

Withdrawal/Redaction Sheet

Clinton Library

DOCUMENT NO. AND TYPE	SUBJECT/TITLE	DATE	RESTRICTION
001. email	Arlene F Reeves to Janet L. Yellen, Rebecca M. Blank, atc@npr.org, ccox@gridnet.com, and press.bar@mail.house.gov. Subject: Survival is costing us our children. (3 pages)	04/22/1999	b(6)

COLLECTION:

Clinton Presidential Records
Automated Records Management System [Email]
CEA ([Yellen])
OA/Box Number: 950000

FOLDER TITLE:

[04/02/1999 - 05/05/1999]

2013-0723-F
ab1297

RESTRICTION CODES

Presidential Records Act - [44 U.S.C. 2204(a)]

- P1 National Security Classified Information [(a)(1) of the PRA]
- P2 Relating to the appointment to Federal office [(a)(2) of the PRA]
- P3 Release would violate a Federal statute [(a)(3) of the PRA]
- P4 Release would disclose trade secrets or confidential commercial or financial information [(a)(4) of the PRA]
- P5 Release would disclose confidential advice between the President and his advisors, or between such advisors [(a)(5) of the PRA]
- P6 Release would constitute a clearly unwarranted invasion of personal privacy [(a)(6) of the PRA]

C. Closed in accordance with restrictions contained in donor's deed of gift.

PRM. Personal record misfile defined in accordance with 44 U.S.C. 2201(3).

RR. Document will be reviewed upon request.

Freedom of Information Act - [5 U.S.C. 552(b)]

- b(1) National security classified information [(b)(1) of the FOIA]
- b(2) Release would disclose internal personnel rules and practices of an agency [(b)(2) of the FOIA]
- b(3) Release would violate a Federal statute [(b)(3) of the FOIA]
- b(4) Release would disclose trade secrets or confidential or financial information [(b)(4) of the FOIA]
- b(6) Release would constitute a clearly unwarranted invasion of personal privacy [(b)(6) of the FOIA]
- b(7) Release would disclose information compiled for law enforcement purposes [(b)(7) of the FOIA]
- b(8) Release would disclose information concerning the regulation of financial institutions [(b)(8) of the FOIA]
- b(9) Release would disclose geological or geophysical information concerning wells [(b)(9) of the FOIA]

**Clinton Presidential Records
Automated Records Management System
[EMAIL] and Tape Restoration Project [Email]**

This is not a presidential record. This is used as an administrative marker by the William J. Clinton Presidential Library Staff.

This marker identifies a responsive email, already made available within another collection.

Collection: 2014-0316-F

Bucket: CEA

Creation Date: 1999-04-02

Subject: overview of latest International Energy Outlook

Creator: Joseph E. Aldy CN=Joseph E. Aldy/OU=CEA/O=EOP [CEA]

**Clinton Presidential Records
Automated Records Management System
[EMAIL] and Tape Restoration Project [Email]**

This is not a presidential record. This is used as an administrative marker by the William J. Clinton Presidential Library Staff.

This marker identifies a responsive email, already made available within another collection.

Collection: 2014-0316-F

Bucket: CEA

Creation Date: 1999-04-02

Subject: developing countries decision memo

Creator: Joseph E. Aldy CN=Joseph E. Aldy/OU=CEA/O=EOP [CEA]

**Clinton Presidential Records
Automated Records Management System
[EMAIL] and Tape Restoration Project [Email]**

This is not a presidential record. This is used as an administrative marker by the William J. Clinton Presidential Library Staff.

This marker identifies a responsive email, already made available within another collection.

Collection: 2014-0316-F

Bucket: CEA

Creation Date: 1999-04-05

Subject: interest rates

Creator: Douglas W. Elmendorf CN=Douglas W.
Elmendorf/OU=CEA/O=EOP [CEA]

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

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

CREATION DATE/TIME: 5-APR-1999 16:09:28.00

SUBJECT: last week's highlights

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

READ:UNKNOWN

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

READ:UNKNOWN

TEXT:

0. No Social Security meetings.

1. I commented on the forthcoming hedge fund study; my memo to Gary Gensler should be in your in-box.

2. I worked on bankruptcy reform, and I've updated Becky on this.

3. I thought carefully about Marty Feldstein's claim that corporate tax revenue would increase under his Social Security plan, and decided that he was even more wrong than I had previously believed. I'll hold off giving you a copy of my analysis until I get feedback from Jeff, David, or Len, just in case I made some embarrassing mistake.

4. I thought a little about rising stock-market prices and will try to write something for you and Robert on the topic in the next few days.

5. I worked on two Web pieces, with lots of help from Chad and Ryan. Robert would like to pursue further the point that the recent stock price runup is narrower (i.e., involves fewer stocks) than usual. I had seen this issue raised in various places, and that's why it appears in the Web (it was in the Post again over the weekend), but Ryan couldn't get all the data we needed to analyze it thoroughly last week. Anyway, I told Robert that Ryan was still pushing ahead, and we should have something by later this week.

6. I thought about the cost to the government of guaranteeing individual accounts. Jeff, David and I discussed this topic a few weeks ago as an appropriate subject for the technical working group, so we're trying to make some headway.

7. I should have a draft of a Minnesota Meeting speech for you by the beginning of next week.

Doug

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Robert.Shapiro@mail.doc.gov@INET@LNGTWY (Robert.Shapiro@mail.doc.gov@INET@LNGTWY [UNKNOWN])

CREATION DATE/TIME: 5-APR-1999 12:50:08.00

SUBJECT: Impact of corrected census data

TO: Janet L. Yellen@eop (Janet L. Yellen@eop [CEA])
READ:UNKNOWN

TEXT:

Here's what Lee and I think you could suggest to Karen. You (we) could ask Census for what kinds of data it provides as the benchmark data for business marketing purposes, and who their customers are, and CEA could make general statements about the importance of these data for business planning and marketing. In addition, BLS has already done an analysis of the impact of the statistical corrections to the 1990 decennial data on employment statistics -- like the unemployment rate. Kathy Wallman could ask other agencies that use demographic microdata to prepare comparable analyses -- eg., Justice, HHS (health), education. Then CEA could say that the use of statistical methods in producing accurate census data makes the following difference for business and economic policy makers, who depend on these data sets.

Hope this helps.

===== ATTACHMENT 1 =====
ATT CREATION TIME/DATE: 0 00:00:00.00

TEXT:

RFC-822-headers:

Received: from conversion.pmdf.eop.gov by PMDF.EOP.GOV (PMDF V5.1-9 #29131)
id <01J9OAS06QY8006JBY@PMDF.EOP.GOV> for yellen_j@al.eop.gov; Mon,
5 Apr 1999 12:49:07 EST

Received: from storm.eop.gov by PMDF.EOP.GOV (PMDF V5.1-9 #29131)
with ESMTP id <01J9OARXK68W006NVW@PMDF.EOP.GOV> for yellen_j@al.eop.gov; Mon,

05 Apr 1999 12:49:03 -0500 (EST)

Received: from mail.doc.gov ([170.110.214.11]) by EOP.GOV (PMDF V5.2-29 #34437)

with SMTP id <01J9OAR7EWV2000ZU2@EOP.GOV> for yellen_j@al.eop.gov; Mon,
05 Apr 1999 12:48:30 -0500 (EST)

Received: by mail.doc.gov(Lotus SMTP MTA v4.6.1 (569.2 2-6-1998))
id 8525674A.005CA5E8 ; Mon, 05 Apr 1999 12:51:57 -0400

X-Lotus-FromDomain: USDOC

===== END ATTACHMENT 1 =====

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Ronald Minsk (CN=Ronald Minsk/OU=OPD/O=EOP [OPD])

CREATION DATE/TIME: 6-APR-1999 18:03:50.00

SUBJECT: Ag memo

TO: Ronald Minsk (CN=Ronald Minsk/OU=OPD/O=EOP @ EOP [OPD])
READ:UNKNOWN

TO: Melissa G. Green (CN=Melissa G. Green/OU=OPD/O=EOP @ EOP [OPD])
READ:UNKNOWN

TO: Ronald M. Cogswell (CN=Ronald M. Cogswell/OU=OMB/O=EOP @ EOP [OMB])
READ:UNKNOWN

TO: Elwood Holstein (CN=Elwood Holstein/OU=OMB/O=EOP @ EOP [OMB])
READ:UNKNOWN

TO: Elise H. Golan (CN=Elise H. Golan/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TO: Shannon Mason (CN=Shannon Mason/OU=OPD/O=EOP @ EOP [OPD])
READ:UNKNOWN

TO: Mark A. Weatherly (CN=Mark A. Weatherly/OU=OMB/O=EOP @ EOP [OMB])
READ:UNKNOWN

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

TO: Sally Katzen (CN=Sally Katzen/OU=OPD/O=EOP @ EOP [OPD])
READ:UNKNOWN

TEXT:

Current version is attached.===== ATTACHMENT 1 =====

ATT CREATION TIME/DATE: 0 00:00:00.00

TEXT:

Unable to convert ARMS_EXT:[ATTACH.D34]MAIL473053902.136 to ASCII,
The following is a HEX DUMP:

MEMORANDUM FOR JOHN PODESTA

FROM: SALLY KATZEN
ELGIE HOLSTEIN

SUBJECT: Department of Agriculture Proposal

DATE: April 7, 1999

At the conclusion of yesterday's meeting, you requested that the Department of Agriculture ("USDA") prepare a proposal that would cost approximately \$1 billion for the 1999 farm year. Attached is the paper that USDA sent to us. The amount of spending is somewhat above the guidance that you provided in yesterday's meeting (based on current estimates), and the USDA proposal would extend through FY 2002.

The principal component of the proposal is an income loss adjustment program that USDA estimates will cost \$1.02 billion of the \$1.160 billion total. Payments are triggered by a 10 percent drop from the five-year average farm income; provide a 10 percent recoupment; and cover the eight major field crops. The proposal also includes an extension of the dairy price support at the present level at a cost of \$125 million in the first year (and \$150 million in the second year), and an on-farm storage component at \$10 million (reduced from the \$50 million proposed earlier). The USDA proposal does not include any payments for livestock.

As mentioned yesterday, USDA's proposal does not include government payments in the calculation of farm income. Accordingly, it is likely that farmers would receive total payments (from the market for a particular crop plus government payments in the form of loan deficiency payments for that crop) that exceed their five-year average income, and still receive income loss payments. If AMTA payments were also included, we estimate that many farmers would not experience a 10 percent drop in their total farm income this year.

The USDA program is triggered by a decline in gross revenues for a particular crop; given that there are year-to-year swings in production, this could lead to income loss payments even though the price holds firm or increases. Finally, USDA has targeted its program by imposing a cap on individual payments, which are set in relation to the AMTA payment limitations.

We have identified six options:

Option 1: Accept the USDA proposal as put forward in the attached paper. Cost: \$1.160 billion for the first year. This option includes nothing for livestock, though hog farmers are hurting. There would presumably be payments for soybeans farmers, though their total income would be

in line with past experience if you include expected loan deficiency payments.

Option 2: Increase the cost of the USDA package by \$200 million to include livestock. Cost: \$1.360 billion for the first year.

Option 3: Include loan deficiency payments in calculating gross revenue. This would result in savings of roughly \$400 million, which would enable us to include livestock in the program under the same terms as the eight major crops and to increase the amount of the recoupment from 10 percent to roughly 11 percent, all within your \$1 billion guidance. Based on current estimates, cotton, rice, and soybeans would not be eligible because they would not experience a 10 percent drop in gross revenue. At the same time, those most in need would receive slightly more assistance than under options 1 or 2. Cost: \$1 billion for the first year.

Option 4: Include AMTA payments as well as loan deficiency payments in calculating farm income. This would result in savings of roughly \$780 million, which again could be used to include livestock in the program under the same terms as the eight major crops and increase the amount of the recoupment even more: from 10 percent to roughly 30 percent. Based on current estimates, cotton, rice, soybeans, corn, and barley would not be eligible because they would not experience a 10 percent drop in gross revenue this year. Only wheat, sorghum, and oats would be eligible. Again, those most in need would receive even more assistance than under the preceding options. Cost: \$1 billion for the first year.

Option 5: Add an additional trigger to the program so that payments would only be made when the price of the covered crop or livestock (as opposed to just gross revenue) dropped by more than 10 percent from the five-year average price. Cost: No additional savings or cost.

Option 6: Add targeting in addition to a limitation on individual payments by making only those farms with less than \$1 million in gross sales (not including government payments) eligible for income adjustment payments. The savings will be roughly one percent of the total assistance provided under any of the above options.

* * *

USDA prefers option 2, although it has no objection to adding option 5 to it. Its second choice would be option 1. OMB and NEC staff prefer option 3, with both options 5 and 6 as overlays.

(Note: We have a call into Peter Scher who is checking on the WTO issue.)

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Ronald Minsk (CN=Ronald Minsk/OU=OPD/O=EOP [OPD])

CREATION DATE/TIME: 7-APR-1999 18:09:21.00

SUBJECT: Ag options

TO: Elise H. Golan (CN=Elise H. Golan/OU=CEA/O=EOP @ EOP [CEA])

READ:UNKNOWN

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

READ:UNKNOWN

TEXT:

----- Forwarded by Ronald Minsk/OPD/EOP on 04/07/99 06:08 PM -----

Sally Katzen

04/07/99 03:15:18 PM

Record Type: Record

To: See the distribution list at the bottom of this message

cc: See the distribution list at the bottom of this message

Subject: Ag options

here's the paper requested at monday's meeting. we await your reactions.

Message Sent

To:

John Podesta/WHO/EOP

Gene B. Sperling/OPD/EOP

Sylvia M. Mathews/OMB/EOP

Lawrence J. Stein/WHO/EOP

Ron Klain/OVP @ OVP

Maria Echaveste/WHO/EOP

Message Copied

To:

Elwood Holstein/OMB/EOP

gfrazier @ usda.gov @ inet

Karen Tramontano/WHO/EOP

Lisa M. Kountoupes/WHO/EOP

David W. Beier/OVP @ OVP

===== ATTACHMENT 1 =====

ATT CREATION TIME/DATE: 0 00:00:00.00

TEXT:

Unable to convert ARMS_EXT:[ATTACH.D23]MAIL49723411R.136 to ASCII,
The following is a HEX DUMP:

MEMORANDUM FOR JOHN PODESTA

FROM: SALLY KATZEN
ELGIE HOLSTEIN
GREG FRAZIER

SUBJECT: Department of Agriculture Proposal

DATE: April 7, 1999

At the conclusion of Monday's meeting, you requested that the Department of Agriculture ("USDA") prepare a proposal to supplement the income of growers of major crops and stabilize dairy prices that would cost approximately \$1 billion for the 1999 farm year. USDA has designed a package that, based on current estimates, is generally consistent with the guidance (\$1.145 billion), although the USDA proposal would extend through FY 2002 (through the end of the 1996 Farm bill) at a total estimated cost of \$1.735 billion.

The principal component of the USDA proposal is a counter-cyclical farm income loss adjustment program that USDA estimates will cost \$1.02 billion for the first year. Payments would be triggered when the gross revenues (total production multiplied by the U.S. season-average price) from one of the eight major crops declines by at least 10 percent from the preceding five-year average. The proposal would provide a 10 percent recoupment of the decline. The amount for any individual farmer would be limited by a cap proportional to the existing \$40,000 per individual program payment limit; that is, if the total paid under this program were one-quarter the amount scheduled for payment under the farm bill, then the limit would be one-quarter the existing payment limit, or \$10,000. USDA estimates that this program would cost \$240 million for the 2000 crop and would not be triggered for the 2001 or the 2002 crops.

The USDA proposal also includes an extension of the dairy price support at the present level (\$9.90 per hundredweight), at a cost of \$125 million in the first year (\$150 million in the second year). The USDA proposal does not include any payments for livestock.

USDA's proposal does not include government payments in the calculation of gross revenues. Accordingly, it is likely that farmers would receive money from the market for a particular crop plus government payments in the form of loan deficiency payments for that crop that exceeds their five-year gross revenues, and still receive "income loss" payments. If AMTA payments as well as loan deficiency payments were included, we estimate that many farmers would not experience a 10 percent decline in gross revenues this year.

Notwithstanding that the program is entitled “income loss adjustment”, it is triggered by a decline in gross revenues for a particular crop. Given that there are year-to-year swings in production, this could lead to “income loss” payments even though the price holds firm or increases. Moreover, there could be a decline in the cost of inputs such that net income remained steady while gross revenues fell; these farmers would still be eligible for “income loss” payments.

We have identified six options:

Option 1: Accept the USDA proposal. Cost: \$1.145 billion (for the first year). This option includes nothing for livestock, even though hog farmers are hurting. There would presumably be payments for soybeans farmers, even though their total income would be in line with past experience if you include expected loan deficiency payments.

Option 2: Increase the cost of the USDA package by \$200 million to include livestock. USDA estimates that such a program would not trigger payments for cattle producers but would for hog producers. USDA does not believe that it will be triggered in subsequent years for any livestock. USDA would also like to add an on-farm grain storage facility construction program to improve farmers’ marketing flexibility. USDA estimates that \$10 million would underwrite \$200 million in loans which would provide capacity for 130 million bushels of grain. Cost: \$1.355 billion for the first year.

Option 3: Include loan deficiency payments in calculating gross revenue. Based on current estimates, cotton, rice, and soybeans would not qualify because they would not experience a 10 percent drop in gross revenue. This results in savings of \$400 million from Options 1 and 2. These savings could be used to increase the recoupment on losses to 14 percent if livestock assistance is not included (Option 1), or to 11 percent while including \$200 million in livestock assistance (Option 2), and still stay within the \$1 billion guidance, while directing more assistance to those most in need.

Option 4: Include AMTA payments as well as loan deficiency payments in calculating gross revenue. Based on current estimates, cotton, rice, soybeans, corn, and barley would not qualify because they would not experience a 10 percent drop in gross revenue this year. Only wheat, sorghum, and oats would trigger. This results in savings of \$780 million from Options 1 and 2. Similar to Option 3, these savings could be used to increase the recoupment to 38 percent if livestock assistance is not included, or to 30 percent with \$200 million in livestock assistance, while staying within guidance and directing even more aid to those most in need.

Option 5: Add an additional trigger to the program so that payments would only be made when the price of the covered crop or livestock (as opposed to just gross revenue) dropped by more than 10 percent from the five-year average price. Cost: No additional savings or cost because all eight commodities are projected currently to meet this trigger.

Option 6: Add targeting in addition to a limitation on individual payments by making only those farms with less than \$1 million in gross sales (not including government payments) eligible for income loss payments. The savings will be roughly one percent of the total assistance provided under any of the above options.

*

*

*

USDA prefers Option 2, although it has no objection to adding Option 5 to it. Its second choice would be Option 1. CEA prefers Option 4 because it targets the aid to those most in need. OMB and NEC agree with CEA that Option 4 is preferable as a matter of economics, but are concerned that Option 4's limited effect may make it politically vulnerable; they therefore prefer Option 3, with both Options 5 and 6 as overlays.

(Note: We have a call into Peter Scher who is checking on the WTO issue.)

