RECORD TYPE: PRESIDENTIAL (TRP NOTES MAIL)

CREATOR: Ron Klain (CN=Ron Klain/O=OVP [OVP])

CREATION DATE/TIME:22-JUL-1997 09:00:06.00

SUBJECT: Rebecca Blank

TO: Janet L. Yellen (CN=Janet L. Yellen/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TEXT:
You asked if the VP actually e-mails responses. He does. I am forwarding

his response to you for authenticity purposes.

--------------------- Forwarded by Ron Klain/OVP on 07/22/97 09:03 AM

Albert Gore

07/21/97 07:52 PM

To: Ron Klain/OVP

cc:

Subject: Re: CEA Member

She sounds good to me. Tell Janet that I am fine with this selection.

Thanks.

RECORD TYPE: PRESIDENTIAL (TRP NOTES MAIL)

CREATOR: Douglas_W._Elmendorf (Douglas_W._Elmendorf@oa.eop.gov [oa])

CREATION DATE/TIME:23-OCT-1998 22:20:19.00

SUBJECT: financial market update

TO: Janet L. Yellen (CN=Janet L. Yellen/OU=CEA/O=EOP [CEA])
READ:UNKNOWN

CC: Douglas W. Elmendorf (CN=Douglas W. Elmendorf/OU=CEA/O=EOP [CEA])
READ:UNKNOWN

TEXT:
The financial-market event that was supposed to happen today and Monday

will NOT happen, thanks to a clarification of the new Japanese regulation.

I can fill you in on the details on Monday if you're interested.

RECORD TYPE: PRESIDENTIAL (TRP NOTES MAIL)

CREATOR: Douglas_W._Elmendorf (Douglas_W._Elmendorf@oa.eop.gov [oa])

CREATION DATE/TIME:26-OCT-1998 17:19:28.00

SUBJECT: financial-market tidbits

TO: Charles F. Stone (CN=Charles F. Stone/OU=CEA/O=EOP [CEA])
READ:UNKNOWN

TO: Janet L. Yellen (CN=Janet L. Yellen/OU=CEA/O=EOP [CEA])
READ:UNKNOWN

TO: Jeffrey A. Frankel (CN=Jeffrey A. Frankel/OU=CEA/O=EOP [CEA])
READ:UNKNOWN

TO: Steven N. Braun (CN=Steven N. Braun/OU=CEA/O=EOP [CEA])
READ:UNKNOWN

CC: Douglas W. Elmendorf (CN=Douglas W. Elmendorf/OU=CEA/O=EOP [CEA])
READ:UNKNOWN

TEXT:
A few minor points to complement the Fed summary:

1. We've noticed for several weeks that the widening gap between the on-the-run and off-the-run 30-year Treasury yields was not mirrored in the 10-year yields. I finally called a friend in NY, who in turn talked to some traders, and the principal explanation seems to be this: The quantity of 30-year securities issued most recently was much smaller than the quantity issued previously, which accentuates the inherent liquidity premium of the on-the-run issue. (This is why it's important for Treasury to maintain sizeable auction sizes, even if auctions occur less frequently as a result.) The reverse is true for the most recent 10-year issues, which offsets the normal liquidity premium.

2. September data from the Natl Federation of Independent Business suggested that small businesses continued to have ample access to credit.

3. Bank credit growth appears to have remained quite strong in October, with large gains in business, real estate and consumer lending.

Doug

RECORD TYPE: PRESIDENTIAL (TRP NOTES MAIL)

CREATOR: Laurence J. Kotlikoff ("Laurence J. Kotlikoff" <kotlikof@bu.edu> [UNKNOWN])

CREATION DATE/TIME:28-OCT-1998 19:19:12.00

SUBJECT: Re: Social Security reform

TO: Janet L. Yellen (CN=Janet L. Yellen/OU=CEA/O=EOP [CEA])
READ:UNKNOWN

TEXT:
Hi Janet,

thanks for the quick reply.

I just want to point out that, apart from cutting government purchases, the only way to fix social security in a way that raises national saving over the next couple of decades is to shift the fiscal burden onto the current elderly relative to a) the intergenerational distribution of the fiscal burden that would arise under current policy and b) the distribution that would arise under a reform that places the transition costs on current and future workers. This is the clear-cut message of the life-cycle model and the life-cycle simulation studies I sent you that compare wage-tax, income-tax, and consumption-tax finance of the transition. So doing something that's "politically feasible" and doing something that will raise national saving are mutually incompatible.

I hope that you're also spreading the message among the "players" that the long-term crisis as measured by the Trustees is twice as large as the Trustees Report is stating. According to Steve Goss, SSA's Deputy Chief Actuary, the system (under intermediate assumptions) needs an immediate and permanent 4.7 percent point OASDI tax rate increase to equate the present value of projected taxes plus the current trust fund to the present value of projected benefit payments. This calculation doesn't truncated the projection at 75 years. If you do that, the requisite tax hike is 2.2 percentage points -- the value reported in the Trustees Report. The 4.7 requisite tax hike is probably a substantial understatement because the intermediate assumptions seem highly optimistic on longevity and real wage growth. Taking 5 cents more out of each dollar the typical worker earns is no minor matter, even if that nickle is taken in small pieces through the kinds of policies that Bob Ball and his gang recommend.

