition	3
Subtotal, Community Development and Defense Conversion	7
Technology and Business Reinvestment and Defense Conversion:	
National labs (non-defense)	14
Government automation and efficiency	204
Subtotal, Technology & Business Reinvestment & Defense Conversion	218
Housing:	
Supportive housing program	
Severely distressed public housing	
HOPE youthbuild	
Subtotal, Housing	0
LIFELONG LEARNING	30
Child Care and Development Block Grant	7
Job Corps: eliminate maintenance backlog	247
JTPA, summer youth employment and training	30
One-stop career shopping	4
Older Americans employment	318
REWARDING WORK	
Equal Employment Opportunity Commission	10

INVESTMENT PROPOSALS (CON'D)

HEALTH CARE	---
Low-income Home Energy Assistance Program	50
Rural Health Initiative	279
VA medical care	120
Improving disability insurance processing	<u>313</u>
	762

TABLE 3

PRIORITIES MEDIUM LIST

Transportation:	
Federal-aid highway program	402
Smart cars/smart highways (part of Federal-aid highway obligations)	(70)
Mass transit formula capital grants	23
High-speed rail and MAGLEV	<u>27</u>
	382
Environment:	
Drinking water state revolving funds (EPA)	24
Watershed Resource Restoration (EPA)	15
Weather Service Modernization (EPA)	84
Environmental Technology (EPA)	14
Clean water state revolving funds (EPA)	54
Natural resource protection and environmental infrastructure (Interior and USDA)	<u>167</u>
	358
Energy:	
Alternative fuels vehicles	18
Advanced Neutron Source	11
Energy conservation and renewable energy programs (Energy Policy Act)	<u>48</u>
	77
Community Development and Defense Conversion:	
Community development banks	45
Technology & Business Reinvestment & Defense Conversion:	
Federal Coordinating Council for Science, Engineering & Technology (research initiatives)	100
Crosscutting high performance computing (NSF, NIH, NASA, and NIST)	53
National Inst of Standards and Technology growth	56
Information highways (Commerce)	6
National Science Foundation	100
Civilian Aviation	<u>36</u>
	354
Housing:	
Preservation and restoration of assisted housing	37
Lifelong Learning:	
WIC (Special supplemental food program for women, infants, & children)	318
Head Start	932
Education Reform and Initiatives	206
National Service	98
Dislocated Worker Assistance Act	60
Youth Apprenticeship	<u>32</u>
	1646
Rewarding Work:	
Crime Initiative, including community Policing, Criminal Records Upgrades & Police Corps	210
Health Care:	
AIDS, women's health, immunizations, NIH research, other public health initiatives	346
AIDS - Ryan White Act	60
Substance abuse prevention and treatment	46
Food safety initiative (USDA) and emergency food assistance	<u>54</u>
	506

Small Investments:

- Environmental restoration and waste management (DOE)
- Natural gas research and development: Emphasize utilization
- NASA short-haul aircraft research
- 100% vouchers (100,000 units)
- Urban Partnership Against Crime
- Worker profiling
- Jobs Corp 50-50

Investments in the PAYGO Side:

- Earned Income Tax Credit
- Enterprise Zones
- Food Stamps
- Immunization
- Parenting and Family Preservation
- High Speed Rail Bonds

TABLE 4

PRIORITIES SHORT LIST

Transportation:	
Federal-aid highway program	402
Mass transit formula capital grants	23
High-speed rail and MAGLEV	<u>27</u>
	452
Environment:	
Clean water state revolving funds (EPA)	54
Natural resource protection and environmental infrastructure (Interior and USDA)	<u>167</u>
	221
Energy:	
Alternative fuels vehicles	18
Community Development and Defense Conversion:	
Community development banks	45
Technology & Business Reinvestment & Defense Conversion:	
Federal Coordinating Council for Science, Engineering & Technology (research initiatives)	100
Crosscutting high performance computing (NSF, NIH, NASA, and NIST)	53
National Inst of Standards and Technology growth	56
Information highways (Commerce)	<u>6</u>
	215
Housing:	
Lifelong Learning:	
WIC (Special supplemental food program for women, infants, & children)	318
Head Start	932
Education Reform and Initiatives	206
National Service	98
Dislocated Worker Assistance Act	60
Youth Apprenticeship	<u>32</u>
	1646
Rewarding Work:	
Crime Initiative, including community Policing, Criminal Records Upgrades & Police Corps	210
Health Care:	
AIDS, women's health, immunizations, NIH research, other public health initiatives	346
AIDS - Ryan White Act	<u>60</u>
	406