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

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

CREATION DATE/TIME: 7-APR-1999 09:25:37.00

SUBJECT: Medicare actuaries

TO: Rebecca M. Blank (CN=Rebecca M. Blank/OU=CEA/O=EOP @ EOP [CEA])

READ:UNKNOWN

TO: Robert F. Schoeni (CN=Robert F. Schoeni/OU=CEA/O=EOP @ EOP [CEA])

READ:UNKNOWN

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

READ:UNKNOWN

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

READ:UNKNOWN

TEXT:

In addition to general skepticism about the effect of untested competition on Medicare spending, here's another reason that the Medicare actuaries may not give much credit to such structural reforms:

The projections already assume that the rate of growth of health costs falls substantially over the next 25 years. (The decline is from "recent past levels" to "the growth rate of average hourly earnings," a pretty big decline. BBA97 puts some near-term wrinkles in this picture too.) That is, they have implicitly included serious structural reforms in their baseline projections, so giving additional credit for those reforms might be viewed as double-counting.

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Elise H. Golan (CN=Elise H. Golan/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME: 8-APR-1999 08:59:16.00

SUBJECT: ag memo

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

READ:UNKNOWN

TEXT:

Janet,

I see we were sent copies of the Podesta memo - with an invitation to comment. I am at a meeting over at USTR now (9:00 -) and will polish our comments when I get back.

Thanks,

Elise

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Rebecca M. Blank (CN=Rebecca M. Blank/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME: 8-APR-1999 10:13:21.00

SUBJECT: Editorial in equal pay

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

READ:UNKNOWN

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

READ:UNKNOWN

CC: Nora E. Gordon (CN=Nora E. Gordon/OU=CEA/O=EOP @ EOP [CEA])

READ:UNKNOWN

CC: Cordelia W. Reimers (CN=Cordelia W. Reimers/OU=CEA/O=EOP @ EOP [CEA])

READ:UNKNOWN

TEXT:

At this morning's Women's Meeting with Ann Lewis, we discussed further work around the equal pay agenda. This included some conversation about the recent AEI book (which we summarized in the WEB), which claims there are no equal pay problems. After some discussion, there was a strong sense that an editorial by the Chair of the CEA on this topic (based on the CEA report) would be a fine thing to do. I happily volunteered to try and make this happen.

Janet, I'm assuming you're willing to be a party to this. I'll try and get a first draft together today or tomorrow for you to respond to. We then need to send it over to Ann Lewis's shop for comments. I'm not entirely sure if she'll get it placed or if that's up to us...but let's get something together first and then we can talk with her staff about how to proceed.

Becky

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Elise H. Golan (CN=Elise H. Golan/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME: 9-APR-1999 07:55:39.00

SUBJECT: farm income proposal

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

READ:UNKNOWN

TEXT:

Janet,

Here are my thoughts on the USDA proposal described in the memo to
Podesta.

Elise===== ATTACHMENT 1 =====

ATT CREATION TIME/DATE: 0 00:00:00.00

TEXT:

Unable to convert ARMS_EXT:[ATTACH.D77]MAIL442362315.136 to ASCII,
The following is a HEX DUMP:

Memorandum to Janet Yellen
From Elise Golan
April 8, 1999

Subject: Farm income loss adjustment program

USDA has prepared a proposal for a counter-cyclical farm income loss adjustment program ("market assistance program"). With this program, payments would be triggered when the gross revenues (total production multiplied by the U.S. season-average price) from one of the eight major crops declines by at least 10 percent from the preceding five-year average. The market assistance payment would be a 10 percent recoupment of the decline. This amount would be allocated to individual farmers according to the distribution of AMTA payments. If a farmer received 10 percent of total AMTA payments, he/she would receive 10 percent of total market assistance payments. The amount for any individual farmer would be limited by a cap proportional to the existing \$40,000 per individual program payment limit: that is, if the total paid under this program were one-quarter the amount scheduled for payment under the farm bill, then the limit would be one-quarter the existing payment limit, or \$10,000 (meaning that in this case, the \$40,000 limit would be bumped to \$50,000).

I have a number of concerns about the market assistance program, particularly if it is extended past one year.

1) Average US revenues by crop may be a poor indicator of farm distress.

A number of problems arise because market assistance payments are triggered by a fall in total US gross revenue by crop. Working at the aggregate has the advantage of avoiding difficult data collection at the farm level but reduces the ability of the program to provide true *income* assistance.

- With the original proposal, any reduction in the amount of acreage planted to a particular crop could trigger a 10 percent fall in crop revenues. For example, if the area planted to wheat declined, average wheat revenues could decline by 10 percent. In this case, farmers who had historically planted wheat would be eligible for market assistance payments - even though they may actually have higher revenues from other crops. This problem could be mitigated through imposing either a yield-per-acre criterion or a price trigger as in option 5.
- Depending on average costs, average gross revenue per crop and average net revenue may move in opposite directions. In this case, market assistance payments could be made when net revenues had actually increased.
- If a region's revenue deviated from the average they would not be eligible for market assistance payments. For example, the Corn Belt tends to dominate national corn statistics meaning that if a region outside the Corn Belt (say South Dakota) had a

particularly bad year while the Corn Belt had good year, national corn revenue could remain high. As a result even though the non-Corn Belt area experienced a significant drop in revenues the market assistance program would not be triggered.

2) Distribution of payments hinges on historical acreages

Another set of problems arise because market adjustment payments are allocated in the same proportions as AMTA payments. Again, this has the advantage of cutting down on costly farm-level data collection but it skews market adjustment payments to farms with larger historical acreages. Because soybeans were not included in the AMTA program, market assistance payments for soybeans will probably be allocated according to a farm's percentage contribution to total US production.

While larger farms may have the most to lose (proportionally) from drops in crop revenue, it is unclear that these farms face any particular market failures that restrict them from pursuing private market or government sponsored options for reducing this risk.

AMTA payments are based on historical acreage amounts. This leaves open the question of whether a farmer who had stopped cultivating a particular crop would still be eligible for market assistance payments.

3) Reduce incentives to participate in other risk reducing programs

This proposal represents an improvement to ad hoc disaster payments but runs some of the same risks with respect to dampening farmers' incentives to participate in private market or government sponsored risk reduction programs that are not free of charge (including on-farm and off-farm diversification). The larger the recoupment percentage the larger the risks. The low recoupment percentage included in the original USDA proposal probably will not have large impacts on incentives.

4) Government payments.

The whole issue of how government transfers are included in the calculations is troublesome. On the one hand, all government payments should be tallied to calculate the government's contribution to alleviating revenue shortfalls. If a farmer suffers a \$40,000 revenue shortfall but then receives \$20,000 in AMTA payments and \$20,000 in loan deficiency payments it seems reasonable to assume that the government has done its part to cushion the drop in revenue. If market assistance payments were made on top of these other government payments then the farmer would be more than compensated for the shortfall. However, if government payments are included in calculating five year average revenues, we will be in the position of having to match the high government transfers and high farm revenues of the early AMTA years. One solution could be a target revenue based on farm revenues (net government payments) and a trigger based on gross revenues (including government payments).

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

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

CREATION DATE/TIME: 9-APR-1999 11:39:25.00

SUBJECT: Op-ed

TO: Rebecca M. Blank (CN=Rebecca M. Blank/OU=CEA/O=EOP @ EOP [CEA])

READ:UNKNOWN

TEXT:

Here is a slightly revised version of the op-ed--only a bit of wording has changed. Feel free to revise my revisions. I would be perfectly comfortable with your circulating it for comments at this point.===== ATTACHMENT 1

=====

ATT CREATION TIME/DATE: 0 00:00:00.00

TEXT:

Unable to convert ARMS_EXT:[ATTACH.D30]MAIL47663531R.136 to ASCII,
The following is a HEX DUMP:

Shrinking the Gender Pay Gap

Janet Yellen

Since the Equal Pay Act was signed into law by President Kennedy in 1963 women workers have made enormous strides. In the Clinton Administration, for example, women hold jobs as Secretary of State, Attorney General, head of the Small Business Administration...and even as chair of the Council of Economic Advisers. New cohorts of women have overtaken men in educational attainment over the last 35 years, and women are entering many high-paying formerly “male” occupations, such as law, medicine, and accounting, in large numbers. Moreover, women are taking fewer years out of the labor force for child-rearing, which means they are accumulating greater work experience. As a result, by 1998 women’s wages had risen to 76 percent of men’s. Before the Equal Pay Act, employers regularly paid women less than men doing the very same job.

While 76 cents on the dollar represents progress, the earnings gap remains much too high. Research on the causes of the remaining gender pay gap were summarized in a recent report by The Council of Economic Advisers. The evidence suggests that about 60 percent can be explained by continuing differences in accumulated years of full-time work experience between men and women, in the broad occupations and industries in which women and men are concentrated, and in union status. After adjusting for these differences -- some of which may themselves be due to differential treatment of women versus men -- the pay ratio rises to about

90 percent, leaving an ongoing 10 percent unexplained gap between men and women's pay.

Interestingly, the evidence suggests that most of the unexplained pay gap is currently concentrated among women with children. Younger childless women receive pay almost at par with younger men. But mothers' wages are an estimated 10 percent lower than those of childless women with the same levels of education and workforce experience.

Some have argued that the prevalence of lower pay for mothers results from the inherent difficulty women face in combining careers with childrearing and is not a problem requiring a public policy response. After all, if women choose to have children, they must bear the consequences. But the impact of family and children on women's careers and earnings is not an unalterable consequence of biology. Rather, it results from current social arrangements and workplace practices that make it difficult to combine career and family.

These behaviors can change, and indeed are changing: fathers can spend more time in household and child-rearing tasks, and employers can offer family-friendly scheduling and benefits policies. Policies to reduce the gender gap further must focus on making it easier for parents -- both women and men -- to combine work and family. For instance, government can help assure that family and medical leave is available to workers, and can increase the availability of safe and affordable child care.

Gender discrimination in the labor market has not disappeared, as the 24,500

gender-discrimination complaints filed with the Equal Employment Opportunity Commission in 1998 attest. And research consistently finds evidence of ongoing discrimination in the labor market and differential treatment of women on the job.

In many workplaces discrimination may take more subtle forms today than in the past. A recent report on female faculty at MIT indicated that even this group of highly skilled, high-achieving women faced discrimination, which the report defined as “a pattern of powerful but unrecognized assumptions and attitudes that work systematically against women faculty even in the light of obvious good will.” This is a familiar story for women who regularly feel that they are treated less seriously, excluded from key decision-making, or passed over for a project assignment without even being asked (“we know she won’t want to do this given her family demands”).

Working toward gender pay equity means fighting workplace discrimination of all types, and strongly enforcing the Equal Pay Act. But it also means promoting policies that allow workers to be both good parents and effective employees. Raising our children to be well-functioning adults may be the most important thing many of us will do in our lives, and this task is vitally important to the future of our nation. We must find ways to support rather than penalize workers who are also active and involved parents.

Janet Yellen is chair of the Council of Economic Advisers, and a parent.

[Automated Records Management System Hex-Dump Conversion]

**Clinton Presidential Records
Automated Records Management System
[EMAIL] and Tape Restoration Project [Email]**

This is not a presidential record. This is used as an administrative marker by the William J. Clinton Presidential Library Staff.

This marker identifies a responsive email, already made available within another collection.

Collection: 2014-0316-F

Bucket: CEA

Creation Date: 1999-04-12

Subject: narrowness of stock price advance

Creator: Douglas W. Elmendorf CN=Douglas W.
Elmendorf/OU=CEA/O=EOP [CEA]

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

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

CREATION DATE/TIME:12-APR-1999 11:10:06.00

SUBJECT: Potus memo on USA accounts

TO: Douglas W. Elmendorf (CN=Douglas W. Elmendorf/OU=CEA/O=EOP @ EOP [CEA])

READ:UNKNOWN

TEXT:

----- Forwarded by Janet L. Yellen/CEA/EOP on 04/12/99
11:10 AM -----

Jeff B. Liebman

04/12/99 11:06:45 AM

Record Type: Record

To: Jacob J. Lew/OMB/EOP, Robert L. Nabors/OMB/EOP, Sylvia M.
Mathews/OMB/EOP

cc:

Subject: Potus memo on USA accounts

FYI. This will get turned in sometime this afternoon.

===== ATTACHMENT 1 =====

ATT CREATION TIME/DATE: 0 00:00:00.00

TEXT:

Unable to convert ARMS_EXT:[ATTACH.D43]MAIL49638351J.136 to ASCII,
The following is a HEX DUMP:

DRAFT

April 12, 1999

MEMORANDUM FOR THE PRESIDENT

FROM GENE SPERLING
DIRECTOR, NATIONAL ECONOMIC COUNCIL

LARRY SUMMERS
DEPUTY SECRETARY OF THE TREASURY

SUBJECT USA ACCOUNTS

This coming Wednesday, April 14th, you are scheduled to announce further details of your Universal Savings Accounts (USAs) proposal. This memorandum describes the new accounts, responds to several issues you raised at our February 22 meeting, and presents recommendations on some important issues that we have not previously discussed with you.

I. Basic Structure of Program

Universal Savings Accounts (USAs) are voluntary individual retirement savings accounts with a progressive tax subsidy.

Automatic Government Contribution. Workers and their spouses in low- or moderate-income households receive an automatic government contribution of \$300, in the form of a refundable tax credit deposited directly into their USA accounts. The automatic credit is phased out between \$40,000 and \$80,000 of adjusted gross income (AGI) for joint filers (\$20,000-\$40,000 for singles; \$30,000-\$50,000 for head of household filers).

Government Match of Individual Contributions. Voluntary individual contributions to a USA account are matched by additional government contributions to the taxpayer's USA account. The matches will also be in the form of a refundable tax credit deposited directly into the USA account. Low- and moderate-income individuals receive a dollar-for-dollar match. The match rate phases down to 50 percent over the same income ranges as the phase-down for the automatic contribution, and then remains at 50 percent until the income level at which eligibility ends (\$100,000 for joint filers with pension coverage, no limit for people without pension coverage). Total contributions (including the credit) to an account are capped at \$1,000 per year.

Eligibility. To be eligible, a taxpayer must have at least \$5,000 of earnings (which can be combined earnings on a joint return) and must not be the dependent of another taxpayer. Thus, an individual without earnings can have a USA account if his or her spouse earns at least \$5,000. Taxpayers younger than age 18 or older than 70 are ineligible. Taxpayers must have AGI of less than \$100,000 for joint filers (\$50,000 for single filers and \$75,000 for head of household filers), unless they have no employer-sponsored retirement plan. All eligible workers without an employer-provided pension would receive at least a 50-percent match, regardless of income.

Investment Choice. Account balances could be held in the "Universal Savings Plan," a universal retirement plan similar to the Federal Thrift Savings Plan (TSP), which is a 401(k)-type plan for federal government employees. Individuals would be able to choose among investment options similar to those offered in the TSP and in many private sector 401(k) plans. We look forward to working with Congress and experts from the private sector to devise the best way to administer the accounts, as well as to explore whether it would be possible to provide account holders with the option of investing directly with private sector fund managers.

Withdrawal Rules. No amount could be withdrawn from a USA account before age 65, unless the account holder dies. Once withdrawals commence after age 64, no additional contributions could be made to the account.

Tax Treatment of Accounts. Voluntary USA contributions would not be tax deductible. Automatic and matching government contributions would not be taxable when deposited to accounts. Earnings would accumulate tax free until retirement. Each withdrawal would be taxable after an approximate adjustment for basis, such that only 85 percent of withdrawal amounts would be taxable.

Protections for Women Including Divorcees and Widows. The design of USA accounts takes into account the facts that women are more likely to spend years out of the labor force than men and have lower average earnings than men, and ensures that women will accumulate significant savings in their USA accounts. First, spouses of workers are eligible for the USA tax credit even if they do not work themselves. Second, the progressive credit formula targets the tax benefits on low and moderate income workers. In addition, the administration looks forward to working with Congress and outside experts to determine whether other steps are needed to ensure that women are protected in case of divorce or widowhood.

II. Benefits of Program

Enhances Retirement Security

- 124 million Americans would qualify for USA accounts, including 73 million people who currently do not participate in employer pension plans.
- Half of American workers do not currently have retirement plans. Under this plan, 59 million workers not in private pension plans would receive automatic USA contributions.

Restores Progressivity to Retirement Savings Incentives

- Currently, two-thirds of tax benefits for pensions and retirement savings go to households with income over \$100,000.
- USA accounts would target 80 percent of their benefits to workers with family income below \$100,000, with the largest tax credits going to low- and moderate-income workers who need the most help saving.

Example: Married Couple with Income of \$40,000

Individual contribution	For Each Spouse			Combined for Couple	
	Automatic tax credit	Matching tax credit	Total deposited in account	Total tax credit	Total amount in the two accounts
\$0	\$300	\$0	\$300	\$600	\$600
\$100	\$300	\$100	\$500	\$800	\$1,000
\$200	\$300	\$200	\$700	\$1,000	\$1,400
\$350	\$300	\$350	\$1,000	\$1,300	\$2,000

If this family saved \$700 a year and received the maximum tax credit of \$1,300, after 40 years they would have wealth totaling \$253,680 in today's dollars -- enough to purchase an annuity that would provide \$19,602 of after-tax income in every year of retirement. The automatic tax credits alone would produce \$76,000 of wealth after 40 years and \$5,800 a year in extra retirement income. In comparison, the average annual Social Security benefit received by a married couple today is \$13,900, and will rise due to wage growth to \$18,500 (in today's dollars) in 2040, around the time that the first people will retire with 40 years of USA contributions.

III. Issues Raised at the Prior Meeting

Ensuring that the Tax Credit is Significant for People with Incomes Between \$60,000 and \$100,000. The proposal we presented to you in February included an annual cap on total IRA and USA contributions of \$2,000 per person. This limit implied that USAs would have provided only a small benefit to taxpayers in the 28 percent income tax bracket, since the USA tax credit provides these taxpayers with a 50 percent savings subsidy, while IRAs provide a tax advantage equivalent to a 40 percent subsidy. Thus, we could have been accused of providing a benefit to these workers that was more illusory than real.

In response to your concerns about this issue, we have dropped the combined cap on IRA and USA contributions. A worker will be able to contribute \$2,000 to an IRA and can have a \$1,000 USA as well. Thus, even workers in the 28 percent bracket will be able to receive significant benefits from USAs. In fact, taking into account not only the annual tax credit but also the value of the ability to compound earnings tax free (the "inside build-up"), the total annual tax benefit to a married couple with \$100,000 of income is over \$1,300.

Lifetime Tax Benefits From One Year's Contribution to USA Account at Age 35, Compared with Other Tax Cut Proposals and IRAs (Married Couple with Two Dependents)

Income	USA Tax Credit			Other Tax Cut Proposals, Per Family			Roth IRA
	Maximum USA Credit	Value of Inside Build-up	Total Tax Benefit	10-percentage cut	Torricelli	Johnson	
\$20,000	\$1,300	\$340	\$1,640	\$0	\$0	\$0	\$239
\$60,000	\$1,030	\$340	\$1,370	\$547	\$75	\$130	\$331
\$100,000	\$667	\$643	\$1,310	\$1,372	\$400	\$60	\$980

Department of the Treasury, Office of Tax Analysis

How Has the Federal Thrift Savings Plan (TSP) Performed Over the Past 10 years? At our meeting you asked for information on the performance of the federal TSP plan. The TSP program has performed very well for federal employees. Over the past 10 years, the TSP stock fund (indexed to the S&P 500) earned an average annual nominal rate of return of 19 percent, the bond fund paid 9 percent, and the interest bearing (Treasury security) fund paid 7 percent (inflation as measured by the CPI averaged 3.8 percent over this time period). An employee who contributed \$1,000 per year (including the employer contribution) over the past ten years to the stock index fund now has \$32,294 in her account; the bond fund would have produced a balance of \$15,987; and the interest bearing fund would have yielded \$14,681. (Currently 57 percent of TSP account assets are invested in the stock fund, 38 percent in the Treasury security fund, and 5 percent in the corporate bond fund). Of course, since recent stock market performance has far exceeded historical norms, we cannot promise similar stock returns in the future.