The long-term Social Security fiscal crisis is, in my view, so dangerous (accompanying, as it does, the government's health-care financing crisis) that concern with what's politically feasible is no longer a luxury we can afford.

Having said this, I know you are the last person playing the role of the politician in the policy discussions. Indeed, you are the only high-level economist in this administration that I trust to think beyond the next election and vigorously advocate what's right. At some point, if you can't make headway against the political economists, you might consider going public with what you think should be done and with how bad you think the situation is. I know this is a perscription for getting fired, but that may be the best thing to do in this environment. I think Marty's public controversy with the Reagan Administration was his finest hour.

My very best, Larry

PS, one variant of my proposal that you might consider (which Peter Diamond would advocate) is having a single government provident fund manage the individual accounts and invest them in the global index fund. Wall Street won't like this, but it will reduce transactions costs. It will also make democrates more comfortable.

At 01:23 PM 10/28/98 -0500, you wrote:

>Message Creation Date was at 28-OCT-1998 13:23:00

>

>Thank you for sending me all of the work on social security reform. Your

plan

>contains some extremely novel and interesting elements, and I have

discussed

>some of them with others here who are working on Social Security reform.

I

>agree that we will have to be ready to move in some new directions to

achieve

>reform, and we are trying to think about novel ideas. I suspect, however,
that
>your suggestions about how to handle the privatization transition
>issue--through lower expenditures, CPI fixes and a consumption tax--are
likely
>to prove politically infeasible. We are certainly sensitive to the need
to fix
>Social Security, however, in a way that raises national saving. Please
let us
>see anything further that you write on this subject. I'll send the
message to
>George. Hope he gets it--I don't.
>

RECORD TYPE: PRESIDENTIAL (TRP NOTES MAIL)

CREATOR: Douglas_W._Elmendorf (Douglas_W._Elmendorf@oa.eop.gov [oa])

CREATION DATE/TIME:12-NOV-1998 19:11:42.00

SUBJECT: Social Security update

TO: Janet L. Yellen (CN=Janet L. Yellen/OU=CEA/O=EOP [CEA])
READ:UNKNOWN

CC: Douglas W. Elmendorf (CN=Douglas W. Elmendorf/OU=CEA/O=EOP [CEA])
READ:UNKNOWN

TEXT:
Jeff and I had lunch today, and I thought I'd pass on his agenda for staff

work over the next several weeks:

1. analysis of traditional reform options (substitutes or complements for

the 3 common reforms we've been using)

2. analysis of sweeteners for Dems (widows' benefits, etc.; Corky is

involved with this)

3. annuities (I'll give you our latest draft on this topic later today)

4. summary description of IA workability (based largely on work done by

the group previously)

5. fiscal effects (continued attention by Jeff and me)

6. guarantees in IAs

7. mechanics of taking new funding off-budget (I suggested this item to

him based on your concerns)

If you have specific thoughts on these issues, or would like others pursued, let me know. Thanks again for getting me into this morning's meeting!

Doug

RECORD TYPE: PRESIDENTIAL (TRP NOTES MAIL)

CREATOR: Douglas_W._Elmendorf (Douglas_W._Elmendorf@oa.eop.gov [oa])

CREATION DATE/TIME:16-NOV-1998 14:09:42.00

SUBJECT: Social Security reforms

TO: Janet L. Yellen (CN=Janet L. Yellen/OU=CEA/O=EOP [CEA])
READ:UNKNOWN

CC: Douglas W. Elmendorf (CN=Douglas W. Elmendorf/OU=CEA/O=EOP [CEA])
READ:UNKNOWN

TEXT:
When we were talking about the feasibility of some of the "common reforms" that our group has suggested, you wondered about two possibilities not in our list. According to the 1994-96 Advisory Council report, their impact on the 75-year actuarial balance would be:

1. eliminate the hiatus in the currently scheduled increase in the normal retirement age: +.10

2. tax OASDI like private pension benefits (including the elimination of the current income thresholds): +.31

The former was included in the IA and PSA plans from the Advisory Council, and the latter was included in the IA, MB and (in part) PSA plans.

RECORD TYPE: PRESIDENTIAL (TRP NOTES MAIL)

CREATOR: Douglas_W._Elmendorf (Douglas_W._Elmendorf@oa.eop.gov [oa])

CREATION DATE/TIME:19-NOV-1998 16:10:35.00

SUBJECT: financial mkts working group update

TO: Janet L. Yellen (CN=Janet L. Yellen/OU=CEA/O=EOP [CEA])
READ:UNKNOWN

CC: Douglas W. Elmendorf (CN=Douglas W. Elmendorf/OU=CEA/O=EOP [CEA])
READ:UNKNOWN

TEXT:
1. Senator Lugar is having a hearing on Dec. 16 to:

* review progress on the hedge fund and derivatives studies that the group is writing

* talk about LTCM

The first panel is all of the CFTC commissioners; the second panel is Pat Parkinson, Roger Anderson (Treasury), and Richard Lindsey (SEC); the third panel is unclear.