IV. Other Important Issues

Implications for Budget Negotiations of Announcing the USA Credit

Treasury expects the USA tax credit to cost approximately \$40 billion a year when fully phased in. This fits within your State of the Union budget framework with some minor reallocation of dollars across years and a 2 to 3 year phase in of the credit (which is likely to be necessary for administrative reasons anyway).

However, momentum is building in Congress for using the entire Social Security surplus for debt reduction, leaving only the on-budget (non-Social Security) surplus to be allocated across tax cuts and new spending initiatives. In addition, it is possible that we will need to fit some of the transfers of bonds to the Medicare and Social Security trust funds within the on-budget surplus.

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
CBO on-budget surplus	-5	11	59	51	68	79	116	134	146	165
Discretionary spending proposed in SOTU	0	27	43	41	40	45	52	52	49	48
Amount remaining for tax cuts or other priorities	-5	-16	16	10	28	34	64	82	97	117

While CBO will probably increase its surplus estimates at mid-year, it will nonetheless be difficult to afford both our discretionary spending and a \$40 billion USA tax credit proposal before 2005 or 2006 if we are forced to live in a world in which only on-budget surpluses are available. Moreover, it could be a strategic mistake to announce a \$40 billion a year tax cut, because that could become the lower bound for negotiating how much of the surplus will be allocated to tax cuts.

It is important to realize, however, there are large strategic differences between the USA proposal and the irresponsible tax cuts the Republicans are proposing. The Republicans recently passed budget resolutions calling for \$820 billion of tax cuts over 10 years in the Senate and \$779 billion in the House -- tax cuts that rise dramatically over the ten-year budget window, and reach \$177 billion in 2009. Moreover, the Republicans allocate no funds for Medicare, and propose significant cuts in discretionary spending. In contrast, your budget framework sets aside funds for Medicare and Social Security first, and allows for needed increases in discretionary spending, while proposing a USA tax cut that is only around one-third as large as the Republican tax cuts when both are fully phased in.

Recommendation:

We recommend going ahead and announcing the USA tax credit now with two important conditions:

- We will say that no tax cut, including the USA proposal, should be adopted before Social Security and Medicare reform are addressed.
- We will say that the program will cost around \$40 billion when fully phased in, but that the timing of the phase in will depend on how much money is needed for Medicare and Social Security reform.
 - If pushed to specify how the phase in would work, we could announce that the matching credit could be delayed or the amount of the automatic credit phased in over time, on order to fit the program within budgetary constraints. For example, for the first few years, the credit could start with only an automatic \$200 credit, before expanding to the full \$300 flat credit and the matches.

Coordination with 401(k)-type Plans

In designing your USA proposal, we have taken care to reduce the risk that workers will have an incentive to shift from existing 401(k)-type plans into USA accounts. In particular, we were concerned that the generous USA subsidies for lower-income families would cause those families to stop participating in 401(k)s (which often have less than dollar-for-dollar matches or no matches at all), and to contribute to USAs instead. If this happened, firms could have difficulty meeting non-discrimination rules, and might drop their 401(k) plans.

To avoid this danger, employees who are eligible to receive USA matches will receive government matches on their contributions to 401(k)-type plans at the same rate as they would for voluntary contributions to a USA. Thus, workers who participate in 401(k) plans will be able to receive matches not only from their employer, but also from the government. The government match will be deposited in the worker's USA account, not in his or her 401(k) account.

Because contributions to a 401(k)-type plan are excludable from taxable income while USA contributions are not, joint filers with AGI of at least \$50,000 (\$25,000 for single filers and \$37,500 for head of household filers) who elect to receive USA matches on 401(k) contributions will be required to include in taxable income 80 percent of the amount contributed by the worker to the 401(k).

Administrative Issues

The creation of an estimated 120 million individual accounts presents enormous administrative challenges. The program will require the development of substantial information systems to coordinate the flow of data to and from the IRS, a federal oversight board, and the participation of one or more private financial institutions. Providing consumer education for tens of millions of households with little or no knowledge of investments and financial markets is an essential, yet costly, challenge. The related customer service needs of 120 million account

holders present an administrative challenge. We intend to work closely with Congress and experts in the private sector to design the most efficient administrative approach.

Treasury is currently studying other private and public retirement savings programs to determine how USAs should be administered, how quickly USAs could be implemented, to estimate the administrative costs (both initial and long term), and to identify other issues associated with the USA account administration. We recommend that forthcoming announcements about USA accounts not present specific details about how they would be administered. Publicly we should simply say that there are difficult administrative issues to work out, and that we would like to start the accounts as soon as is feasible. We recommend against giving out any projected date of implementation. In particular, Treasury believes that we should not at this time commit to implementation before tax year 2003 (returns filed in 2004).

Marriage Penalties and USA Credits for Single Parents

Because the generosity of the USA tax credit falls as a taxpayer's income rises, the proposal creates marriage penalties for some high-income couples. In the most extreme case, two single taxpayers with pension coverage could see their USA tax credit decline by \$650 when they got married (For example, if a \$20,000 a year worker receiving a \$650 credit married a \$81,000 worker, the married couple would have total income above \$101,000 and would not be eligible for the credit. Thus, by getting married, the two taxpayers would lose the \$650 credit that the lower earner was receiving.).

In addition, because the proposal phases out the credit for head of household filers (single parents) at a rate that is between the rate for single taxpayers and the rate for married taxpayers, marriage penalties are introduced for some middle-income couples. For example, a two-earner couple with one spouse earning \$20,000 and the other earning \$40,000 would have a USA marriage penalty of \$136. (Before marriage, the \$20,000 earner could receive a USA credit of up to \$650, and the \$40,000 worker, assumed to be a single parent, could receive up to \$514 -- a total of \$1,164. After marriage, the couple has income of \$60,000, and each spouse can receive a credit of \$514 -- a total of \$1028.)

In aggregate, the USA proposal would create \$3.7 billion in marriage penalties -- \$0.8 billion more than would occur if heads of household were treated the same as single filers. By comparison, Rep. Nancy Johnson's marriage penalty relief proposal to make the joint standard deduction twice the single amount would reduce aggregate marriage penalties by \$2.8 billion.

Because head of household filers are more likely to be poor over their lifetimes and less able to save than other single taxpayers, your advisors believe it is sensible to provide a USA tax credit schedule for head of household filers that is more generous than the schedule for other single taxpayers (just as the standard deduction and income tax brackets are more generous for head of household filers than for single filers). This is especially true because the bulk of the marriage penalties in this proposal would exist even without the more generous schedule for household heads. However, in light of the on-going debate over marriage penalties, we wanted to make sure that you were aware of this feature of the USA proposal.

Protections for Widows and Divorcees

We have had a series of discussions with representatives of women's groups about the design of USA accounts. Women's groups are eager for us to include protections for widows and divorcees in our proposal. They raise two concerns. First, if men have larger account balances than women, then it is important to ensure that women are treated fairly in case of divorce. Men could end up with larger account balances either if men arrive at marriage with larger accounts (due to higher earnings), or if married couples make a disproportionate share of their voluntary contributions into the husband's account. Second, since women tend to outlive their husbands, it is important to design measures to raise the chance that they will still have income-producing assets when they reach widowhood.

The existing design of USA accounts addresses some of these concerns. In particular, both the husband and wife receive the automatic contribution into the account, even if only one of them is working. Moreover, the progressive benefit formula should partially offset the impact of lower earnings for single women.

We are analyzing a number of policy options for further addressing these concerns, and will make specific recommendations to you at a later date. For now, we recommend that you take credit for the features of this proposal that enhance the retirement security of women, and promise to work with Congress and outside experts to devise provisions that will ensure that women are protected in the case of divorce or widowhood.

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Alan S. Polasky (CN=Alan S. Polasky/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME:12-APR-1999 10:59:47.00

SUBJECT: electricity rollout

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

READ:UNKNOWN

CC: Joseph E. Aldy (CN=Joseph E. Aldy/OU=CEA/O=EOP @ EOP [CEA])

READ:UNKNOWN

CC: Quindi C. Franco (CN=Quindi C. Franco/OU=CEA/O=EOP @ EOP [CEA])

READ:UNKNOWN

CC: Rebecca M. Blank (CN=Rebecca M. Blank/OU=CEA/O=EOP @ EOP [CEA])

READ:UNKNOWN

TEXT:

Janet: On Thursday in the OEOP (time tba), the Administration will rollout this year's version of its Electricity Restructuring Bill. As part of this event, DOE would like you to speak for a couple of minutes about why the Bill is good for the economy. They would like to know today whether this will be possible.

The event will be 1 hour or less. Secretary Richardson will make a brief presentation. DOE would like to have the VP present to make some comments. DOE will ask Carol Browner to take a couple of minutes to say why the Bill is good for the environment and you to say why the Bill is good on economic grounds. DOE will also try to have several congressional allies present to make some remarks. There will then be some Q/A.

I think this event should be relatively painless and the basic message is one I think we agree with: promoting competition in electricity generation will lead to efficiency gains yielding savings to consumers. If you agree to do it, we will pull together a 2-3 minute presentation and some Q/A on the anticipated cost saving and climate change aspects of the Bill.

Steve

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Alan S. Polasky (CN=Alan S. Polasky/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME:13-APR-1999 18:03:22.00

SUBJECT: electricity rollout

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

READ:UNKNOWN

CC: Quindi C. Franco (CN=Quindi C. Franco/OU=CEA/O=EOP @ EOP [CEA])

READ:UNKNOWN

CC: Joseph E. Aldy (CN=Joseph E. Aldy/OU=CEA/O=EOP @ EOP [CEA])

READ:UNKNOWN

TEXT:

Janet: attached is a draft of a short speech on electricity. The rollout will be on Thursday morning from 9:30 to 10:30 in OEOB 450. Richardson, Browner, possibly Glickman and approx. 4 congressional members will be present. Howard G. assured me that you would not have to take questions. Steve

===== ATTACHMENT 1 =====

ATT CREATION TIME/DATE: 0 00:00:00.00

TEXT:

Unable to convert ARMS_EXT:[ATTACH.D36]MAIL48683771R.136 to ASCII,
The following is a HEX DUMP:

“opening stuff”

The economic policies of the past six years have nurtured and sustained what is now the longest peacetime expansion on record. Over 17 million jobs were created between the beginning of 1993 and the end of 1998. More Americans are working than ever before, the unemployment rate, currently 4.2%, is the lowest in a generation, and inflation remains tame.

This Administration through its policies has laid a strong foundation for economic growth. We believe that the Administration’s Comprehensive Electricity Competition Plan can play an important role in enhancing productivity and promoting continued economic growth. The heart of the plan is to introduce competition in electricity generation. Under the plan, business and residential consumers could choose among competing electricity suppliers. Competition will provide electric utilities strong incentives to improve their efficiency and lower costs, in order to be able to offer competitive rates to consumers. In a \$212 billion industry, even small efficiency gains from competition can have large benefits. The Administration estimates that retail competition will save consumers over \$20 billion dollars a year on their electricity bills. This translates into direct savings to the typical family of four of over \$100 per year. Because electricity is used in the production of other goods and services, lower electricity prices will result in lower costs for other goods and services, yielding indirect savings of approximately \$125 per year for the typical family of four.

The Administration’s Comprehensive Electricity Competition Plan is an excellent example of enlightened policy that will improve performance in the electricity sector and contribute to continued economic growth.

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Rebecca M. Blank (CN=Rebecca M. Blank/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME:14-APR-1999 16:36:41.00

SUBJECT: Op ed

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

READ:UNKNOWN

TEXT:

Ok, here's my rewritten version of Ann Lewis's version of the op ed. This version is entirely fact-checkable, but has tried to maintain some of the "punch" that Ann put into it. I'm very much hoping you'll be happy with this, or a close modification, since I think others will find it acceptable. But it's your op ed, coming out under your name. So let me know what you think.===== ATTACHMENT 1 =====

ATT CREATION TIME/DATE: 0 00:00:00.00

TEXT:

Unable to convert ARMS_EXT:[ATTACH.D98]ARMS16258391X.136 to ASCII,
The following is a HEX DUMP:

Shrinking the Gender Pay Gap

Janet Yellen

When the Equal Pay Act was signed into law by President Kennedy in 1963, the ratio of female to male wages was around 60 percent -- not a surprise in an era when classified ads listed jobs for men and women separately, with the lower paying jobs reserved for women. In the 36 years since that time, the American workplace has changed. Working women constitute a growing share of the workforce in almost every field, including such well paid, formerly "male" occupations as law, medicine, and accounting. Younger cohorts of women now have similar levels of educational attainment as men. Yet the gap between men's and women's wages has shrunk only one half a cent a year -- so that full time women workers now earn approximately 76 cents to the full time man's dollar, and this amount is even lower for minority women.

A recent report to the President by the Council of Economic Advisers, examined the reasons for the persistence of the wage gap. This report concluded that among the causes are the fact that men are more likely to work in higher paying or unionized occupations and industries, as well as continuing differences in accumulated work experience. After adjusting for these differences -- each of which in itself may reflect differential treatment of women and men in school and the workplace -- there continues to be a 10 per cent gap between men's and women's pay.

The bottom line is that gender discrimination in the labor market has not disappeared, as the 24,500 gender-discrimination complaints filed with the Equal Employment Opportunity Commission in 1998 attest. Research consistently finds evidence of ongoing discrimination in the labor market and differential treatment of women on the job. One recent study compares men and women whose productivity can be directly measured in manufacturing facilities and finds

that pay differences between comparable women and men are too large to be explained by productivity differences.

It is true that discrimination may take more subtle forms today than in the past. A recent report from the Massachusetts Institute of Technology documents the differential treatment of men and women faculty members even among these highly trained professionals. The researchers at MIT found that one important explanation for the 10 to 20 percent pay gap faced by women professors was “a pattern of powerful but unrecognized assumptions and attitudes that work systematically against women faculty even in the light of obvious good will.” This is a familiar story for women who regularly feel that they are treated less seriously, excluded from key decision-making, given fewer resources, or passed over for a project assignment without even being asked (“we know she won’t want to do this given her family demands”).

Interestingly, several recent studies find that much of the otherwise unexplained pay gap is currently concentrated among women with children. There is little difference between the pay of younger, childless women and their male colleagues. But mothers’ wages are an estimated 10 per cent lower than those of childless women with similar levels of education and workforce experience.

Some have stated that the prevalence of lower pay for mothers results from the inherent difficulty women face in working outside the home while also parenting children. According to this argument, if women choose to have children, they must accept the consequences. For instance, a recent report by AEI suggests that there should be no public policy concern over lower wages received by mothers. But the impact of family and children on women’s earnings is not an unalterable

consequence of biology or of economic policy. Rather, it results from current social arrangements and workplace practices that make it difficult to combine career and family.

Working toward gender pay equity means fighting workplace discrimination of all types, and strongly enforcing the Equal Pay Act. That is why President Clinton is urging Congress to pass the Paycheck Fairness Act introduced by Senator Daschle (D-SD) and Congresswoman DeLauro (D-CT). This legislation includes additional pay data collection for enforcement of the wage discrimination laws, provides full compensatory and punitive damages for violating the Equal Pay Act, prohibits employers from punishing employees for sharing salary information with their co-workers, and increases training for EEOC employees to identify and respond to wage discrimination claims.

But gender pay equity also requires promoting policies that allow workers to be both good parents and effective employees. Indeed, there is clear evidence of change underway: fathers spending more time in household and child-rearing tasks, and employers offering family-friendly scheduling and benefits policies. Government can help assure that family and medical leave is available to workers, and can increase the availability of safe and affordable child care.

Employers must be able to rely upon productive and responsible workers. But the workplace must find way to support rather than penalize active and involved parents. Raising our children to be well-functioning adults may be the most important thing many of us will do in our lives; this task is vitally important to the future of our nation.

Janet Yellen is chair of the Council of Economic Advisers, and a parent.

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: nelson@tcf.org@INET@LNGTWY (nelson@tcf.org@INET@LNGTWY [UNKNOWN])

CREATION DATE/TIME:14-APR-1999 09:31:58.00

SUBJECT: Comments on prospectus (again)

TO: Janet L. Yellen@eop (Janet L. Yellen@eop [CEA])

READ:UNKNOWN

TEXT:

>Rebecca M. Blank

>04/13/99 05:58:50 PM

>

>Record Type: Record

>

>

>To: ew @ rsage.org.amrog @ tcf.org

>

>cc:

>Subject: Comments on prospectus

>

>I had a meeting cancelled this afternoon and used the time to read the

>prospectus for the project on sustainable development, and its various

>attachments. Just a few quick comments I want to throw into the mix:

>

>1. I want to add another vote for looking at how the sustained low

>unemployment/low inflation is affecting different groups. In part, this i

s

>a question of "spillover effects" (i.e., does the growth really trickle

>down to everybody?) In part, this is a question of compositional effects

>(i.e. how much of the aggregate change is due to relative changes within

>specific groups.)

>

>2. The current proposal says little about labor force participation,
which

>I think is a key variable in explaining the current labor market. We've

>had a surge in female labor force participation in the 1990s, especially

>among women with younger children. While the growth in LFP among less

>skilled women has been most discussed, these changes are not limited to

>that group. Immigrant growth may also be part of this story. Of course,

>one would expect that the LFP changes are simultaneously determined with

>the other labor market changes, which creates all sorts of econometric
fun.

>

>3. To the extent that we have any capacity to look at productivity
changes

>within sectors and link it to labor market changes, this work needs to be

>done. (The big question is whether anybody believes the productivity data

>for some key sectors.) The higher-than-trend productivity growth of the

>past two years is an important piece of the unemployment/inflation

>combination we've been able to achieve. Whether this is cyclical or more

>permanent is a key question for long-term sustainability.
>
>4. I think a key overarching goal of this project should be to explore
>what reasonable policy levers one has to deal with these issues. As Alan
>K. notes, the small amounts of job matching/job training stuff the
>government is doing can't possibly explain a lower NAIRU. One approach
to
>the current economy is the passive onlooker: "We've all been very lucky.
>Let's see how long it lasts." While I don't believe that economic policy
>by itself can either create or sustain the current good economy , I
suspect
>that it can nudge things one way or another on the margins. If you agree
>with this, then there are two important policy questions: (1) Which
>policies were important in helping to create this situation? and (2)
Which
>policies should we be pursuing at present that will either sustain the low
>unemployment/inflation situation for a longer period of time, or guarantee
>that its benefits spill over to more groups?
>
>I'll look forward to the conversation on May 10.
>
>
>Rebecca M. Blank
>Council of Economic Advisers
>Old Executive Office Building
>Washington, D.C. 20502
>202-395-5036
>202-395-6947 FAX
>
>
>
>

Greg Anrig, Jr.
Vice President, Programs
The Century Foundation
41 East 70th St.
P: (212)452-7724; F (212)535-7534
ganrig@tcf.org

===== ATTACHMENT 1 =====
ATT CREATION TIME/DATE: 0 00:00:00.00

TEXT:

RFC-822-headers:

Received: from conversion.pmdf.eop.gov by PMDF.EOP.GOV (PMDF V5.1-9 #29131)
id <01JA0OHD7IWW001CTD@PMDf.EOP.GOV> for yellen_j@a1.eop.gov; Wed,
14 Apr 1999 09:30:59 EST

Received: from storm.eop.gov by PMDF.EOP.GOV (PMDF V5.1-9 #29131)
with ESMTP id <01JA0OH8GLCW001CFN@PMDf.EOP.GOV> for yellen_j@a1.eop.gov; Wed,

14 Apr 1999 09:30:52 -0500 (EST)

Received: from mail.centuryfoundation.org ([207.237.37.3])
by EOP.GOV (PMDF V5.2-29 #34437) with SMTP id <01JA0OH04A5S000DDK@EOP.GOV> for

yellen_j@a1.eop.gov; Wed, 14 Apr 1999 09:30:44 -0500 (EST)

Received: from [207.237.37.189] by mail.centuryfoundation.org (SMTPD32-3.04)

id A9A5228F00FE; Wed, 14 Apr 1999 09:35:33 -0400

X-Sender: nelson@207.237.37.3

X-Mailer: QUALCOMM Windows Eudora Light Plus Version 3.0.4 (32) with Spelling
Checker

===== END ATTACHMENT 1 =====

**Clinton Presidential Records
Automated Records Management System
[EMAIL] and Tape Restoration Project [Email]**

This is not a presidential record. This is used as an administrative marker by the William J. Clinton Presidential Library Staff.

This marker identifies a responsive email, already made available within another collection.

Collection: 2014-0316-F

Bucket: CEA

Creation Date: 1999-04-15

Subject: Paper on Eurobond Restructuring

Creator: Nouriel Roubini CN=Nouriel
Roubini/OU=CEA/O=EOP [CEA]

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

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

CREATION DATE/TIME:19-APR-1999 17:30:36.00

SUBJECT:

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

READ:UNKNOWN

TEXT:

There is likely to be a principals meeting tomorrow AM to discuss what information to give to Senator Mikulski. She requested some information about distributional impacts some time ago, and a meeting has been scheduled for Wednesday with her and the other members of the Senate Democratic SS task force to discuss the results of SSA's analysis. But David Wilcox and I argued strongly in this afternoon's hour-long conference call that releasing this report as it stands would be a mistake. Corky and Becky and I have all read the draft report, and Corky and I have sent specific comments along. Depending on your schedule, you might want to talk with me, or with me and Corky and Becky, before tomorrow's meeting, although I think that the options paper for tomorrow's meeting will present the issue fairly and clearly.

**Clinton Presidential Records
Automated Records Management System
[EMAIL] and Tape Restoration Project [Email]**

This is not a presidential record. This is used as an administrative marker by the William J. Clinton Presidential Library Staff.

This marker identifies a responsive email, already made available within another collection.

Collection: 2014-0316-F

Bucket: CEA

Creation Date: 1999-04-19

Subject: Proposed Draft on Developing Country Participation

Creator: Robert Z. Lawrence CN=Robert Z.
Lawrence/OU=CEA/O=EOP [CEA]

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: nelson@tcf.org@INET@LNGTWY (nelson@tcf.org@INET@LNGTWY [UNKNOWN])

CREATION DATE/TIME:19-APR-1999 14:56:31.00

SUBJECT: high employment comments

TO: Janet L. Yellen@eop (Janet L. Yellen@eop [CEA])

READ:UNKNOWN

TEXT:

Attached are Steve Nickell's comments on the high employment May 10

meeting.===== ATTACHMENT 1 =====

ATT CREATION TIME/DATE: 0 00:00:00.00

TEXT:

Unable to convert ARMS_EXT:[ATTACH.D80]ARMS28364362M.136 to ASCII,

The following is a HEX DUMP:

Comments on Sustainable Employment Papers

1. It would be unwise to go too far into issues of world economic instability.
2. Looking at the fundamental question of how u rates in the US have got to such low levels without triggering inflationary pressure from the labour market, various questions arise. i) The number of low educated individuals (e.g. high school dropouts) has fallen a great deal in the last two decades. Since these have typically done very badly in the labour market (e.g. their employment/population ratios are lower than in Europe, even ignoring those in prison), how much has this helped? ii) Have wages become more flexible within firms, e.g. by correlating them with profits, one way or another. This tends to make employment within firms more stable and leads to a reduction in the inflow into unemployment. iii) Has produce market competition increased, thereby increasing downward pressure on wages and reducing such union power as remains even in a tight labour market?
3. Finally, it is important to recognise that the question in 2. remains to be answered even if the actual process which has resulted in the recent economic strength of the US lies outside the labour market.

Stephen Nickell

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Ryan D. Edwards (CN=Ryan D. Edwards/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME:20-APR-1999 13:42:13.00

SUBJECT: Background on Japanese dinner

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

READ:UNKNOWN

TEXT:

Hi Janet,

Following is the brief background that Stan wrote to me on the Japanese dinner on Thursday:

EPC issues: I've been contacted by the Japanese delegation here to invite Janet Y. to a dinner on the margins of the EPC (May 6-7) hosted by their Ambassador Nogami. They suggest the evening of May 6th. The "occasion" would be the incipient promotion of their Ambassador to the rank of Vice-Minister for Economic Affairs (in July), meaning that he will be elevated to the level of "sherpa" for the G-7 meetings. Details are not final yet, but I'd like to check if Janet is agreeable first.

-Ryan

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Nouriel Roubini (CN=Nouriel Roubini/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME:21-APR-1999 08:36:53.00

SUBJECT: Rubin speech daft attached

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

READ:UNKNOWN

TEXT:

Janet, this is only a draft, not the final version.

Nouriel

----- Forwarded by Nouriel Roubini/CEA/EOP on 04/21/99
08:35 AM -----

Brad.Setser @ do.treas.gov

04/19/99 07:42:27 PM

Record Type: Record

To: Nouriel Roubini/CEA/EOP

cc:

Subject: My paper with ideas on Eurobond restructurings -Reply

Date: 04/19/1999 07:38 pm (Monday)

From: Brad Setser

To: ex.mail("Nouriel_Roubini@cea.eop.gov")

Subject: My paper with ideas on Eurobond restructurings -Reply

nouriel

here is the latest draft of the RER architecture speech. FYI basically,
as it has
been through a couple of iterations with RER.

bws

- RERSAIS6.WPD

===== ATTACHMENT 1 =====

ATT CREATION TIME/DATE: 0 00:00:00.00

TEXT:

Unable to convert ARMS_EXT:[ATTACH.D73]ARMS24087082D.136 to ASCII,

The following is a HEX DUMP:

April 19, 1999. 4.25 p.m.

Estimated at 35 minutes

DRAFT

Remarks on the Reform of the International Financial Architecture

SAIS, April 21, 1999

I am here today to discuss the United States' agenda for the future global financial architecture: the actions we have taken already and are in the process of taking, and our proposals for further change.

In the past two years, the international community has mobilized enormous official resources in response to the financial crisis that has adversely affected a large number of nations and peoples around the world. This crisis has heightened the broad-based awareness – in both developed and developing countries - of the risks and opportunities of a global economy. While our own economy has remained strong, American workers, businessmen and farmers have been affected by the crises. Certain sectors have been hit severely, and the crises have created additional risks to the economy overall. That is why Americans have a critical stake in an effective response to this crisis, as well as in building a stronger, more stable international financial system for the future. And that is why the United States, and so many nations, have been intensely focused on international financial reform, and must continue to be intensely focused on reform for a long time to come.

Our approach to this work has been informed by the fundamental belief that a market-based system provides the

best prospect for creating jobs, spurring economic activity, and raising living standards in the U.S. and around the world. But we have an equally strong belief that government action is needed for markets to produce the best results. There are certain purposes, for example, universal education, that markets by their nature cannot meet. And markets, by themselves, do not necessarily create the conditions needed for them to function well, for example, the provision of full and adequate information.

President Clinton's approach to international financial reform is built on these two beliefs. Our overall goal is to build an international financial system that best promotes global growth, that best contributes to broadly sharing that growth, and that is less prone to crisis, and that is better able to manage crises when they occur. We want to equip all countries to be able to participate effectively in the global financial system. That means both working with developing countries to identify the policies needed to realize most effectively the benefits of global finance and integration while limiting its potential risks, and creating stronger incentives for developing countries to put those policies in place. It also means acting to induce creditors and investors in industrial countries to weigh risk more appropriately, so as to help avoid the excesses in capital flows and leverage that contributed significantly to the crisis. And it means equipping the international community to more effectively deal with those crises that occur.

Let me spend just one minute on the causes of the recent crises, because the experience of the past two years has provided important insights on how we can best go forward. The crisis that first erupted in Thailand did not have a single, simple cause. Weak policies and institutions in many developing countries, and an inadequate focus on risk on the part of banks and investors in industrial countries, combined together to produce vulnerabilities in these economies. It was this

[Automated Records Management System Hex-Dump Conversion]

combination that led ultimately to the abrupt collapse in confidence that spread through Asia and other emerging economies from the summer of 1997 onwards. And after confidence was lost, the collapse risked become self fulfilling, as investors who had previously extended excessive credit to developing countries over-reacted in the opposite direction, and began to pull out of developing countries indiscriminately.

Just as the causes of the crisis were complex, so too are the issues we face in reforming the architecture of the global financial markets. There are no simple answers or magic wands. There are often powerful competing considerations that need to be reconciled. And there are some problems to which there is not currently a completely satisfactory solution. The consequence is that reform is not going to involve a single dramatic announcement but a collection of actions over time. Some of these have already been taken or are in the process of happening. Others will take shape going forward.

We have helped to build a broad-based international consensus on the appropriate framework for reform. This consensus has made possible concrete progress in a number of critical areas:

- There is a dramatic improvement underway in the quality of the information available to markets about the risks in emerging market economies.
- A set of more powerful tools is now or soon will be in place to equip the international community to respond effectively to crises, including the IMF's Supplemental Reserve Facility — which is now being used in all of the IMF's most recent programs -- and the proposed Contingent Credit Line. The Contingent Credit Line is designed to

[Automated Records Management System Hex-Dump Conversion]

reduce the risk of contagion to countries with strong policies and institutions. It will be structured so as to help induce a range of policies to reduce a country's vulnerability to crisis, including the adoption of sound debt management practices, efforts to develop strong bankruptcy and supervisory regimes and the maintenance of sound macroeconomic policies and sustainable exchange rate regimes.

- Substantial progress has been made toward developing a much broader set of standards and best practices, based on the model of the Basle Core Principles, in areas that are essential to making financial systems work in today's global economy: be it an effective legal system, elements of sound monetary and fiscal policies or internationally agreed principles of good corporate governance.

To continue to build a market-based system that is less susceptible to crisis, a critical challenge is to develop better inducements and incentives for stronger policies in developing economies, and for sounder risk assessment by creditors and investors in industrial countries. These range from better transparency and disclosure for both developing and industrial countries, to focus attention on potential difficulties; to the conditions we place on official finance — including the new Contingent Credit Line in the IMF; to changes in capital standards and an improved focus on risk management in industrial countries.

In all of these areas, our work must be done with full respect for and recognition of the differences among nations. Different countries may implement the same principles in different ways. Yet we all must recognize that the costs of weak policies and poor credit decisions, whether in developing or developed economies, are not just borne by the countries

themselves and their creditors. In an interdependent world, as we have learned, these mistakes can well spill over and affect their neighbors and the rest of the world. This growing interdependence has given all nations a greater stake in each other's avoiding problems and being successful, and creates a responsibility for all nations to pursue sound policies.

Our framework for reform involves changes in a great many areas. What I would like to do today is focus on concrete further steps we support in five particularly difficult areas of the agenda:

- the role of the private sector in resolving crises;
- exchange rate regimes;
- how developing countries deal with capital flows;
- excesses in capital flows and leverage on the part of creditors and investors in industrial countries; and
- greater support for those most in need in crisis countries.

The role of the private sector in resolving crises

The role of the private sector in resolving crises is one of the most complex issues that we currently confront, involving powerful competing considerations. The steps we take must not undermine the obligation of countries to meet their debts in full and on time. Otherwise, the private investment and financial flows that are critical to trade and growth will diminish, and the risk of contagion will increase. Yet market discipline will only work if creditors bear the consequences of

[Automated Records Management System Hex-Dump Conversion]

the risks that they take. The high yields on many emerging market debts indicate private creditors' expectations that some of these debts will not be paid in full or on time.

Striking the right balance between these considerations will always be difficult and must proceed on a case-by-case basis. There can be no one-size-fits-all approach. What we need to work toward is a system in which countries can address debt problems in a market-based, cooperative and orderly way, which may or may not be accompanied by official finance, and that does not threaten the health of the system as a whole.

The practical approaches the international community has taken in recent cases are establishing a growing set of examples about the right balance, and about how the relevant parties should interact with each other. The international community should continue to make these judgments in the context of this overall framework, and work towards refining these approaches over time.

When a government's capacity to pay its debts on time and in full may depend on the provision of official resources, we believe that the international community will need always to consider carefully whether there is a role for the private sector in sharing the burden of adjustment. But, as I have just discussed, the question of what this role should be in a given case is extraordinarily complicated. In some cases it may be appropriate to seek maintenance of exposure levels or to seek a restructuring or refinancing of a country's private debt obligations. In other — truly exceptional — cases, negotiations may break down and it may not be possible to avoid a temporary interruption in some debt payments. When a country is nonetheless implementing a strong program of policy reform, the door to official finance should be kept open even if

cooperative efforts to clear outstanding arrears with private creditors have yet to be concluded. More broadly, there is no reason why one category of unsecured private creditors should be regarded as inherently privileged relative to others in a similar position. When both are material, claims of bondholders should not be viewed as necessarily senior to claims of banks.

Going forward, we believe the international community should continue to encourage the broader use of provisions in bond contracts of clauses that can facilitate creditor coordination. These clauses are desirable for both borrowers and lenders. We also support steps to strengthen national insolvency codes and to strengthen the operation of insolvency regimes, since these can help prevent private debt problems from accumulating and ultimately spilling over to the sovereign.

Exchange rate regimes

Second, choice of exchange rate regimes. No exchange rate, fixed or floating, can remain stable unless it is backed by sound policies. Flexible rates generally allow more monetary policy independence and greater flexibility in response to shocks. But countries with a history of extreme volatility understandably may show a preference for greater exchange rate stability. Countries that choose fixed rates must recognize the costs and tradeoffs. They must be willing, as necessary, to subordinate other policy goals to that of fixing the rate. Recent history suggests that institutionalizing that subordination may be essential or close to essential for sustaining a credible commitment to fixed rates; and in some cases, where the conditions are right, currency boards appear to have been effective toward that end. But these institutional mechanisms will only work when backed with a real political commitment to reform and sound policy.

The right exchange rate regime is a choice for the individual country. Yet at the center of each recent crisis has been a rigid exchange rate regime that proved ultimately unsustainable. The costs of failed regimes can be significant, not only for the countries involved but also for other countries and for the system as a whole. We believe that, in the circumstances, the international community's judgements about how to respond to the recent crisis were right. Yet it is also important to shape expectations about the official response going forward, as this will have an important impact on policy choices and we want to strengthen incentives for the adoption and maintenance of sustainable exchange rate regimes. As a matter of policy, we believe that the international community should not provide exceptional large scale official finance to countries intervening heavily to defend an exchange rate peg, except where the peg is judged sustainable and certain exceptional conditions have been met, such as when the fixed exchange rate has been institutionalized through arrangements like a currency board or when an immediate shift away from a fixed exchange rate is judged to pose systemic risks.

Some countries have recently considered making another country's currency their own: in particular, adopting the dollar. This is a highly consequential step for any country, and one that has to be considered very carefully and in consultation with United States authorities. On the one hand, dollarization offers the attractive promise of enhancing stability. On the other hand, the country also must be prepared to accept the potentially significant consequences of doing without the capacity independently to adjust the exchange rate or the direction of domestic interest rates. The implications for the United States are also consequential. We do not have an a priori view. There are a variety of possible ways for a country to dollarize. But it would not, in our judgment, be appropriate for United States authorities to extend the net of bank supervision, to provide access to the Federal Reserve discount window, or to adjust bank supervisory responsibilities or the

procedures or orientation of U.S. monetary policy in light of another country's decision to dollarize its monetary system.

Dealing with capital flows

Third, dealing with capital flows, including the issues of debt management and capital controls. One of the striking elements of the recent crisis was the extent to which countries actually reached for short-term capital, and thereby greatly increased their vulnerability to crises down the road. The lesson of these experiences is that the greater protection provided by long-term borrowing is worth paying for.

Countries' own interest in avoiding the costs of crisis provides a strong incentive to better protect themselves against market volatility in the future. But the costs of inappropriately reaching for short-term capital are not born just by the countries and creditors concerned — the international community has a large stake in these decisions. That is why we are supporting the development of international guidelines for sound debt management to discourage countries from taking too many risks.

These guidelines would aim to encourage both a greater reliance on long-term rather than short-term borrowing and the development of domestic debt markets that allow governments and corporations to borrow at longer maturities in their own currencies. It may be cheaper to borrow at short maturities, and it is often easier than making the sometimes difficult policy changes needed to be able to borrow long-term, and to attract more investment flows. But the benefits of short-term borrowing, even if substantial, are often more than offset by the benefits of a debt profile better insulated from

periods of market volatility.

Going forward, the recent crises have shown equally clearly that it not enough for governments to do a better job of managing their own debt. They also should resist tax regimes, restraints on long-term investment and special facilities that distort private flows toward short-term borrowing. Where financial systems and supervisory regimes are underdeveloped, steps are probably needed to limit banks' foreign currency exposures, especially their short-term foreign borrowing. The limits of governmental guarantees for the external obligations of domestic borrowers — especially banks — should be made clear, and the nature and scope of the domestic financial safety nets clearly defined.

Some countries may deem more comprehensive measures — such as Chilean style taxes on short-term capital inflows -- to be appropriate. Like all controls, they can be difficult to administer and decline in effectiveness over time. This suggests that if they are adopted, they should be seen as transitional measures. What is most important is that they not be a substitute for fundamental reform to strengthen and liberalize financial systems.

When crisis strikes, countries may be tempted to introduce controls on capital outflows in an *ad hoc* response. But the bulk of experience suggests that controls on capital outflows become ineffective over time. Most important, they can do long-term damage to a country's capacity to attract foreign investment, and are often used to avoid or delay fundamental reforms.

Excesses in capital flows and excesses in leverage

[Automated Records Management System Hex-Dump Conversion]

Fourth, we must take steps in industrial countries to address excesses in capital flows and excesses in leverage.

Excesses in capital flows and excesses in leverage are separate but related problems. Excessive leverage can at times fuel excessive capital flows. In addition, both excessive capital flows and excessive leverage can be indicative of broader failures in transparency and risk management. While creditors and debtors now may be unduly withdrawing capital from developing countries, there is still a need to address the weaknesses in risk assessment that contributed to the recent crisis.

Our market-based economy relies on market participants to provide discipline. But market discipline can break down, and market history indicates that even painful lessons recede from memory with time. That is why we support mechanisms to induce a much stronger focus on risk management during good times, because reducing the excesses of the booms will reduce the likelihood and severity of busts.