2. There will probably be a principals' meeting the first week after Thanksgiving to discuss policy alternatives in very broad terms. Rubin is actively considering policy proposals with Gary Gensler and Roger Anderson, and I presume the Fed, CFTC and others are thinking about this too. Nobody thinks that specific proposals will be debated or adopted at this meeting, but Rubin wants to get some discussion going before the hearing. When the meeting draws closer, I'll give you various materials that have been produced by the group. I agree that this is not an issue we should devote a lot of time to, but at least I don't want you to be surprised by what comes up at the meeting.

Doug

RECORD TYPE: PRESIDENTIAL (TRP NOTES MAIL)

CREATOR: Douglas_W._Elmendorf (Douglas_W._Elmendorf@oa.eop.gov [oa])

CREATION DATE/TIME:20-NOV-1998 19:40:23.00

SUBJECT: Social Security update

TO: Janet L. Yellen (CN=Janet L. Yellen/OU=CEA/O=EOP [CEA])
READ:UNKNOWN

CC: Douglas W. Elmendorf (CN=Douglas W. Elmendorf/OU=CEA/O=EOP [CEA])
READ:UNKNOWN

TEXT:
Hi Janet:

1. The current plans for the WH conference on 12/8 and 12/9:

   * several hundred attendees, by invitation, largely from interest groups that did not feel part of the previous public forums

   * first day -- opening remarks by the President and Congressional leaders; comments by organizers of forums on what was learned; parallel meetings of small groups in which interest groups can express their views to Admin officials

   * second day -- small groups to interact on possible reforms

2. I went to a meeting in Barbara Chow's office with the "fiscal responsibility" folks from the Hill. These were staffers for Stenholm, Breaux, Kolbe, Moynihan, etc. I'll leave a copy of my notes with Alice, but the main points that achieved rough consensus were:

   * they want people outside of the Hill leadership to be at the table for negotiations, esp. because their Members are not in the leadership

   * they want the Admin to "deal honestly with Soc Sec liabilities" which many plans (they mentioned Ball and Gramm) do not

* they think the President needs to offer more specific principles for reform (or a plan) SOON -- some suggested specific principles and then behind-the-sceens advice to some Members on plans which the Members would introduce as bills

* they encourage a "center out" strategy, in which the left and right are ignored (a la welfare reform)

The only Admin folks there were Barbara, Jeff, David, me and some OMB leg affairs folks.

3. David testified yesterday to Ways and Means, saying that everything was on the table except an increase in the payroll tax rate (as the President had previously said).

4. The WSJ reported today that "the WH is cool to Livingston's proposal to break out the SS budget." I'll ask Jeff who said that.

5. There will be a meeting with the President on Tuesday.

Doug

RECORD TYPE: PRESIDENTIAL (TRP NOTES MAIL)

CREATOR: Douglas_W._Elmendorf (Douglas_W._Elmendorf@oa.eop.gov [oa])

CREATION DATE/TIME:23-NOV-1998 16:57:41.00

SUBJECT: budget policy in the ERP

TO: Janet L. Yellen (CN=Janet L. Yellen/OU=CEA/O=EOP [CEA])
READ:UNKNOWN

TO: Jeffrey A. Frankel (CN=Jeffrey A. Frankel/OU=CEA/O=EOP [CEA])
READ:UNKNOWN

CC: Charles F. Stone (CN=Charles F. Stone/OU=CEA/O=EOP [CEA])
READ:UNKNOWN

CC: Douglas W. Elmendorf (CN=Douglas W. Elmendorf/OU=CEA/O=EOP [CEA])
READ:UNKNOWN

TEXT:
The original outline for chapter 2 of the ERP included a section on budget policy -- the accomplishment of a balanced budget and the challenges for the future.

Chad and I discussed last week whether this material should appear instead in chapter 1. I went ahead and tried drafting it anyway, accumulating 6 pages of very rough draft. But I realized last night that chapter 2 was getting pretty long, and Chad says that Janet wanted to cover the topic in chapter 1 anyway. So I'm passing along my work to Chad, and you'll see only a brief discussion of fiscal policy in the forthcoming chapter 2 draft.

RECORD TYPE: PRESIDENTIAL (TRP NOTES MAIL)

CREATOR: Douglas_W._Elmendorf (Douglas_W._Elmendorf@oa.eop.gov [oa])

CREATION DATE/TIME:23-NOV-1998 16:12:18.00

SUBJECT: financial-market conditions

TO: Janet L. Yellen (CN=Janet L. Yellen/OU=CEA/O=EOP [CEA])
READ:UNKNOWN

TO: Jeffrey A. Frankel (CN=Jeffrey A. Frankel/OU=CEA/O=EOP [CEA])
READ:UNKNOWN

CC: Douglas W. Elmendorf (CN=Douglas W. Elmendorf/OU=CEA/O=EOP [CEA])
READ:UNKNOWN

TEXT:
Two points that we did not make in last week's WEB piece about improving

conditions:

1. There have been substantial re-flows into equity mutual funds and

high-yield bond mutual funds after several months of heavy withdrawals.