In this context we believe it critical to create the right incentives for prudent bank credit judgements and lending decisions. This is why we consider it very important that the Basle Committee work quickly to complete its updating of the Basle Capital Accord, by expanding the number of credit-risk categories and revising the current all or nothing system for classifying loans to sovereign borrowers. We also strongly support actions that are being taken by the international community and within the United States to focus supervisors' much more strongly on banks' assessment of market risk and their systems for evaluating that risk. With respect to both of these concerns, the President's Working Group on Financial Markets, which includes the chair persons of the principal federal regulatory bodies in the United States and the Secretary of the Treasury, will soon be releasing proposals to require more disclosure of the exposure of financial institutions to other

financial institutions. This will increase market scrutiny over the interbank market — including the market for interbank lending to developing countries — as well as increased scrutiny of exposure to highly leveraged market participants.

As we strengthen risk management in the major financial centers, we also need to do more to make sure that these efforts are not uncut by lax practices in offshore financial centers. A variety of incentives could be used to press offshore centers to improve their standards, including a higher risk weighting on bank lending to counterparties operating out of an offshore jurisdiction that does not adhere to the regulatory standards major market centers or provide adequate supervision.

Beyond these measures, we need to take additional steps to address excessive leverage. As events in global financial markets in the summer and fall of 1998 demonstrated, the amount of leverage in the financial system, combined with aggressive risk taking, can greatly magnify the negative effects of any shock. Additionally, the near-collapse of Long Term Capital Management highlighted the possibility that excessive leverage in one financial institution could increase the likelihood of a general breakdown in the functioning of financial markets.

In this context, hedge funds have generated a great deal of attention. But excessive leverage is not limited to hedge funds. Other financial institutions, including some banks and securities firms, are larger, and generally more highly leveraged, than hedge funds. That is why there is a strong case for improving public reporting and disclosure by financial institutions and their creditors and for tightening risk management practices more generally. The President's Working Group on Financial Markets will soon be releasing detailed, concrete proposals in these areas.

Concerns have been expressed about the impact of such highly leveraged and other large institutional investors on market dynamics generally, and on vulnerable economies in particular. While we believe that such activity can affect markets in some circumstances and for limited periods, we do not believe that it was a basic cause of the financial market crises of the past two years.

Greater support for those most in need in crisis countries

Building a system that is less prone to crisis and better able to address crises when they occur is one of the best things that we can do to see the benefits of growth are shared more broadly in the world. The recent crisis threatened or reversed the middle income ascendancy of many and worsened the hardships of the poor. The international community should take additional steps to help prevent crises from having undue effects on the most vulnerable, and to help countries put into place, before crisis strikes, the kind of policies that can make them more resilient if it does occur.

To help protect the vulnerable during times of crisis, the MDBs should rearrange their lending priorities and make available fast-disbursing emergency lending to help support safety nets, basic health care and education. Special programs to help create jobs for the most vulnerable may also have a role. The IMF should take into consideration the impact of its prescribed fiscal stance on social spending, and make sure that budgets for core social programs like health and education are maintained, or at least not disproportionately cut, even during periods of needed fiscal consolidation.

More broadly, an open international financial system works best if all countries equip their people to prosper in a modern economy. Such policies are the responsibility of individual governments. But the international community can

help, by identifying and helping to finance the implementation of the policies needed to provide this foundation for broad-based growth, from the provision of basic education and public health, to support for core labor standards that promote worker participation in the benefits of growth.

Conclusion

Market based economic systems, and global capital flows, offer great promise for the global economy, but we can and must greatly reduce the disruptions that can occur, with all the hardship that they produce. The issues involved in this reform are complex and pose difficult questions balancing strong competing factors. As I have said, there are no magic bullets. But over time, the steps we have taken and those we propose constitute a very powerful program of reform – one that will have an increasingly powerful effect on the way the global financial system functions. The result should be a more robust global economy – one less susceptible to crises, one better equipped to deal with crises and one with greater growth, more broadly shared. And the continued strong engagement by the United States, working with the rest of the international community, will be essential if this outcome is to be achieved. Thank you very much.

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Ryan D. Edwards (CN=Ryan D. Edwards/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME:21-APR-1999 11:33:06.00

SUBJECT: talked with Stan

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

READ:UNKNOWN

TEXT:

Hi Janet,

Stan tells me that he had spoken with the Secretariat about these issues, but that it had been a while ago. So I suspect what happened was he didn't clear it with them recently, so they got surprised. But he was relatively adamant that it had been a topic of conversation and that they should've known it was coming.

Stan feels the same way we feel; he talked with Martine Durand and agreed for them to do whatever they'd like to fix things, which means that Martine will talk to Molitor and ask that he perhaps speak during Friday's lunch. So we'll let the Secretariat do whatever they like on this front.

Please let me know if I can do anything else on this topic.

Best,

-Ryan

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Bert I. Huang (CN=Bert I. Huang/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME:21-APR-1999 16:43:56.00

SUBJECT: Overview of the 5/24 PCAST panel

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

READ:UNKNOWN

CC: Michele Jolin (CN=Michele Jolin/OU=CEA/O=EOP @ EOP [CEA])

READ:UNKNOWN

TEXT:

Dear Janet:

From my conversation with Joan Porter of PCAST, here is an overview of the 5/24 event and your involvement. I have more background materials, reports, literature, and a draft agenda, but first the basics:

- (1) PCAST is inviting you to moderate a small panel from 3:30 to 5:15. They hope that you can first speak for about 20 minutes, then introduce and facilitate Q&A for the others. You do not have to answer questions, but may if you choose.
- (2) Your session will be the last in a full day of meetings for the 19 PCAST members. PCAST members are prominent members of industry and academia who meet on occasion to discuss science and technology policy. There may be 50 people in the public audience, but they do not generally participate.
- (3) The other panelists invited are Paul Romer and Michael Porter. They have both written reports recently on the topic. They are not confirmed attendees.
- (4) No other principals from WH are expected to be present during your session. Gene Sperling will meet with the PCAST members during lunch, but will not be at your session "unless you so request."
- (5) There should be very little press coverage. Some scientific press usually cover the meetings, but very rarely are major media or TV/video cameras present.
- (6) About the content of your remarks: For now, I have suggested to Joan that you would be most comfortable discussing how mainstream economists view technology and reviewing what the CEA has said previously about R&D -- and that it would be best to leave "new paradigms," "new compacts," and "new economies" to other speakers.

I have collected some OSTP, CEA, and academic literature -- and will get copies of the Porter and Romer literature from Joan. In addition to remarks, I will prepare lead-off questions for the two panelists that you

may use as moderator.

Meanwhile, if you have ideas of alternate speakers in case Paul Romer and Michael Porter choose not to attend, I will pass them to Joan Porter.

Thanks -- this should be interesting.

Bert

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Ryan D. Edwards (CN=Ryan D. Edwards/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME:22-APR-1999 09:46:12.00

SUBJECT: OECD & Climate Change

TO: Rebecca M. Blank (CN=Rebecca M. Blank/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

TO: Joseph E. Aldy (CN=Joseph E. Aldy/OU=CEA/O=EOP @ EOP [CEA])
READ:UNKNOWN

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

TEXT:

This message is primarily addressed to Joe, but Janet or Becky may know more of the specifics.

Stan Otto at USOECD explains below that the OECD would like to know our reaction to "the detailed answers they provided to our questions" on the whole Green model business. Have you seen them, Joe? I personally haven't. If you have, could you either email Stan directly and cc: me, or mail me and then I'll mail Stan.

-Ryan

----- Forwarded by Ryan D. Edwards/CEA/EOP on 04/22/99
09:43 AM -----

"Otto, Stan A" <OttoSA2 @ state.gov>
04/22/99 05:27:24 AM

Record Type: Record

To: Ryan D. Edwards/CEA/EOP
cc:
Subject:

Ryan,

Yet another thing -- but then, there are always more things leading up to the EPC meeting. I was talking with the Secretariat about climate change, and they asked if there was any reaction to the detailed answers they provided to our questions on the results from GREEN following WP-1. They would, naturally, like to avoid a very negative U.S. reaction to the climate

change paper that will be presented to EPC. So what do we have? Are we in agreement now? Will there be any response to the Secretariat forthcoming? Would be good to resolve this well before the meeting, n'est-ce pas.

Thanks,

Stan

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

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

CREATION DATE/TIME:22-APR-1999 17:00:41.00

SUBJECT:

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

READ:UNKNOWN

TEXT:

revised piece of draft===== ATTACHMENT 1 =====

ATT CREATION TIME/DATE: 0 00:00:00.00

TEXT:

Unable to convert ARMS_EXT:[ATTACH.D55]ARMS232540030.136 to ASCII,

The following is a HEX DUMP:

Revision of last paragraph on page 6: (also sent via email)

Yet, despite these increasing outlays, the budget is projected to remain in surplus until the 2050s. How is that possible? One critical factor is the assumption that we maintain a very tight constraint on discretionary spending. If we hold discretionary spending constant in real dollars, then, as both the population and real income per capita grow over time, discretionary spending will become a smaller share of total national income. However, reaching this objective would be quite difficult, as the current levels of defense and nondefense discretionary spending represent their smallest shares of GDP in thirty-five years. Another key factor ...

Withdrawal/Redaction Marker

Clinton Library

DOCUMENT NO. AND TYPE	SUBJECT/TITLE	DATE	RESTRICTION
001. email	Arlene F Reeves to Janet L. Yellen, Rebecca M. Blank, atc@npr.org, ccox@gridnet.com, and press.bar@mail.house.gov. Subject: Survival is costing us our children. (3 pages)	04/22/1999	b(6)

COLLECTION:

Clinton Presidential Records
Automated Records Management System [Email]
CEA ([Yellen])
OA/Box Number: 950000

FOLDER TITLE:

[04/02/1999 - 05/05/1999]

2013-0723-F
ab1297

RESTRICTION CODES

Presidential Records Act - [44 U.S.C. 2204(a)]

Freedom of Information Act - [5 U.S.C. 552(b)]

P1 National Security Classified Information [(a)(1) of the PRA]
P2 Relating to the appointment to Federal office [(a)(2) of the PRA]
P3 Release would violate a Federal statute [(a)(3) of the PRA]
P4 Release would disclose trade secrets or confidential commercial or financial information [(a)(4) of the PRA]
P5 Release would disclose confidential advice between the President and his advisors, or between such advisors [(a)(5) of the PRA]
P6 Release would constitute a clearly unwarranted invasion of personal privacy [(a)(6) of the PRA]

b(1) National security classified information [(b)(1) of the FOIA]
b(2) Release would disclose internal personnel rules and practices of an agency [(b)(2) of the FOIA]
b(3) Release would violate a Federal statute [(b)(3) of the FOIA]
b(4) Release would disclose trade secrets or confidential or financial information [(b)(4) of the FOIA]
b(6) Release would constitute a clearly unwarranted invasion of personal privacy [(b)(6) of the FOIA]
b(7) Release would disclose information compiled for law enforcement purposes [(b)(7) of the FOIA]
b(8) Release would disclose information concerning the regulation of financial institutions [(b)(8) of the FOIA]
b(9) Release would disclose geological or geophysical information concerning wells [(b)(9) of the FOIA]

C. Closed in accordance with restrictions contained in donor's deed of gift.
PRM. Personal record misfile defined in accordance with 44 U.S.C. 2201(3).
RR. Document will be reviewed upon request.

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Ryan D. Edwards (CN=Ryan D. Edwards/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME:26-APR-1999 15:42:41.00

SUBJECT: EPC documents and comments from others

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

READ:UNKNOWN

TEXT:

Hi Janet,

As you may recall, the EPC has the following items on the docket, which I list along with notes as to the current degree of our preparedness:

1. General Macro assessment

2. Current account imbalances

Robert has given me notes from his introductory comments on this topic given during the last WP-3 luncheon.

3. Jobs Strategy

Becky has given me her two pages of notes on the WP-1 paper from which the discussion is drawn.

4. Climate Change

Joe has all the relevant material and has agreed to formulate statements (or help me formulate them) in response to the Issues for Discussion on this topic.

I think I could draw up statements on #2 and #3 based on what I have from Robert and Becky, but would you like me to pass them the relevant Issues directly and ask for comments?

Another twist is of course that Gov. Meyer may well like to have a few things to say on #1 and #2. Would you like me to research statements on #1?

Unless I hear otherwise, I'll plan to synthesize Becky's and Robert's notes into statements on #2 and #3, get Joe's statement on #4, and leave #1 alone for the time being.

-Ryan

**Clinton Presidential Records
Automated Records Management System
[EMAIL] and Tape Restoration Project [Email]**

This is not a presidential record. This is used as an administrative marker by the William J. Clinton Presidential Library Staff.

This marker identifies a responsive email, already made available within another collection.

Collection: 2014-0316-F

Bucket: CEA

Creation Date: 1999-04-26

Subject: Problems in the near-term outlook

Creator: Steven N. Braun CN=Steven N. Braun/OU=CEA/O=EOP
[CEA]

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: thom@MIT.EDU@INET@LNGTWY (thom@MIT.EDU@INET@LNGTWY [UNKNOWN])

CREATION DATE/TIME:26-APR-1999 11:45:11.00

SUBJECT: Modigliani Paper - Social Security Reform

TO: Janet L. Yellen@eop (Janet L. Yellen@eop [CEA])

READ:UNKNOWN

TEXT:

See previous message.===== ATTACHMENT 1 =====

ATT CREATION TIME/DATE: 0 00:00:00.00

TEXT:

Unable to convert ARMS_EXT:[ATTACH.D93]ARMS29311313Y.136 to ASCII,

The following is a HEX DUMP:

Clinton Presidential Records Automated Records Management System [EMAIL]

This is not a presidential record. This is used as an administrative marker by the William J. Clinton Presidential Library Staff.

Hex Dump file is not in a recognizable format, has been incorrectly decoded or is damaged.

File Name: p_x3131138_cea_html_1.msoff

Attachment Number: [ATTACH.D93]ARMS29311313Y.136

Clinton Presidential Records Automated Records Management System [EMAIL]

This is not a presidential record. This is used as an administrative marker by the William J. Clinton Presidential Library Staff.

Hex Dump file is not in a recognizable format, has been incorrectly decoded or is damaged.

File Name: p_x3131138_cea_html_2.msoff

Attachment Number: [ATTACH.D93]ARMS24411313Z.136

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Joseph E. Aldy (CN=Joseph E. Aldy/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME:26-APR-1999 17:58:14.00

SUBJECT: testimony

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

READ:UNKNOWN

CC: Alan S. Polasky (CN=Alan S. Polasky/OU=CEA/O=EOP @ EOP [CEA])

READ:UNKNOWN

CC: Quindi C. Franco (CN=Quindi C. Franco/OU=CEA/O=EOP @ EOP [CEA])

READ:UNKNOWN

CC: Robert Z. Lawrence (CN=Robert Z. Lawrence/OU=CEA/O=EOP @ EOP [CEA])

READ:UNKNOWN

TEXT:

Janet,

We have received some revised numbers from EMF which change slightly what we reported in your last testimony. Also, we need to change the discussion on electricity restructuring, since the new bill has been sent to the hill. Attached is the latest version of the written testimony, the changes in the latest draft of your oral testimony I have, and an updated chart of the EMF-16 results. Here are the changes:

changes in both oral and written testimony:

- * 12 global models (we formerly listed results from 10)
- * Annex I trading cuts permit prices 60% (we formerly noted 53% reduction in prices)
- * Global trading cuts permit prices 81% (we formerly noted 80% reduction in prices)

changes in written testimony:

- * Footnote stating that EMF results are forthcoming in special issue of the Energy Journal
- * One model finds that Annex I trading reduces US permit price 77% (we formerly noted 72%)
- * SGM in EMF exercise is above the median Annex I price, and just below the median global trading price
- * On electricity restructuring, we changed the following:
 - Bill was released earlier this month
 - Bill would result in carbon emissions reductions of 40-60

MMTCE

Technical analysis of bill will be released in near future

written testimony:

oral testimony:

EMF summary table:

Let me know if you would like to talk about these.

Joe===== ATTACHMENT 1 =====
ATT CREATION TIME/DATE: 0 00:00:00.00

TEXT:
Unable to convert ARMS_EXT:[ATTACH.D66]ARMS23638713J.136 to ASCII,
The following is a HEX DUMP:

**TESTIMONY OF DR. JANET YELLEN
CHAIR, COUNCIL OF ECONOMIC ADVISERS
BEFORE THE
U.S. HOUSE OF REPRESENTATIVES
COMMITTEE ON SMALL BUSINESS**

APRIL 29, 1999

Thank you, Mr. Chairman. I appreciate having this opportunity to discuss with you the economics of climate change and the Administration's efforts to address this significant environmental challenge. As you know, the Administration released a report last July, entitled "The Kyoto Protocol and the President's Policies to Address Climate Change: Administration Economic Analysis." The report states that, in the Administration's view, the costs of achieving our Kyoto target would be modest if we can succeed in implementing international trading, joint implementation, and the Clean Development Mechanism in an efficient manner and we achieve meaningful developing country participation. In addition, since the 1997 Kyoto Conference, a variety of research on the economics of Kyoto, and especially on the economics of Kyoto's flexibility mechanisms, has been undertaken. Today, I will provide a brief summary of the Administration's Economic Analysis and review several of the key findings in the recent economic literature on climate change.

The Potential Impact of Climate Change

The Intergovernmental Panel on Climate Change (IPCC) concluded in 1995 that "the balance of evidence suggests that there is a discernible human influence on global climate." Current concentrations of greenhouse gases have reached levels well above those of preindustrial times. If growth in global emissions continues unabated, the atmospheric concentration of carbon dioxide (CO₂) will likely double relative to its preindustrial level by midway through the next century and continue to rise thereafter. As a result of the increased concentration of CO₂, the IPCC estimates that global temperatures will increase by between 2 to 6 degrees Fahrenheit in the next 100 years, with a best guess of about 3.5 degrees Fahrenheit. Potential consequences associated with this shift in climate include a rise in sea levels, greater frequency of severe weather events, shifts in agricultural growing conditions from changing weather patterns, threats to human health from increased range and incidence of diseases, changes in availability of freshwater supplies, and damage to ecosystems and biodiversity. Further discussion of the costs of climate change is contained in the Administration Economic Analysis.¹

¹ Please refer to the attached paper copy or <http://www.whitehouse.gov/WH/New/html/kyoto.pdf> for a PDF version of this document.

The Kyoto Protocol and the Buenos Aires Conference of the Parties

The Kyoto Protocol provides several mechanisms that would allow countries to achieve the emissions targets established in this agreement in a cost-effective fashion. These mechanisms, which permit what we have termed “when”, “what”, and “where” flexibility in meeting the Kyoto emissions targets, are described in detail in the Administration Economic Analysis. Since securing international emissions trading, the Clean Development Mechanism, and joint implementation in Kyoto, the Administration has worked in bilateral and multilateral arenas to promote understanding of these mechanisms and to develop rules that will promote their efficient operation. Last fall in Buenos Aires, a workplan to resolve key implementation issues regarding these mechanisms by the end of 2000 was agreed to by all the participating countries. I want to reiterate that efficient implementation of these flexibility mechanisms is critical to reducing the costs of achieving the targets established in the Kyoto Protocol.