2. The supply of funds for commercial real estate has definitely suffered,

owing to troubles with REITs and low-rated commercial mortgage backed

securities.

RECORD TYPE: PRESIDENTIAL (TRP NOTES MAIL)

CREATOR: Douglas_W._Elmendorf (Douglas_W._Elmendorf@oa.eop.gov [oa])

CREATION DATE/TIME: 1-DEC-1998 18:32:03.00

SUBJECT: the Fed's daily financial market update

TO: Janet L. Yellen (CN=Janet L. Yellen/OU=CEA/O=EOP [CEA])
READ:UNKNOWN

TO: Steven N. Braun (CN=Steven N. Braun/OU=CEA/O=EOP [CEA])
READ:UNKNOWN

CC: Douglas W. Elmendorf (CN=Douglas W. Elmendorf/OU=CEA/O=EOP [CEA])
READ:UNKNOWN

CC: Mary A. Thomas (CN=Mary A. Thomas/OU=CEA/O=EOP [CEA])
READ:UNKNOWN

TEXT:
Unless you object, Mary will distribute this to you once a week from now

on. Monday's version--which incorporates data for the previous week--seems

most useful.

RECORD TYPE: PRESIDENTIAL (TRP NOTES MAIL)

CREATOR: Douglas_W._Elmendorf (Douglas_W._Elmendorf@oa.eop.gov [oa])

CREATION DATE/TIME: 1-DEC-1998 20:24:32.00

SUBJECT: provocative Social Security ideas

TO: Janet L. Yellen (CN=Janet L. Yellen/OU=CEA/O=EOP [CEA])
READ:UNKNOWN

CC: Douglas W. Elmendorf (CN=Douglas W. Elmendorf/OU=CEA/O=EOP [CEA])
READ:UNKNOWN

TEXT:
(See attached file: brook1.wpd)

I'm leaving Alice a hard copy as well.

- brook1.wpd=================== ATTACHMENT 1 ===================
ATT CREATION TIME/DATE: 0 00:00:00.00

TEXT:
Unable to convert ARMS_EXT:[ATTACH.D70]ARMSZZ000WCRQ.000 to ASCII,
The following is a HEX DUMP:

MEMORANDUM TO JANET YELLEN
FROM: Doug Elmendorf
DATE:December 1, 1998
SUBJECT: Provocative Social Security Ideas

There are several pieces here that could be rearranged or combined as desired:

1) Individual accounts have serious problems but also real advantages. (Pages 2-5)
   This is new to you, although it includes text and ideas you've seen before.

2) Is "pain-free" Social Security reform possible? (Page 6)
   I think I passed these notes on to you earlier.

3) Cutting benefits vs. prefunding benefits. (Page 7)
   I think I passed these notes on to you earlier as well.

4) Why do we want to fix Social Security? (Page 8)
   This is a summary of Larry Summers' opening comments at the meeting with the President several weeks ago. As you recall, it covers several issues we've discussed.

I'm happy to rework this material or to start again in some other direction if I've misunderstood what you're looking for.

Individual accounts have serious problems but also real advantages.

The basic problem: Social Security benefits would become defined contribution rather than defined benefit. The basic advantage: Social Security would be removed from the unified budget.

Serious Problems

1. Administrative costs

The Social Security Administration uses less than 1 cent per dollar of benefits paid out. In terms of annual fees, this corresponds to about 5 bps per year.

Vanguard--one of the mutual fund industry's leaders in cost reduction--uses 20 bps per year for indexed funds. The cost of IAs would be significantly higher:

* much smaller accounts,
* needing to keep track of *how much* money goes into *which* accounts, and
* management fees on non-indexed funds.

Alternatively, we could have more limited services.

2. Investment choices and government guarantees

Many people have no experience in making investment choices. They might make bad long-term choices (no stocks) or mis-time market moves.

We could limit portfolio choices or provide some type of guarantee.

Marty Feldstein has claimed that providing a guarantee against investment risk would not be costly to taxpayers. But he has understated the risk in several ways:

* even if the chance of needing the guarantee is small, the amount to be paid in that situation could be huge -- this is the essence of insurance
* he assumes that people hold a fixed portfolio 60:40 stocks and bonds -- but people would presumably have the option of going entirely into stocks, and might do so if there were a good guarantee -- or, people could mis-time the market by buying at peaks and selling at troughs -- both of these would raise the probability of needing a guarantee and the amount to be paid out

3. Annuitization
Social Security provides an inflation-indexed annuity, protecting beneficiaries against both longevity and inflation risk.