Costs of Action

In assessing the economic effects of the Kyoto Protocol, the Administration has drawn on the insights of a wide range of models and analysis. Examples include models of the energy sector and economy over the next 25 years, such as those participating in the Stanford Energy Modeling Forum, the Intergovernmental Panel on Climate Change’s review of the economic and social dimensions of climate change, the work of the Organisation for Economic Co-operation and Development (OECD) on the economic dimensions and policy responses to global warming, and the Administration’s staff-level interagency analysis. In addition, the Administration used other tools, such as a meta-analysis, basic economic reasoning, overviews of the domestic and international energy sectors, statistics regarding energy efficiency and greenhouse gas emissions, and economic indicators from World Bank, International Energy Agency, and Energy Information Administration databases.

Assuming that effective mechanisms for international trading, joint implementation, and the Clean Development Mechanism are established, and assuming also that the United States achieves meaningful participation by key developing countries, the Administration’s overall assessment is that the economic cost of attaining the targets and timetables specified in the Kyoto Protocol will be modest for the United States in aggregate and for typical households. This conclusion is not entirely dependent upon, but is fully consistent with, formal model results. The Administration believes that there are limitations to relying on any single model to assess the economic impact of the Kyoto Protocol. However, model results can further inform and improve the understanding of the effects of climate change policy. To complement the economic analysis of the Administration’s policy to address climate change, we have conducted an illustrative assessment with a modified version of the Second Generation Model (SGM). The results from the SGM substantiate the conclusion that the economic effects of an efficient, effective, and global policy to address the risks of climate change will be modest.

An assessment using the SGM model that accounts for effective trading and developing country participation yields permit price estimates ranging between \$14/ton and \$23/ton, and direct resource costs to the U.S. between \$7 billion and \$12 billion/year (1997 dollars). The range reflects uncertainty about the extent of Annex I participation in international trading.

Under the assumptions of the Administration's analysis, permit prices in the range of \$14/ton to \$23/ton translate into energy price increases at the household level between 3 and 5%.

Under these permit prices, fuel oil prices would increase about 5 to 9 percent, natural gas prices about 3 to 5 percent, gasoline prices about 3 to 4 percent (or around 4 to 6 cents per gallon), and electricity prices about 3 to 4 percent. This increase in energy prices at the household level would raise the average household's energy bill in ten years by between \$70 and \$110 per year, although such predictions may not be observable because they would be small relative to typical energy price changes, and nearly fully offset by electricity price declines from Federal electricity restructuring. By 2008-2012, the anticipated 10 percent decline in electricity prices from restructuring is projected to lead to expenditure reductions of about \$90 per year for the average household.

The illustrative modeling analysis does not account for several key components of the Kyoto Protocol and the Administration's policies to reduce greenhouse gas emissions. These include the benefits of reducing net emissions through carbon sinks, the Administration's electricity restructuring proposal, the Administration's Climate Change Technology Initiative (increases in R&D funding and new tax incentives in the Administration's FY 2000 Budget), the Administration's sectoral consultations to encourage and support voluntary efforts by U.S. industry to undertake emissions reductions, including the provision of credit for early action, and the Administration's efforts to reduce federal energy use. There are also ancillary benefits of reducing greenhouse gas emissions -- in particular, the corresponding reductions in conventional air pollutants like sulfur dioxide and fine particulate matter. These benefits alone could produce savings equal to about a quarter of the costs of meeting our Kyoto target.

The Administration released earlier this month its proposed electricity restructuring legislation. The Administration's proposed Comprehensive Electricity Competition Act (CECA) is estimated to reduce greenhouse gas emissions by about 40 to 60 million metric tons of carbon equivalent per year by 2010. Further, the electricity restructuring proposal provides potential cost-savings in four areas: dispatch efficiency, improved capital utilization, savings in capital additions and cost reductions in fuel procurement, non-fuel operation and maintenance expenses, and administrative and general expenses. These four categories of savings, when translated to consumers, are likely to reach or exceed \$20 billion annually. The Department of Energy is revising its technical analysis of last year's proposal to reflect changes in the latest proposed legislation and will release the new analysis to the public in the near future.

Recent Research on the Economics of Climate Change

Since December 1997, many economists have conducted and made available their analyses of the Kyoto Protocol. I have noted in previous appearances before Congressional Committees that there are limitations to relying on one or a small set of models and that we were eager to see assessments of the Kyoto Protocol by other models. Two large efforts have been undertaken to coordinate and compile modeling results on the Kyoto Protocol. First, the Stanford University Energy Modeling Forum (EMF), a long-running model comparison exercise involving many of the leading climate and energy models, has coordinated full scale analyses of the Kyoto Protocol. Second, the Organisation for Economic Co-operation and Development (OECD) held an economic modeling workshop this past fall, and has since published the proceedings of this workshop which includes 16 papers. In addition, several research teams have undertaken work in evaluating the potential for intergas trading and the cost-savings of a six-gas target relative to a carbon dioxide-only target. I would like to take this opportunity to provide an overview of this recent research.

Kyoto Modeling Analyses

The final results of the Energy Modeling Forum comparison exercise of the Kyoto Protocol reflect the work of twelve modeling teams from the United States, Europe, and Asia.² In evaluating the Kyoto Protocol, all of the participating teams used economic models that incorporate the potential for international trading in greenhouse gas permits. The OECD workshop included presentations by 10 modeling teams, 9 of which had global models as well.^{3,4}

By explicitly incorporating international trading, these models can evaluate the opportunities for cost-savings through trading among Annex I nations and among Annex I and developing countries were they to adopt emissions targets. Since the Kyoto Protocol enables all countries with emissions targets to trade emissions allowances among other countries with targets, these models are well-suited to assess the economic implications of the international trading component of the agreement.

While the models used in the EMF exercise and the OECD workshop can assess international trading, there are several other flexibility mechanisms of the Kyoto Protocol that they cannot, at present, readily assess. For example, these models did not incorporate the effects of sinks. While several modelers did assess the economic costs of achieving the Kyoto targets

² The results of the Stanford Energy Modeling Forum's Kyoto Protocol exercise will be published in a forthcoming issue of the *Energy Journal*.

³ Please note that several modeling teams participating in the EMF exercise made presentations at the OECD workshop.

⁴ PDF-formatted files of the OECD workshop proceedings can be downloaded from the OECD webpage at <http://www.oecd.org/dev/news/Environment/Modelling.htm>.

with “off-line” assumptions about sink activity, none incorporated an integrated energy-land use model. Further, most of the modelers did not evaluate opportunities to reduce costs by trading across greenhouse gases. These models are primarily energy models and are focused on the economics of reducing carbon emissions from fossil fuel combustion. Again, some modelers analyzed the Protocol by making some “off-line” assumptions about the potential reductions in non-carbon dioxide greenhouse gases, but none employed a model with cost curves for these gases. Finally, it should be noted that these models did not include opportunities for emissions reduction through Administration proposals, such as electricity restructuring or the Climate Change Technology Initiative, that could slow the growth over time of greenhouse gas emissions thereby lowering greenhouse gas permit prices.

The results from both the EMF and OECD efforts provide very useful context for the Administration’s economic analysis. First, the illustrative model used by the Administration, the Second Generation Model of the Pacific Northwest National Laboratory, tends to fall in the middle of the range of this set of models in terms of U.S. permit prices.⁵ For example, under Annex I trading SGM generates a permit price which is above the median of this set of models, while under full global trading, the SGM permit price is just below the median permit price. Second, the EMF exercise found that the reduction in permit prices as trading expands from no trading to Annex I trading to full global trading is robust. On average, the EMF models found that Annex I trading would cut the U.S. permit price by 60% relative to a no trading scenario. Of these models, one estimated a 77% reduction in the permit price under Annex I trading. In full global trading, the permit price would be, on average, 81% lower than the no trading price. Several models estimated permit price reductions of about 90%.

The reported results from the OECD workshop found similar reductions in permit prices by going from no trading to Annex I trading. On average, the OECD workshop models found that Annex I trading would cut the U.S. permit price by 57% relative to a no trading scenario. Moreover, they found that the European Union and Japan would benefit more from unconstrained Annex I trading. For both the E.U. and Japan, the average reduction in permit prices across these models would be nearly 75%.

Analyses of Trading Constraints

In addition to the modeling of various efficient international trading scenarios, several EMF modeling teams have considered the impact of constraints on the opportunity to buy or sell emissions allowances in an international market. While the United States is unambiguously

⁵ Please note that the version of SGM used in EMF differs from the analysis conducted by the Administration because the EMF version does not include cost curves for non-carbon dioxide greenhouse gases used by the Administration. Since efficient trading across gases would lower costs and permit prices, and accounting for six gases affects the stringency of some countries’ targets, the EMF version of SGM yields slightly higher permit prices than the Administration version.

opposed to trading restrictions, several parties to the agreement have indicated support for some form of a trading constraint, for example, by setting a limit on the amount a party can purchase through the trading system. Trading restrictions would generate no benefit for the global climate while they could significantly increase the costs of achieving the Kyoto targets.

Before describing the economic costs of trading constraints, I would like to explain why such constraints yield no climate benefits. Regardless of where a greenhouse gas emission reduction occurs, it has the same effect on total emissions and the same effect on the climate. A ton reduced in New York generates the same climate benefit as a ton reduced in Berlin. In proposing trading constraints, some have focused on countries such as Russia, that will have emissions below their Kyoto targets during the commitment period because of the decline in their economic output associated with the transition to market economies. If trading constraints are established that restrict the ability of Russia to sell permits (or restrict the opportunity for other Annex I countries to buy Russian permits), then emissions during the first commitment period would be lower than in the absence of such constraints. However, Russia would simply bank its allowances and use these allowances in a subsequent commitment period when its emissions exceed its target. While a trading constraint might lower emissions during the first commitment period, the cumulative emissions over several commitment periods from Annex I countries would be the same with and without the trading constraint. Given the long residence times of greenhouse gases (on the order of a 100 or more years), the cumulative effect is what is most relevant in terms of changes in the global climate.

To provide a sense of the economic implications of trading constraints, I would like to share with you two examples from work done by EMF modeling teams. First, consider a trading constraint that mandates that at least two-thirds of the emissions reductions necessary for a country to achieve its Kyoto target must occur through domestic actions. Evaluating this trading constraint with the EPPA model based at the Massachusetts Institute of Technology, the permit price for the United States is almost four times higher with the constraint than under an unconstrained global trading system. It is important to note that the effects of this constraint are even more pronounced for the European Union and for Japan. The permit price for the EU would be more than five times higher than the unconstrained global trading permit price, and the Japanese permit price would be thirteen times higher. As these results indicate, the trading constraint would result in each country experiencing a different marginal cost of abatement, and there would be no common permit price for a ton of carbon equivalent. Since the constraint restricts opportunities for countries like the United States, Japan, and members of the EU to buy emissions allowances, the competitive price for emission allowances from countries like Russia would fall below the unconstrained level.

Second, consider a trading constraint that mandates that acquisitions of permits through international trading could not exceed 10% of a country's emissions allocation. For example, the U.S. target is approximately 1.5 billion tons of carbon equivalent on an annualized basis. Under this trading constraint, the United States, or private firms in the United States, could not purchase more than 150 million tons on an annual basis from other countries. Assessing this

trading constraint with the Second Generation Model, the permit price for the United States would more than triple relative to the unconstrained global trading permit price. For the E.U., the permit price would nearly double, and for Japan, the permit price would be eleven times as high as the unconstrained global price.

While trading constraints increase greenhouse gas permit prices (and subsequently, energy prices) in the United States, the European Union, and Japan, they also reduce the gains from trade by the countries likely to be sellers of emissions allowances. For example, Russia and large developing countries that adopt emissions growth targets and participate in international trading, e.g., China and India, would sell fewer emissions allowances at lower international permit prices under such trading constraints than in an unconstrained global trading environment. Such restrictions lessen the benefits of participation by developing countries in international trading.

Estimated reduction in costs from trading across gases

As we note in the Administration Economic Analysis, the Kyoto Protocol provides additional flexibility in achieving emissions targets by specifying these targets as a basket of 6 types of greenhouse gases (carbon dioxide, methane, nitrogen dioxide, hydrofluorocarbons, perfluorocarbons, and sulfur hexafluoride). Countries can effectively trade across gases, based on their global warming potential, so that the aggregate weighted emissions reductions occur at least cost. Most models used to evaluate the Kyoto Protocol have not incorporated this kind of flexibility, although several modeling teams are actively working to modify their models to include emissions of non-CO₂ greenhouse gases. In the Administration's analysis, cost curves for these other gases for the United States were used in conjunction with the SGM model. These simulations suggest that trading across greenhouse gases can lower costs up to 15% relative to a situation where no trading across gases occurs.

Complementing this finding, recent work by a group of researchers at the Massachusetts Institute of Technology has found that including the opportunity to abate non-CO₂ greenhouse gas emissions and promote carbon sinks reduces the costs to the United States by about 25% relative to a carbon-only approach (assuming no international trading). On average, they find that Annex I countries' costs would fall by more than 20%. In addition, work by University of Illinois researchers and others has evaluated the changes in costs of abating methane and carbon dioxide to achieve the U.S. Kyoto target instead of abating carbon dioxide alone. They found that meeting an emissions target through cost-effective trading between carbon dioxide and methane reductions could reduce costs by nearly 20% relative to a case with no intergas trading. Finally, research by several Dutch analysts presented at the OECD workshop found significant opportunities for the European Union to substitute abatement of non-CO₂ greenhouse gas emissions for carbon dioxide reductions. They found that 27% of the total reduction effort necessary for E.U. countries to achieve their emissions targets could occur through the abatement of these non-carbon dioxide gases.

Developing Country Participation

Last year during the Buenos Aires Conference, two non-Annex I countries, Argentina and Kazakhstan stated that they will announce emissions targets and expressed their interest in engaging in international emissions trading. We believe that these two countries' efforts may encourage other non-Annex I countries to follow their lead. Economic and environmental benefits could accrue to developing countries if they adopt binding emissions targets and participate in international trading. Setting a target below the business as usual emissions level for the commitment period would generate climate benefits by reducing global emissions below what they would otherwise have been. In addition, if the target is set not too far below the business as usual emissions level, the participation of the country in a global trading system would produce economic benefits or "gains from trade" for both the developing country and its trading partners. Emissions trading by developing countries would occur only if they chose to undertake emissions reductions above and beyond their commitments -- reductions that would generate trading extra income for them as long as their marginal abatement cost is below the world trading price for greenhouse gas permits. Many of the EMF models reveal that, for large developing countries, like China, such excess reductions would indeed be profitable, so that these countries would export allowances and gain from trade. Developing countries would also reap ancillary benefits of reducing conventional air pollutants, which may be substantial. Benefits from trading would also accrue to Annex I countries. Annex I countries (and private firms in these countries), who would purchase these emissions allowances in the world market, would achieve their targets at lower costs than without the participation of the developing countries. However, it should be noted that the more stringent the target for the developing country, the lower the gains from trade both for that country and for Annex I countries such as the United States. Indeed, an extremely stringent target could conceivably make the developing country a net importer of emissions allowances, and raise the international trading price for a greenhouse gas permit. Still, these models illustrate the potential to create targets that simultaneously make the environment, the developing country, and Annex I countries all better off.

Conclusion

The Administration's overall conclusion is that the economic impact of the Protocol will be modest under the conditions we have identified in our economic analysis. The purpose of this testimony has been to summarize the analysis we have presented in the Administration Economic Analysis on climate change and to provide a brief update of recent research efforts outside of the government.

I look forward to continuing to work with members of this Committee, as well as with other interested parties, in further analyzing the Kyoto Protocol and evaluating the net effects of reducing greenhouse gas emissions. It is my hope that economic analysis will continue to play a key role in designing policies in this area.

I welcome your questions.

**ORAL TESTIMONY OF DR. JANET YELLEN
CHAIR, COUNCIL OF ECONOMIC ADVISERS
BEFORE THE
U.S. SENATE
COMMITTEE ON ENERGY AND NATURAL RESOURCES**

MARCH 25, 1999

Thank you, Mr. Chairman. I appreciate having this opportunity to discuss with you the economics of climate change and the Administration's efforts to address this significant environmental challenge. As you know, the Administration released a report last July, entitled "The Kyoto Protocol and the President's Policies to Address Climate Change: Administration Economic Analysis." In addition, since the Kyoto Conference, a variety of research on the economics of Kyoto, and especially on the economics of Kyoto's flexibility mechanisms, has been undertaken. Today, I will provide a brief summary of the Administration's Economic Analysis and review several of the key findings in the recent economic literature on climate change.

Administration Economic Analysis

The Administration's Economic Analysis found that, assuming that effective mechanisms for international trading, joint implementation, and the Clean Development Mechanism are established, and assuming also that the United States achieves meaningful participation by key developing countries, the economic cost of attaining the targets and timetables specified in the Kyoto Protocol will be modest for the United States in aggregate and for typical households.

An illustrative assessment using the Second Generation Model that accounts for effective trading and developing country participation yields permit price estimates ranging between \$14/ton and \$23/ton, and direct resource costs to the U.S. between \$7 billion and \$12 billion/year. Under the assumptions of the Administration's analysis, permit prices in the range of \$14/ton to \$23/ton translate into energy price increases at the household level between 3 and 5%, but this would be roughly offset by the Administration's electricity restructuring proposal. I would be happy to further discuss this analysis during the question and answer period.

Recent Research on the Economics of Climate Change

Since December 1997, many economists have conducted and made available their analyses of the Kyoto Protocol. For example, the Stanford University Energy Modeling Forum (EMF), a long-running model comparison exercise involving many of the leading climate and energy models, has coordinated full scale analyses of the Kyoto Protocol with 12 global models. Further, the Organisation for Economic Co-operation and Development (OECD) has published the proceedings of the economic modeling workshop it sponsored this past fall. The modeling results from EMF and OECD provide very useful context for the Administration's economic analysis. First, the illustrative model used by the Administration, the Second Generation Model of the Pacific Northwest National Laboratory, tends to fall in the middle of the range of the EMF models in terms of U.S. permit prices. Under Annex I trading the SGM permit price is at the median of this set of models and under full global trading it is just below the median permit price. Second, both modeling exercises found that the reduction in permit prices as trading

expands from no trading to Annex I trading to full global trading is robust. On average, the EMF models found that Annex I trading would cut the U.S. permit price by 60% relative to a no trading scenario, while the OECD models found a 57% average price reduction. In full global trading, the permit price would be, on average, 81% lower than the no trading price.

Several EMF modeling teams have considered the impact of constraints on the opportunity to buy or sell emissions allowances in an international market. While the United States is unambiguously opposed to trading restrictions, several parties to the agreement have indicated support for some form of a trading constraint. Trading restrictions would generate no benefit for the global climate while they could significantly increase the costs of achieving the Kyoto targets. In my written testimony I describe two examples of trading constraints where the U.S. permit price would increase by up to four times higher than the unconstrained price.

Most models used to evaluate the Kyoto Protocol only focus on carbon dioxide emissions and do not account for the 6 types of greenhouse gases comprising Kyoto targets and the opportunity to trade across gases. However, recent work by a group of researchers at MIT has found that including the opportunity to abate non-CO₂ greenhouse gas emissions and promote carbon sinks reduces the costs to the United States by about 25% relative to a carbon-only approach (assuming no international trading). Other recent research has found similar results.

The EMF modeling indicates that economic and environmental benefits could accrue to some developing countries if they adopt emissions targets. Setting a binding emissions target would generate climate benefits by reducing global emissions below what they would otherwise have been. In addition, if the target is set not too far below the business as usual emissions

level, the participation of the country in a global trading system would produce economic benefits or “gains from trade” for both the developing country and its trading partners, such as the United States. Annex I countries (and private firms in these countries), who would purchase these emissions allowances in the world market, would achieve their targets at lower cost than without the participation of the developing countries.

Conclusion

The Administration’s overall conclusion is that the economic impact of the Protocol will be modest under the conditions we have identified in our economic analysis. The purpose of this testimony has been to summarize the analysis we have presented in the Administration Economic Analysis on climate change and to provide a brief update of recent analytic efforts outside of the government.

I look forward to continuing to work with members of this Committee, as well as with other interested parties, in further analyzing the Kyoto Protocol and evaluating the net effects of reducing greenhouse gas emissions. It is my hope that economic analysis will continue to play a key role in designing policies in this area.

I welcome your questions.

EMF-16: Modeling Exercises of Kyoto Protocol: Permit Prices

Model	No Trading (U.S.)	Annex I Trading	Percent Change from No Trading	Global Trading	Percent Change from No Trading
FUND	n/a	\$17/ton	n/a	\$11/ton	n/a
G-Cubed	\$90/ton	\$64/ton	30%	\$23/ton	74%
RICE	\$157/ton	\$73/ton	53%	\$22/ton	86%
SGM	\$224/ton	\$101/ton	55%	\$27/ton	88%
MIT	\$230/ton	\$91/ton	61%	n/a	n/a
AIM	\$182/ton	\$77/ton	58%	\$45/ton	75%
MRT	\$282/ton	\$92/ton	67%	\$32/ton	89%
CETA	\$200/ton	\$55/ton	73%	\$31/ton	84%
MERGE3	\$315/ton	\$161/ton	49%	\$103/ton	67%
Oxford	\$489/ton	\$267/ton	45%	\$147/ton	70%
ABARE	\$384/ton	\$127/ton	67%	\$28/ton	93%
WORLDSCAN	\$101/ton	\$24/ton	77%	n/a	n/a
Average (SD)	\$241/ton (120)	\$96/ton (67)	60%	\$47/ton (43)	81%

All permit prices are in 1997\$.

Sinks are assumed to be zero.

Non-carbon dioxide greenhouse gases are assumed to have no offsetting impact on the magnitude of carbon dioxide emissions reductions necessary to comply with Kyoto targets.

In global trading, non-Annex B countries are assumed to have targets set at 2010 BAU.

Results are based on modeling runs reported in March 1999 and reflect results that will be published in forthcoming special issue of the Energy Journal.

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: thom@MIT.EDU@INET@LNGTWY (thom@MIT.EDU@INET@LNGTWY [UNKNOWN])

CREATION DATE/TIME:26-APR-1999 11:42:47.00

SUBJECT: Modigliani Paper - Social Security Reform

TO: Janet L. Yellen@eop (Janet L. Yellen@eop [CEA])

READ:UNKNOWN

TEXT:

I am enclosing a thoroughly revised version of our earlier paper. I would appreciate it if you could take a look, in particular, at the new sections: 3 - The Transition Mechanism and 5 - Conclusions. The charts and tables referred to in the text will follow shortly.

Please contact my assistant if you have any difficulty opening the files.
I look forward to hearing your criticisms and suggestions.

- Franco Modigliani

FM/tcl

attachments===== ATTACHMENT 1 =====

ATT CREATION TIME/DATE: 0 00:00:00.00

TEXT:

Unable to convert ARMS_EXT:[ATTACH.D61]ARMS21970313Q.136 to ASCII,
The following is a HEX DUMP:

AN MIT SOLUTION TO THE SOCIAL SECURITY CRISIS

Formatted

By

Franco Modigliani, Maria Luisa Ceprini, Arun S. Muralidhar

Formatted

Sloan Working Paper 4051 March 1999

Formatted

AN MIT SOLUTION TO THE SOCIAL SECURITY Program
to Reform the Social Security System **CRISIS**

By

Franco Modigliani*, Maria Luisa Ceprini**, Arun S. Muralidhar***

Sloan Working Papers 4051

Formatted

Revision -- April/March 1999

Formatted

Abstract **Introduction** and Executive Summary

In the United States, ~~as~~like in many other countries, the function of helping individuals to make provisions for their retirement takes the form of universal, compulsory saving through contributions to a ~~public pension fund~~ like the Social Security (SS) in the U.S. These institutions typically rely on *pay-as-you-go* (PAYG) financing in which the current contributions of participants are used to pay the current pensions, ~~in~~ ~~in~~ contrast to a *funded* system in which the individual contributions are accumulated and invested in financial assets that, at retirement, are liquidated and converted into a pension.

PAYG has long been admired as an ingenious financial innovation that made it possible, at the start of the public pension system, to ~~also~~ ~~also~~ pay pensions ~~also~~ ~~also~~ to those ~~who~~ ~~that~~ had never contributed. ~~But~~However, today it is facing PAYG schemes are in serious dangers of ~~being~~ insolvency all over the world because of an unanticipated slowdown in growth. Furthermore, even if the current problem can ~~be~~ somehow ~~be~~ fixed, there is no assurance that it will not surface again later. The program laid out in this paper is intended to cure the problem, once and for all, by replacing the PAYG with a new *funded* system – the New Fund (NF). It is shown that, by the time the replacement is completed, the ~~new~~ Fund would be greatly superior to PAYG in ~~four~~three essential respects:

* Institute Professor Emeritus, Massachusetts Institute of Technology (email.francom@mit.edu)

** While contributing to this paper was Research Associate at the Sloan School, —Massachusetts Institute of Technology (email.ceprini@esteri.it).

*** While contributing to this paper was at the World Bank, managing the investment portfolio of the pension fund investment, and assisting developing countries in reforming their pension systems (email.arunmura@hotmail.com) funds.

The authors would like to thank Neetu Bhatia and Ronald van der Wouden for their dedicated assistance.

ii) It is far more cost effective in that the contribution required to provide a given set of benefits is much smaller – e.g., the contribution for the benefits currently provided by ~~SSocial Security~~ could be cut down (under realistic assumptions about the long run rate of return of the market portfolio) to around 5%, compared with the current 12.5-14% and a probable 17% by the middle of ~~the next century~~. This remarkable reduction is made possible by the return on the capital accumulated in the funded system.

Formatted: Bullets and Numbering

iii) It is financially much more sound in that, in contrast to PAYG, its ability to deliver the promised benefits is in no way affected by ~~changes~~by changes in the population age structure and little affected by changes in the productivity growth. This is because the pensions are not paid by the contributions of ~~the~~of the active population, but by the
i) ———capital individually accumulated.

Formatted: Bullets and Numbering

iii) Under PAYG, the compulsory savings are used to pay pensions and thus largely consumed, whereas in our funded system they are invested in ~~financial~~in financial assets and thus contribute to national saving, investment and capital – and ~~this contribution~~ positive externality would be very large and beneficial.

Formatted: Bullets and Numbering

iv) It permits ~~cto changes choices about~~with respect to benefits and contributions, which pose enormous problems within the ~~PAYG structure~~PAYG structure. For example ~~To illustrate~~, if one decided to reduce the replacement rate in countries where it is outlandishly ~~high~~in high, in a funded system this can be achieved by reducing contributions and benefits for those ~~entering~~after entering after a certain date. ~~What with PAYG~~, reducing the contribution of the ~~younger~~younger would make it impossible to pay the ~~pensions promised~~pensions ~~to~~promised to the older, and already paid by them. In other words, there is a cost of transition that somebody must pay (see below).

Formatted

In addition, our plan would pave the way for ~~three~~two important innovations:

i) It would make it possible for firms in the private sector to offer retirement plans in competition with the ~~p~~Public system.

Formatted: Bullets and Numbering

ii) Each participant will have an individual account that will be credited with his periodic contributions, together with the accrued returns resulting from the investment in the pooled portfolio. These individual accounts serve many purposes. They will keep the participant abreast of the progress of his accumulation and give him new confidence that the funds will be available to pay his pension at the proper time. They will also eliminate the danger that Congress may be tempted to tamper with the large funds that will be accumulating in SS. Congress will not be able to raid the aggregate without raiding individual portfolios!

ii) ~~ii) In addition,~~ The accumulation in the retirement account which is totally illiquid under the present SS, could be imparted some liquidity by allowing participants to borrow from their own account, with suitable limitations, and strictly enforced repayment rules and penalties—. This would provide the participants with the opportunity to choose a ~~path~~ path of saving more flexible than that imposed by the straight-jacket of the contribution rules, and would be especially valuable for younger people short of liquidity, as confirmed by the experience with the successful 401(k) plans—. ~~The danger risk that aof default could reduccing the retirement reserves could be controlled by an insurance thatinsurance that covered some fraction of thew principal, with the full penalty levied on the individual.~~

iii) It would make it possible for firms in the private sector to offer retirement plans in competition with the public system.

Other significant advantages are described later in the paper ~~set out in the text.~~

At the same time, the reform we advocate would preserve all the characteristics that have generated the broad popular support that ~~Social Security~~SS enjoys, and in particular, the *defined benefits* (DB) feature—. The defined benefit that we would propose is a guaranteed real return on contributions. This would be achieved by pooling the contributions and investing them in a single "indexed" portfolio consisting of an appropriate share of the market portfolio of ~~all~~ publicly traded financial assets—. ~~Theis~~

Formatted

return of this portfolio—portfolio would be “swapped” against that of a portfolio of—
portfolio of treasury bonds carrying a guaranteed *real* rate of return (around 5% at the
present time, ~~but—and~~ not necessarily fixed forever, but ~~Exchanged as little as~~
~~possiblepossible~~, and then only for younger people)¹~~early for extended periods~~).

In this respect, our solution differs in a fundamental way from the many proposals that
have been put forward and even implemented, notably in some South American countries,
and have come to be known under the misnomer of “privatization of Social Security”².
The basic feature of these approaches is to maintain a system of mandated retirement
saving, but to achieve funding, at least partially, by diverting some—these contributions
from the pPublic pPension system to individual accounts, to be invested in marketable
securities chosen to be invested in a portfolio of marketable securities managed by the
participant, though generally within— However, these investments are severely restricted
by regulatory constraints.

We submit that this solution is distinctly inferior to ours for ~~fourthree~~two main reasons³.
First, it unavoidably results in a *defined contribution system* (DC), which greatly increases
the risk borne by individuals. This is— especially serious for poorer and less sophisticated
participants who are least equipped to bear this risk⁴. — Second, ~~and it—wouldit would~~
foster inequalities by causing equal compulsory contributions—tocontributions—resultto
resulting in possibly in widely different pensions per equal compulsory contributions,
with, with some altogether inadequate for sustenance. (Nor can the individual portfolio
approach be expected to improve the overall performance of the market, since for every
“smart one” that does better than the average, there are “dumb ones” that do worse). The
very spirit of—publieof public pension demands that people not be allowed to gamble with
thei-r retirement
nest egg— Defined contributions schemes are acceptable for voluntary saving, but not for
the compulsory component⁵. It has been ~~suggested—thatsuggested that—~~ if ~~some~~ portfolio
returns~~performances~~ are too low, the government could provide a supplement⁶. ~~—but~~ This

¹ By doing so, the scheme is fully funded for the promised ~~benefit—which~~benefit, which is critical to ensure
solvency. Further, this arrangement is unlikely to impact the markets significantly, which is a fear that many

Formatted

is not only expensive, but would encourage irresponsible risk taking (Though one could conceivably offer an option for flexible contributions above some minimum). Our The defined benefits system clearly shifts the risk to to the government the risk the risk that the return on the market portfolio may fall short of the return guaranteed to the NF. But clearly However, we hold that the government is in a far better position to absorb this risk because of its size and because, with infinite life, it can redistribute the risk of a single cohort over a large number of cohorts. Furthermore, De facto it would, de facto bear th — is risk as well in the defined contribution case, if de jure or dthe facto it insured some minimum outcome. Third, it is more efficient to offer means-tested pensions and ensure redistribution objectives from DB schemes than it would be from DC schemes. One part of the risk to retirement income results from low salaries or salary growth and DB schemes like the current SS provide a valuable service to society by offering means-tested pensions. This would be extremely difficult and expensive to provide under a DC umbrella. In our approach, the result could be achieved by making In the DB case, the final annuity could be calibrated accordingly by raising pensions for very poor and reducing pensions for very rich participants (The ratio of the annuity to terminal accumulation could be made to decrease somewhat with the size of the terminal accumulation (relative to the average) multiple cohorts retired poor as a consequence of poor asset performance.

Formatted

Formatted

Formatted

Formatted

The fourth third A second source of inferiority arises from the consideration that managing the fully indexed portfolio of the government is a purely mechanical operation that, we know, can cost no more than a small fraction of 1%. By contrast, But However, active management of an individual portfolios, can be very costly, especially, for those with small portfolios. (Though profitable for the portfolio managers that will stand united against our proposal) In South America, the charges by the government authorized funds have, supposedly, run up to 20% of contributions and more. But By contrast, even a modest — modest charge of 1% — of % of principle charge principal represents 20% 1/5 of the likely return in the New Fund. Equally More important, their passive indexation and delivery of returns through a “swap” vehicle immunizes the SS fund from the critique that politicians will manipulate the funds.

opponents of investing in the equity markets have voiced.

Apart from the issue of the choice of the best funded scheme is the issue of the awesome costs of transition from PAYG to a funded system. These costs arise from the need to make up for the unfunded liabilities of PAYG, or equivalently, to pay for the gift made to the earlier generations that were granted a pension without a corresponding contribution. These huge costs must be borne by the current and/or future generations in the form of increased saving, in order to establish a fully funded system. It is this cost, plus the obvious dislike of elected governments to make decisions that put the burden on the current electors, and, perhaps, plus some misconceptions, that have contributed to delaying serious efforts to move to a funded system.

The main contribution of this paper is to outline and illustrate with a number of two simulations; an operational program for performing this transition very gradually (over many decades) so that the cost, if any, on any generation is small, if any. It is also

Finally it is argued that the United States, at this time in its history, is in a uniquely favorable position to carry out the transition, because of the large potential surplus expected to materialize over the next fifteen-15 years, a large portion of which has already been pledged to support the present creaky leaky weak PAYG system. We argue that by appropriately re-deploying this resource, it would be possible (without any additional mandated contribution in any form by current or future participants) to bring to completion a transition that would, by the middle of the next century, most likely reduce the contribution rate required to ensure a preservation of today's benefit by 50% relative to the current level, and by two-thirds relative to the contributions that would be needed with a continuation of PAYG, according to the projections of the Social Security Administration (SSA). It is shown that these results could be achieved with a Government contribution of some 4.5% of payrolls for 15 years, which is roughly of the magnitude already proposed by the President with some apparent bipartisan support. Furthermore, this use of the surplus is essentially equivalent to using it to retire the Federal debt, which appears to enjoy substantial support. We show that by appropriately re-deploying appropriately this resource, it would be possible to carry out the transition without any additional contribution in any form by the participants. Specifically, A government contribution of no more than 4 1/2 % of payrolls for the next fifteen years would be sufficient to carry out the transition, and We ensure project that by the middle of the next

century the contribution rate required to ensure a preservation of today's benefit will, most likely, be some 50% lower than today, instead of as much as 50% higher, as projected by the Social Security Administration (SSA) it would be with a continuation of PAYG, according to current projections. Further, And this use of the surplus is essentially equivalent to using it to retire the Federal debt, which appears to enjoy substantial support.

We therefore enter a plea that this lucky occurrence of a large surplus not be used to cut taxes or increase current spending. Further, we recommend that it not be used to temporarily fix temporarily an inefficient, unreliable, and poorly designed system, such as PAYG, but be used instead, in an imaginative way, to make the transition to the more efficient and reliable funded system. This would be in the best interest of the country, both for the present and especially for the future. of our children, and their descendants, and of the country as a whole.

THE MIT PLAN FOR SPREADING THE BURDEN - THROUGH A GRADUAL TRANSITION

1. Description of the basic transition mechanism

The centerpiece of our plan is the creation of a new fund -- the New Fund (NF), which like Social Security SS is financed by mandated contributions, and will offer defined benefits, but which will be fully funded. The reasons for maintaining the defined benefit are provided above and the defined benefit will be equivalent to a guaranteed return on contributions. In the transitional period, the NF will operate alongside the current Social Security which, which will remain responsible for paying the current benefits, and collecting the needed contributions. For convenience of exposition, we will initially assume that these contributions (together with any other needed measure) have been calibrated so as to ensure that SS will be able to meet its promises, during most, if not all, of the transition period (or most of it). Accordingly, the NF must initially be financed by a supplementary contribution. By whom and how this supplement will be paid is examined below. The size of the new contribution is largely optional and at

Formatted

Formatted

Formatted

Formatted

Formatted

Formatted

Formatted

Formatted

Formatted

Formatted

Formatted

Formatted

Formatted

the discretion of the policy makers, although a lower initial contribution will tend to result in a longer transition.

5

Each participant's contributions will be credited to an individual accounts, which will serve the multiple purposes described earlier. promised which would ing. reasons advantages. But of function reason h rather.

The NF will pay pensions from the very beginning, following the rules appropriate to a funded system — i.e. that is, it will pay pensions to those who reach the retirement age in so far as they have contributed to NF. — and its These pension amounts will be established by annuitizing the participant's credit balance on that date. Note the difference with the rules of a PAYG system, where pensions are paid from the beginning also to people who have never contributed, such as like those already retired, and to older people that made only partial contributions. In the NF, only those who have had the opportunity of making the full required years of contribution, will on retirement, be entitled to the full pension. However, But the NF pensions will not actually be paid to the pensioners, who will be already be receiving the pension to which they are entitled from SS the pension to which they are entitled. Instead, the flow of aggregate pensions to be paid maturing will be transferred in bulk to SS, and the SS who will use these flows from NF credit to reduce the contribution charged to all participants, by an appropriate reduction in the contribution rate.

Formatted

Formatted

— The flow of transfers from NF to SS will, initially, be tiny as only a few participants will have reached the retirement age and they will have very small balances, having contributed to the fund only for a short time. — But However, the flow it will grow rapidly, because the number of pensioners will grows (and will continue to increase for a number of years related to life expectancy) and because those retiring will have larger and larger balances than previous cohorts, as they would have contributed longer to the fund.

Formatted

— The key idea of the MIT plan is that, with an appropriate choice of the (permanent) contribution rate, the NF flow to SS will keep growing. (even in a

stationary economy.) until it reaches "maturity", at which time the flow will be equal to the flow of pensions that are to be paid by the old PAYG system. (Maturity is reached when everybody in the system will have contributed to the system throughout his working life.) At this point there will be no longer be any need for the old PAYG SS to collect contributions to pay the pensions, and it can be abolished. The only contribution that participants will have to pay is the (permanent) contribution to the New Fund, the only remaining public pension institution. In addition, And one can expect that that contribution will may be expected to be dramatically lower, than the old PAYG contribution, as we have indicated earlier. We confirm this conclusion And will confirm below.

Formatted

Formatted

In the next section, we will illustrate the mechanics of the transition and its effect through a number of two sets of simulations. The first is purely hypothetical and the next two second dealing explicitly with the "intermediate" scenario that the SSA projects the US will face in the next century.

2. An overview of contributions required under PAYG versus a US Funded system:

Formatted

Formatted: Bullets and Numbering

The contributions needed to ensure some stated benefits under different financing methods, as well as the path of transition, depend on a number of parameters. Some of these are "exogenous" — i.e., outside the direct control of policy makers — and others some primarily reflecting primarily the decision of the policy makers.