Annuitizing individual accounts is possible but complicated:

* government control and involvement would be large
    * Unless annuitization were mandatory, some people would run out of money, and adverse selection would be a serious problem.
    * Unless annuitization were publicly run, costs would be high and unisex pricing would be impossible.
    * Unless early access were restricted, some people would have too little money for a comfortable retirement.
    * Unless the public program were off-budget, budget numbers would be badly distorted.
* ensuring the desirable outcome on these specifics would be difficult to ensure
    * Policymakers will focus on the perceived key issues, and annuitization details are not likely to be on that list.
    * Many of the specifics involve more public rules or involvement than IA supporters are likely to support.
* volatility of payment levels owing to financial-market developments would be substantial
    * Gradual purchase of annuities helps, but equity variability is large.
    * Variable annuities could be used, but then you lose the inflation protection.

These problems would be much larger if IAs represented a larger share of total Social Security benefits.

In sum

Defined-benefit pension plans have real advantages over defined-contribution plans: they naturally spread investment and longevity risk, and they have low administrative costs and require little knowledge by participants.

DB plans have diminished in importance in the private sector because of our dynamic labor market. People don't work for the same company their entire lives, and companies come and go. So non-portable benefits that depend on consistent corporate management have a problem. But these problems don't exist with Social Security, so this is the place to have DB pensions.

Note that many of the solutions to these problems amount to making IAs behave more like DB pensions. But then what are the advantages of IAs?

Real Advantages

The primary advantage is removing Social Security from the unified budget, which would have several effects (#1-#4 below). There are also other effects (#5-#7 below).

1. Pre-funding

We could pre-fund benefits in a way that we've proven unable to do with Social Security in the unified budget. This would raise national saving, which is probably the appropriate response to an aging population. (It would probably not raise saving dollar-for-dollar, because of private saving responses.) Moreover, it would make each cohort more responsible for its own retirement, which probably is fair.

2. Equity returns without corporate governance problems

Putting equities into the public retirement system would have minimal effects on the nation as a whole: Although one can work out a variety of general equilibrium effects, the primary impact is simply to leave more bonds and fewer equities in private hands.

Still, there may be advantages to this step. For example, raising the expected return on public assets relative to private assets may be progressive, since private assets are held disproportionately by rich people. (Risk-sharing is probably not a reason to do this, contrary to Peter Diamond's claims. Efficiency of financial markets would not be improved by government risk-sharing because ownership of major equities is already sufficiently broad. Equity would not necessarily be improved either. The government already bears substantial equity risk through capital taxation, and that may be enough to achieve appropriate intergenerational risk-sharing. Poor people bear no direct risk today (or receive the higher return directly), but they bear some through the government budget, and they probably would not be the residual claimant through the Social Security system anyway.)

But public equity investments raises a host of concerns:

* deciding what to buy -- some of this emerges under IAs as well, if we limit investment options
* deciding how to exercise control -- the government could hold 10% or more of total equities under some hypothetical plans (and depending on equity performance)

3. Less budget distortion

With Social Security in the unified budget, we seem flush with money now and will seem starved for money in 20 years. These swings in availability of funding for other needs are not useful.

4. Less political risk

Pre-funded benefits would be less susceptible to the whims of future political leaders.

5. More clarity about redistribution

In addition to the progressive income redistribution, Social Security redistributes money in a variety of other ways (for example, from dual-earner families to single-earner families). These issues have not been discussed openly for decades, and setting up IAs would force the country to be explicit about the types and amount of redistribution we favored.

6. Less distortion to labor supply

People tend to view current FICA "contributions" as taxes. Some of that is related to real redistribution, but some is related to the general fog around the whole system in people's minds. IAs would be clearer, so people's perceived marginal tax rates would be smaller for the same amount of actual redistribution.

7. "Double-counting" may seem less peculiar

Moving the funds out of the government would at least prevent triple counting by some future Congress.

Is "Pain-Free" Social Security Reform Possible?

- Several years ago, concern about the Social Security imbalance (and growing entitlements for the elderly in general) implied that benefits should be cut or taxes raised. These painful measures have been the standard in Social Security reform (for example, in 1983).

- Suddenly, the possibility of "pain-free" reform has emerged, stemming from two novelties:
    - the emergence of projected budget surpluses
    - a willingness to invest public funds in the stock market

- But these developments do not really offer a free lunch.

  Devoting too much of the projected surpluses to reform has costs:
    - Projected surpluses might not materialize, leaving a big fiscal gap.
    - Surpluses used to fund benefits cannot be used for spending initiatives or tax cuts.

  Investing in equities has costs:
    - Stocks may not yield the return we expect.
    - Swapping equities for bonds with the private sector contributes nothing to the nation as a whole.

- Because of population aging, the nation cannot maintain historic patterns of Social Security replacement rates, tax rates, and discretionary spending into the next century. Small adjustments in each of these areas would reduce the need for big adjustments in any one area.

- Trimming benefits or raising taxes--in addition to setting aside some of the projected surpluses--is good public policy.

Cutting Benefits vs. Prefunding Benefits

We have been viewing these options as perfect substitutes in terms of fiscal responsibility, and I think this view is mostly correct. However, several factors suggest that cutting benefits is more fiscally responsible than prefunding them--for a given projected 75-year impact:

1. Benefit cuts have better effects beyond the 75-year window.

2. Prefunding benefits has greater risk.
   If we cut benefits, they're cut. But the projected effect of prefunding depends on equities earning the return we project and yet-unrealized surpluses coming to pass.

3. Prefunding wouldn't raise saving as much as we project.
   Our calculations assume that all of the surplus devoted to prefunding represents incremental saving. In fact, some of the money placed in IAs would be offset by lower other saving (and maybe extra money placed in the trust fund would be offset too), and some of the money used for tax cuts would be saved. So the net saving could be 2/3 or so of our projections.

4. Future flows matter as well as stocks.
   Large deficits cause economic dislocations and put pressure on other spending even if the stock of debt is low. (Note that under TF in equities plans, future deficits are smaller because of equity sales.) Large amounts of dis-saving cause economic dislocations even if the stock of capital is high.

In addition, we may also prefer the equity implications of benefit cuts. If we believe that the government is already committing too large a share of its resources to older people in the next century, then we would prefer to devote some of the surpluses to other national needs. (Politics may make this difficult, however.)

These arguments suggest that devoting more of the surplus to Social Security reform in order to raise future benefits--an idea raised at the principals' meeting--is not good policy.

Also, these arguments illustrate the limitations of calculating changes in national savings. National savings is the best measure of the impact of reform on the size of the future economic pie. National savings adjusted for changes in benefit levels is the best measure of what we're doing for future generations.

Larry Summers: Why Do We Want to Fix Social Security?

First, because currently legislated taxes are insufficient to pay currently legislated benefits over the next 75 years. Social Security is essentially a pension system, and the actuaries have given us a bad report on the funding of that system. This problem could be fixed by raising the payroll tax, cutting benefits, achieving a higher rate of return, or transferring general revenue.

Second, because the share of the U.S. population over age 65 will increase sharply in the next century. Regardless of what pieces of paper are held by the Social Security Trust Fund, society will face a larger burden of caring for older people. This burden has been perceived partly as an "entitlements problem," because growing government expenditures for the elderly could direct money away from other social needs. People who have been concerned about this problem might feel that using general revenue to finance Social Security would move our fiscal system in exactly the wrong direction.

Third, because we want to block the use of the projected surpluses for a large tax cut that would mortgage our future to a greater degree. The key question here is what would happen to the surpluses in the absence of Social Security reform. If the surpluses would be eliminated by a tax cut, then using them for Social Security reform instead would improve the situation in 2030. But if the surpluses could be maintained without Social Security reform, then committing them to the Trust Fund creates a danger of making the 2030 problem worse if the surpluses do not materialize.

RECORD TYPE: PRESIDENTIAL (TRP NOTES MAIL)

CREATOR: Douglas_W._Elmendorf (Douglas_W._Elmendorf@oa.eop.gov [oa])

CREATION DATE/TIME:11-DEC-1998 20:58:04.00

SUBJECT: some thoughts on the Feldstein plan

TO: Janet L. Yellen (CN=Janet L. Yellen/OU=CEA/O=EOP [CEA])
READ:UNKNOWN

CC: Douglas W. Elmendorf (CN=Douglas W. Elmendorf/OU=CEA/O=EOP [CEA])
READ:UNKNOWN

TEXT:
TO: DAVID

FROM: DOUG

Potential Feldstein line:

1. Relative to current policy, he's doing more pre-funding of the defined benefits in Social Security. This is classic Marty on Social Security and saving.

2. Plus, he's pre-funding additional benefits. This doesn't raise future resources available for others, but neither does it reduce them.

3. The national savings estimates of the Technical Working Group assume that pre-funding raises national saving only during the surplus era; after that, the contributions to IAs are offset by larger deficits. But an alternative political economy rule says that those deficits would force tax increases or spending cuts, so the savings impact of moving to a funded system is larger than we estimate.

4. The national savings estimates of the TWG stop at 75 years. But his plan is pre-funding not just the first 75 years of benefits (like most trust fund-style plans) but benefits in years beyond that.

Rebuttal:

1. Raising expected benefits based on projected surpluses and projected equity returns is dangerous. (In fact, Marty wants to assume a higher return than the actuaries.) We're committing to future benefits and taking on large risk.

2. Instead of saving resources for oldsters, we should spend them now (or save them) for youngsters.

3. The national saving effects of pre-funding are not as large as they appear because there are savings offsets (some of tax cuts would be saved, and some of IA contributions would reduce other saving -- we don't calculate these) and because the equity stuff is asset-swapping with the private sector (we do calculate these).

4. Pre-funding benefits is not a substitute for cutting benefits. I think I sent you my one-pager on this before. My arguments:

a. benefits cuts have better effects beyond the 75-year window -- true for trust fund plans but not IA plans

b. prefunding has greater risk -- already made in #1

c. prefunding wouldn't raise saving as much as we estimate -- already made in #3

d. future flows matter as well as stocks -- large deficits and dis-saving cause economic dislocations even if debt is low and the capital stock is high

Re-rebuttal:

1. The risk of the Feldstein plan is not substantially different than the risk of any other politically feasible plans (i.e., benefits are not going

to be cut and equities are going to be used). Any greater commitments are matched by greater pre-funding.

[I'd need to see our estimates of the plan to see if this is true. But I can imagine some version of the following: The Feldstein plan uses more surplus early and less in the out-years than other suggested plans (e.g., our 68% of surplus into the trust fund for equities plan), which reduces risk. In any case, political economy rules will force future tax and spending adjustments if the deficit or stock market do badly. However, the Feldstein plan buys more equities than other plans. Also, the plan assumes a higher return than the actuaries say, but Summers and Wilcox think the actuaries are too low also.]

2. Saving in the government is never going to really work. You'll never be able to really pre-fund in the trust fund, even if current budget rules for equities imply that you can. Thus, the key to more saving via pre-funding is moving really and truly out of the budget.

3. Nobody is going to save or spend more on youngsters anyway.

My summary:

I think that raising expected benefits would be about the worst possible outcome of the reform process. At the same time, pre-funding benefits in a way that is not offset by other government borrowing would be about the best possible outcome of the reform process. The Feldstein plan does both -- so it is hardly my favorite, but I can imagine worse. (And I don't think it is really the antithesis of earlier Feldstein, as you suggested.)

I'd really like to see one of our budget/national savings tables for this plan -- guess I'll ask Jeff.

One way to rephrase this is that I don't mind the Feldstein structure so much (assuming we did a TSP variant), but I don't like the amount of surplus they're throwing into it. I'm concerned that political compromise is going to end up raising benefits -- not because of a bidding war for oldsters, but in order to both shore up traditional SS for the Dems and give IAs to the Repubs. A simple rearrangement of the Feldstein flows would cover the 2.19 shortfall AND set up small IAs (a hybrid with much higher expected benefits). But this directs even more resources to the elderly.

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TO: DOUG

FROM: DAVID

I'll look at this more carefully over the weekend. Here's a quick reaction.

If the base line is save the surpl, Feldst is appalling (lower taxes at every

point, more benefits.) Under his baseline (spend the surpl), his baseline is better than baseline. How much of the surp doe you need to spend or taxcut away for his plan to be neutral relative to baseline on natl saving?

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TO: DAVID

FROM: DOUG

That's a good question.

I know it won't have any effect on the policy process, but I'd be curious to re-estimate our saving effects incorporating crude estimates of:

some fraction of the surplus paying down debt

some fraction of tax cuts being saved

some fraction of IAs crowding out other private saving

For example, we now assume that every dollar moved out of the surplus into IAs increases national saving by one dollar. But suppose that: 1) The true baseline is 50% tax cuts, 30% spending increases, and 20% pay down the debt. 2) 10% of tax cuts (which would be 5% of surplus) would be saved. 3) 25% of IA contributions would be offset by less other saving.

Then, every dollar moved into IAs would increase saving by 50 cents. This is much smaller, but of course nontrivial. To get the whole picture, we need to look at future benefits, etc.

RECORD TYPE: PRESIDENTIAL (TRP NOTES MAIL)

CREATOR: Douglas_W._Elmendorf (Douglas_W._Elmendorf@oa.eop.gov [oa])

CREATION DATE/TIME:11-DEC-1998 22:09:50.00

SUBJECT: Feldstein plan and misc.

TO: Janet L. Yellen (CN=Janet L. Yellen/OU=CEA/O=EOP [CEA])
READ:UNKNOWN

CC: Douglas W. Elmendorf (CN=Douglas W. Elmendorf/OU=CEA/O=EOP [CEA])
READ:UNKNOWN

TEXT:
Jeff Liebman will get us a copy of Goss's analysis of the Feldstein plan on Monday. This analysis does not include the fiscal tables that we have done for our hypothetical plans. Jeff and I tried to talk through what those table would show, but it's tricky. We guess that Feldstein's benefits are 8-10% higher than current law, which is on the high side of the plans we've looked at. Also, he is funding this excess through a higher assumed rate of return, so it is not paid for through extra saving.

FYI on other topics:

I attended a long meeting this week on bankruptcy reform, which the Admin. is trying to formulate a position about for the new Congress. And I attended a long financial mkts meeting, in which various regulators reported on hedge funds and their counterparties. The good news: LTCM was really unusual in its size and leverage. The bad news: lenders have not been following their written procedures on lending to hedge funds, although this may be changing.

RECORD TYPE: PRESIDENTIAL (TRP NOTES MAIL)

CREATOR: Douglas_W._Elmendorf (Douglas_W._Elmendorf@oa.eop.gov [oa])

CREATION DATE/TIME:14-DEC-1998 17:57:17.00

SUBJECT: budget accounting

TO: Janet L. Yellen (CN=Janet L. Yellen/OU=CEA/O=EOP [CEA])
READ:UNKNOWN

CC: Douglas W. Elmendorf (CN=Douglas W. Elmendorf/OU=CEA/O=EOP [CEA])
READ:UNKNOWN

TEXT:
An exchange between me and David Wilcox this morning:

ME: (also to Jeff Liebman)

I assume you've both seen Alicia Munnell's column in the Post this morning.

Is taking Social Security out of the budget a completely dead issue, or

could it be revived somehow? It does seem to be an approach with some

bipartisan support ...

DAVID:

I don't think it's completely dead. The difficulty, however (and not one

to

be minimized) is how we would deal with the fact that it effectively

would "move the goalposts" on one of the Administration's signal

achievements -- namely having "balanced the budget." How could we

do this proposal without jeopardizing that legacy?

ME:

The other problem with taking so much money off the table is that we want to spend some ourselves. I don't underestimate the difficulty of doing this, but I wish the idea would be discussed, at least, at higher levels.

ME: (also to Jeff Liebman)

How about taking SS out of the budget gradually?
Since we project on-budget surpluses beginning in 2002 or 2004, we could take SS out of the budget over a five-year period and preserve the surpluses. We also might have some room for new spending or tax cuts. The gradual approach might seem flaky, but actually I think that's too harsh. I don't think there's a great economic argument for it, but the sensible policy argument is that we've used one method of budget accounting for many years, and we need to adjust slowly to the new location of the goalposts.

RECORD TYPE: PRESIDENTIAL (TRP NOTES MAIL)

CREATOR: Douglas_W._Elmendorf (Douglas_W._Elmendorf@oa.eop.gov [oa])

CREATION DATE/TIME:15-DEC-1998 14:50:26.00

SUBJECT: sell now!

TO: Janet L. Yellen (CN=Janet L. Yellen/OU=CEA/O=EOP [CEA])
READ:UNKNOWN

TO: Steven N. Braun (CN=Steven N. Braun/OU=CEA/O=EOP [CEA])
READ:UNKNOWN

TO: m1ked99 (m1ked99@frb.gov [UNKNOWN])
READ:UNKNOWN

CC: Douglas W. Elmendorf (CN=Douglas W. Elmendorf/OU=CEA/O=EOP [CEA])
READ:UNKNOWN

TEXT:
From Slate's Moneybox column:

"Analysts now expect the companies in the S&P 500 to grow earnings by 18 percent in 1999. Given global economic conditions, the only way this could be accurate is if we're going to be colonizing a new planet in January and American companies are going to be exclusive suppliers to this previously untapped market."

RECORD TYPE: PRESIDENTIAL (TRP NOTES MAIL)

CREATOR: Douglas_W._Elmendorf (Douglas_W._Elmendorf@oa.eop.gov [oa])

CREATION DATE/TIME:31-DEC-1998 13:33:19.00

SUBJECT: Re: next chapter for you to edit

TO: James M. Treadway (CN=James M. Treadway/OU=CEA/O=EOP [CEA])
READ:UNKNOWN

TO: Janet L. Yellen (CN=Janet L. Yellen/OU=CEA/O=EOP [CEA])
READ:UNKNOWN

TO: Jeffrey A. Frankel (CN=Jeffrey A. Frankel/OU=CEA/O=EOP [CEA])
READ:UNKNOWN

TO: Michele Jolin (CN=Michele Jolin/OU=CEA/O=EOP [CEA])
READ:UNKNOWN

CC: Douglas W. Elmendorf (CN=Douglas W. Elmendorf/OU=CEA/O=EOP [CEA])
READ:UNKNOWN

TEXT:
Mike:

I'm in the process of revising chapter 2 in response to interagency comments, so only I have the latest version. Let me know when you want to start editing it.

Doug

RECORD TYPE: PRESIDENTIAL (TRP NOTES MAIL)

CREATOR: Douglas_W._Elmendorf (Douglas_W._Elmendorf@oa.eop.gov [oa])

CREATION DATE/TIME: 8-JAN-1999 15:40:16.00

SUBJECT: budget

TO: Janet L. Yellen (CN=Janet L. Yellen/OU=CEA/O=EOP [CEA])
READ:UNKNOWN

TO: Jeff B. Liebman (CN=Jeff B. Liebman/OU=OPD/O=EOP [OPD])
READ:UNKNOWN

TO: David.Wilcox (David.Wilcox@ms01.do.treas.sprint.com [UNKNOWN])
READ:UNKNOWN

CC: Douglas W. Elmendorf (CN=Douglas W. Elmendorf/OU=CEA/O=EOP [CEA])
READ:UNKNOWN

TEXT:
I was just reading about the Repubs' plan for a tax cut, and I'd like to venture the following prediction: The Admin proposes option #1, but the 30% we earmark for Medicare and the rainy day fund goes to a broad tax cut. The UP is also a tax cut of sorts, so the Repubs get almost half the total for tax cuts and the Dems get half for Soc Sec.

The political calculation underlying this prediction is that saving SS beats a tax cut, but a tax cut beats anything else. (Since the out-of-the-budget option barely leaves enough money for saving SS, the tax cut would be squeezed out. But I understand why talking about that is beating a dead horse.)