In the first group, the most important are:

- i) the rate of growth of (real) income (y), and its two components (items ii and iii);
- ii) the growth of the labor force (n); and
- iii) of productivity growth (q);
- iv) longevity; and
- v) to a large extent, the rates of return on various financial assets, and their volatility.

The policy-determined parameters include:

-i) the standard retirement age, which together with longevity determines the average duration of pensions;
ii) the portfolio- in which the accumulated capital of the fund is invested (important mostly for a funded scheme since under PAYG there is supposed to be no significant accumulation); and
And (iii) the so-called "rate of replacement", or the ratio of the pension received to some measure of income earned while working and contributing.—. The specification of the replacement rate involves detailing what measure of income should be used (e.g., terminal versus life-time average) and how it is related to the years of contribution².

The effect of the major parameters on the required contribution rate under different financing schemes is illustrated in Tables 1A and 1B, which also serves to support our contention that, under realistic assumptions, a funded system is far more efficient economically as well as less "at risk" than PAYG.

The calculations in the tables assume the following parameters: 40 years of contributions and a replacement rate of 50% of life average income— (if the replacement rate were different, all the contributions rates reported would change in proportion).— As for average length of life after retirement, we show the implications of two alternative assumptions.—. In the left side-portion of the tables we assume 16 years, which happens to be the level anticipated around the middle of next century in the Report of the OASDI trustees (the Report), under the so-called "low cost" assumptions.—. On the right hand side, life expectancy is assumed to be 18 years, corresponding to the "intermediate cost" assumptions.—. It is further assumed that the assets of the fund are invested in the "indexed portfolio" of all marketable securities.

² Since the rate of return and contributions determine the replacement rate for given demographics, policy makers need to ensure consistency in these choices.

It must be recognized from the outset that the figures in the tables are calculated omitting many of the refinements of true actuarial computations, - and must therefore be considered as approximate rather than precise ~~representations of the SS situation estimates.~~

~~But~~ However, we believe the approximation is quite adequate for the purpose of gauging the difference between ~~different~~ different choices and demonstrating the transition mechanism.

a). The Pay-as-you-go Scheme

On both sides ~~Under both life expectancy assumptions, the top portion of the table~~ Table IA shows an estimate of the ratio of ~~-current pensions to contemporaneous (taxable-) wages, or the so-called "cost ratio" of the OASI trustee Report (the Report), - for different parameters~~ ~~values~~ values. These figures ~~reflect~~ reflect what benefits have been promised and are therefore independent of the method in which they are financed. However, under a PAYG- financing scheme, since pension outlays must (on the average) be paid out of current

contributions, the cost ratio also measures ~~also~~ the ratio of required contributions to wages, or the equilibrium "contribution rate". ~~On the other hand, this does not hold by any means for a funded system as shown in Table I B below.~~ The main thing to note in ~~this part of the table~~ Table IA is the extreme sensitivity of the contribution rate to parameters n and q , and hence their sum, y . The contribution rate declines with population growth, n , through the well-known ~~-age-pyramid effect~~ $\rightarrow$ the higher n , the higher the ratio of active, contributing people to retired beneficiaries; and hence the smaller the required contribution rate.

The effect of

productivity growth is more complex, - but it works in the same direction and is quantitatively very similar. Assume ~~it seen~~ for instance, that there is a decline of growth, y , by 2% to 0%, through declines in n , or q - or a combination of the two. This requires ~~a near~~ doubling of the contributions, from roughly 11% to 20%. ~~And~~ Conversely, if SS had promised pensions on the assumption of a 2% growth, an actual decline to zero growth would imply that contributions would have, ~~roughly~~, to roughly double with a rise of nearly 10

Formatted

Formatted

Formatted

Formatted

percentage points—. Alternatively, ~~or that~~ benefits would have to be halved (or some combination of these two unsavory options).

A

As a more realistic illustration, consider the two entries ~~marked with a circle~~ highlighted in both the right ~~and the left~~ portion of Table 1A ~~the table~~—. These correspond roughly to the forecasts of e , n and q ~~for the second half of next century, offered in the Report~~ respectively under the “low cost” scenario ($e = 16$ years, $n =$ approximately 1% and $q = 1.4\%$) ~~and in the “intermediate cost”~~ ($e = 18$ years, n and q close to zero and 1% respectively)—. The difference in the required contribution ~~(or benefits affordable for given contribution)~~ is again enormous: 70% or 7 percentage points—.

In short, ~~the~~ PAYG financing is much too susceptible to small and very plausible ~~e~~ changes in prospective growth ~~prospective~~ to provide the basis for a reliable system that is not continuously threatened by major ~~crises~~, such as the ~~current~~ current one.

b) The Funded Scheme

Consider next ~~the lower portion of the~~ Table 1B, which ~~that~~ reports the contribution needed under a funded system. A comparison with Table 1A ~~the top part~~ reveals in striking fashion the much greater ~~efficiency~~ efficiency of the funded system in the sense of a much smaller required contribution for given benefits—. Take the limiting case of zero growth and a 6% real rate of return—. The PAYG contribution is 20% versus 3.3% for the funded system! Such a difference may seem impossible: ~~how can the funded system deliver pension amounting to 20% of current wages with a contribution amounting to less than 3.5% of wages??~~ The answer, of course, is to be found in the accumulation of ~~earning~~ assets under the funded scheme, and the return on these assets, supplementing the direct contribution—. By the time the funded system reaches maturity, the aggregate assets held by the NF amounts ~~to about 2.8 times wages, the return on which at 6% is 16.7%.~~

~~It may be~~ Some may objected that the combination selected is not realistic. ~~But the difference remains large even for more realistic cases.~~ Indeed, it will be seen that for

Formatted
Formatted
Formatted

any growth up to 2%, which is roughly in line with the forecasts for the USA, the PAYG contribution is over 11% and hence appreciably higher than that required by the funded system, even for a rate of return as unrealistically low as 3%. In particular, if we hypothesize a ~~not reasonably-unreasonably optimistic~~ modest real return of 5%, and combine it with the assumption of the "low cost" case, the funded system requires a contribution of ~~some~~ 4.9%.³ This is less than half that required under PAYG, which is around 11%; and the difference is even more dramatic for the "intermediate cost" case, 5.2% versus 17.2%.

Clearly, ~~a~~ lower return ~~assumption~~ would require a higher contribution under the funded scheme. But, under any reasonable assumption, at present or in the foreseeable future, the funded scheme contribution is much lower than the PAYG one. For example, even for a rate of return as low as 4% with a productivity growth of 1%, the required contribution - 7% - is well below half of that required in the PAYG - 17.2%.

But However, Tables 1A and B also brings out several other aspects in which a funded system dominates PAYG financing⁴. The first is that, in a funded system, the required contribution is in no way affected by the growth of population, or age composition — by i.e., whether there are 100 workers per retired person or merely one! The reason, as noted earlier, is that the support for the old need not, and with full funding, does not, come from the working population, but from the assets the retired people have accumulated through their working life and the return thereof. A second notable thing is that, with funding, a rise in q requires a *larger* contribution (the opposite of what happens under PAYG); but the effect is puny. Even for the highest rate of return, a change in q from zero to 2% requires

A change in contributions of less than 50 basis points. The third is that, surprisingly, even changes in life expectancy have only a small impact. A rise in e from 16 to 18 years, which is reasonably pretty conspicuous, requires an increase in contribution of only around 20 basis points. Thus, in practice, the required contribution depends only on the rate of return.

³ Currently, Treasury Inflation Proof securities (TIPs) are yielding a real return of approximately 3.7%-3.8% for tenors ranging from 10 to 30 years. Hence one would expect that a portfolio of publicly traded assets would provide a higher return.

Formatted

However, even for changes in the rate of return, the change in contribution for say a 1-% variation in the 4-5% range would be around 150 basis points- not altogether traumatic.

3-. The transition mechanism – —some illustrations:

In order to clarify the mechanism we have developed to carry out the transition of the pPublic pPension system from PAYG to funded, we present two~~three~~ simulations~~-. The first is designed to facilitate an understanding of the working of our ~~our~~ approach, by applying it to a hypothetical economy ~~which~~ that is "stationary"; i.e. both the labor force and its productivity are constant~~-. In the second simulation, ~~instead~~ our approach is instead applied to an economy in which labor force, productivity and ~~life expectancy~~ develop in the- next 75 years along the path -projected by the Social-Sec~~urity~~ in its so-called "intermediate cost" projection.~~~~

~~stationary economy and the "intermediate cost" case projected by the SSA. The intermediate case differs principally from the stationary case in that this simulation assumes some growth in productivity. For simplicity, in both cases we ignore the issue of survivor pensions. This aspect is modeled more efficiently in a complete actuarial model. Instead we assume that the life expectancy for the entire economy (i.e., accounting for both participants and dependents) is equal to the life expectancy indicated for the two simulations.~~

a) — An hypothetical stationary economy

Our first simulation, presented in Table 2H and Figures 1 and 2, is~~-. purely hypothetical and to facilitate the exposition conveniently assumes zero values for both n and q (population and productivity)~~-. The other parameters have the same values as in Tables 1A and 1B except that life expectancy is taken as 15⁴-. Under these assumptions the cost ratio, and hence the required contribution for PAYG, ~~turns out to~~ 18.75% $(15 \times 0.5 / 40)^6$ -. For the funded system, we assume a rate of return of 6% and the required contributions~~~~

⁴ See also "Transition to a Fully Funded Pension System: Five Economic Issues," by Martin Feldstein, NBER Working Paper 6149, August 1997.

⁵ This ~~includes~~ includes working life of 40 years and 50% replacement on life-average income.

Formatted

Formatted

Formatted

is found to be about 3.13%. This is the "equilibrium" contribution rate to NF that, if paid by all the active (and by the retired—when they were active), and supplemented by the return on its assets, would enable the fund to cover the cost ratio of 18.75%.

The table gives a year by year account of the ~~main~~-relevant variables— ~~that are~~ are expressed as a percentage of taxable payroll—. The first column shows the pensions ~~due/paid~~-payable or cost ratio—. Since the economy is stationary, all the entrees in this column are 18.75%—. The second column shows the contribution to the NF—. This variable plays a key role in our design—. At some point in time, this rate has to become and remain equal to the equilibrium rate. ~~;~~ However, ~~but~~ the initial contribution may well be different, and in ~~particular~~ particular may be chosen to be lower in order to keep down the burden on the older generations that will have to pay this supplemental contribution, while deriving no personal benefit from it.

~~As the transition takes many years, t~~ However, the older population will not benefit from the later decline in the contribution rate. In Table 2, we have assumed that the supplementary contribution to the NF is initially 2% and gradually rises to 3% — see column (2)—. The sum of columns (1) and (2) is the amount that must be contributed to the pension system in order to pay pensions and finance the NF—. In the beginning it is 20.75%, which is 2 percentage points higher than before the plan—. But the amount actually paid by the participants differs from this by the flow of pensions— from NF to SS which, we recall, is used to reduce the contribution—. This flow is shown in column (3) and Figure 1—. As expected, it starts out ~~being negligibly~~negligibly small, but rises rapidly, and keeps rising till the fund reaches maturity—. Column (4a) shows the amount to be paid net of the NF contribution—. The values in this column decline steadily as the NF flow rises—. By the year 232, the NF flow reaches 2% and the net flow of (4a) is back to the starting value of 18.75%—. The excess of column (4) over column (1), represents the incremental cost borne by the economy because of the transition— to a funded system—. This ~~incremental~~transition cost is shown in column (5), and ~~equals~~ equals the excess of what is contributed to the NF (column 2) over what that fund contributes (~~column~~column 3)—. It is seen that the cost starts at 2% and declines gradually— becoming negligible

¹ Fifteen retirees paid 50 cents on the dollar by forty active participants implies an 18.75% contribution from the active taxable payroll.

around the 20th year and disappearing by year 234. The path of these variables over time is charted in Figure 1. By year 28, pensions exceed contributions i.e., thereafter (2) - (3) becomes negative, i.e.,. In effect, the NF makes a positive contribution, that is becomes equal to the PAYG cost ratio minus the contribution to the fund in our case 18.75% - 3.13% or 15.62%. In contrast, the transition cost comes to an average of approximately but 1% per year for less than 25 years.

The next question to consider is how that cost might be allocated. This cost, it will be recalled, is that of increasing saving (at least temporarily) to augment the capital of the system to the level appropriate to a funded system, or equivalently, to fund the unfunded debt of PAYG. There are many ways of accomplishing this and to correspondingly spread the cost between different group. For instance, one could place the burden on the current workers by increasing their contribution rate, to the level indicated by column (4); or on the current retirees by lowering pensions temporarily. Both actions or either actions or any combination of the two would reduce consumption. Alternatively, the transition cost could be absorbed by the government government could absorb the transition cost, and the employees' contributions would remain constant until the transition cost ceases, and then decline thereafter as shown by column (6). The government contribution, in turn, could be financed by increased public saving through higher taxes or lower government consumption, or finally by borrowing and increasing government debt, with the burden falling on future generations. It must be understood however that the latter method would be counterproductive, for the increase in debt would offset the new saving of the NF, thus negating one of the important benefits of funding, namely that of increasing national saving and capital.

Once the transition burden disappears, the further increase in NF pensions can be used for two purposes: i) to reduce participants' contributions, or ii) to increase the contribution to NF till it reaches the equilibrium level of -3.13%. The order is not important. In Table 2, we have chosen to increase first the contribution to NF to the equilibrium level (rounded to 3%) because that shortens the transition period (which ends at 40+15 years after the last adjustment in the contribution rate). That adjustment is completed by the year 27, and thereafter the required participant contributions declines steadily. By the year 36, it is participants are paying 300

basis point less than below the PAYG level; while 20 years later, the required contribution is less than half—. By 2075 the contribution is down to 4% year 51, very close to the steady state rate or permanent rate of contribution of 3.1%.

participant contributions are 8.7% or 10% percentage point lower than under PAYG. By year 76, it falls below 4%. It never reaches the equilibrium value of 3.13%.

The great decline reduction in contribution is made possible by the large accumulation of assets, which is documented in because we have rounded off the contribution to 3%, instead of 3.13%². Further, the full equilibrium is only reached in the year 82 (27 + 55). Column (6)7). In the steady state, it reaches a level of 2½ 4/2-times wages. This capital, with the assumed 6% rate of return, provides the return reported in column (7). In the steady state, it comes to 15.6%, which together with the cash contribution of 3.1 % provides the 18.75 funding for the pensions amounting to 18.75.

shows the (real) value of assets accumulated in the NF, and column (8) the interest earned on them which together with the contribution of 3.13% matches the cost ratio.

The dynamics of the NF are demonstrated in Figure 2. It is seen that the permanent saving in contributions is enormous. Unfortunately, the time required for the full transition is long - even the half-life takes nearly 50 years. B, but this is the price one

pays for avoiding a heavy burden on early generations. The transition cost reported in column (5) is modest: comes to an average of some -1% of wages for a little over 20 years.

The next question to consider is how that cost might be allocated. This cost, it will be recalled, is that of increasing saving (at least temporarily) to augment the capital of the system to the level appropriate to a funded system, or equivalently, to fund the unfunded debt of PAYG. There are many ways of accomplishing this and spreading the cost between different groups. For instance, one could place the burden on the currently active participants by increasing their contribution rate of the active by the full extent of the transition cost. In this case, the contribution rate would follow the path shown in

² In the table, on the very last line, we show the effect over the very long-term of stabilizing the contribution at 3.13%.

column- (4-a). Alternatively, the transition cost could be placed on the retirees -by reducing

temporarily reducing -pensions -by the transition cost, either partially or totally. In the latter case,- the contribution rate would follow the path (4b). Either approach would reduce consumption and hence raise saving. Another possibility would be for the Government

to absorb the transaction cost, through a direct -contribution to NF. The participants would bear no cost and have no reason to save more. The government should therefore pay by increasing its saving or surplus, raising taxes or reducing expenditure. Another possibility might be to borrow increasing government debt and future interest,- with the burden falling on future generations. It must be understood, however, that the latter method would be counterproductive, for the increase in debt would offset the new saving of the NF, thus negating one of the important benefits of funding, namely that of increasing national saving and capital. In the long run, the decline in contribution would not come from the income produced by the additional capital, but rather from an increase in government interest payments, requiring presumably a similar increase in taxes.

-The key is that the final gain is enormous.

b)B The transition to a funded system under the "intermediate cost" assumption

Table -3 and Charts 2 and 3 report the

Formatted

Formatted

Formatted

Formatted

Formatted

~~3F3~~results of ~~seosee~~ simulations in which the hypothetical parameters of the first simulation are replaced by the values estimated in the Report for the *intermediate cost* case, by the middle of next century, to wit, a value of ~~equal to~~ q just below 1% per year, of ~~n~~ approximately equal to zero, ~~of and~~ a life expectancy of ~~with of~~ ~~equal of~~ 18 years. Similarly, the pensions owed, or cost ratio, reported in column (1) of Table 3, is that projected by the Report. ~~the right hand side of HA right portion, %.~~ This estimate ~~jibes~~ These estimates appear to be consistent ~~ibes~~, umm, T3IIIII. It is seen that this ratio, now, and for the next few years around 9.7.7%, is expected to rise ~~gr~~ gradually, to just over 17% as we move into a period of slower growth. ~~—~~ This figure is consistent with the cost ratio estimated for the PAYG system in Table 1A, for $n = 0$, $q = 1$ and $e = 18$, namely 17.2%. ~~But~~ ~~nder~~ under a PAYG, the contribution rate must match the cost ratio. Hence for ~~SSSS~~ to be able to provide the benefits it has promised, the ~~contribution~~ contribution rate would have to increase, between now and 2075, by an amount ~~measured by the Social Security Balance~~ of col. (4) of Table 2 and terminating 50% above the

Formatted

~~current 12.5% (higher than 9.7% because the system is currently running a surplus) increasing from some 30% in 2025 to 50% by 2075, or else the benefits would have to be curtailed drastically. This is the Social Security dilemma.~~

Formatted

The simulations presented below are designed to illustrate how our ~~“solution”~~ can insure the maintenance of all benefits without ever raising the contribution ~~rates above the current level~~, ~~but~~ instead lowering them before the middle of next century to bring them finally to a much lower steady-state level, as the system reaches steady state with full funding. But this miracle does not come for free. ~~it requires that the government commit itself to devote a sizable share of the~~ In the simulation below, we estimate a moderate transition cost beginning at 4% of payrolls but dwindling to zero in about 25 years, averaging about 2%. But this transition cost can be absorbed by the Government taking advantage of the very large surplus of the ~~(unified)~~ budget expected over the next 15 years in order ~~to make an appreciable contribution to the new fund-NF over that period~~. In our simulations, we assume that that contribution will be ~~of the order of 4.5% of payrolls per year~~. ~~This figure is of the same order of magnitude as that which has been promised by the President~~ the President has pledged in order to save SS - with apparent support from Congress.

Formatted

Formatted

The contribution rate that can be achieved ~~once the system is fully funded depends, of course, on~~ the rate of return ~~that the government is prepared to guarantee in the swap against the return of the market with the NF~~. In ~~the e-simulation~~, we have replaced the earlier 6% assumption with the more conservative one of ~~5%~~, a figure quite consistent with historical experience. From Table 1B we find that, for this rate of return, the required equilibrium contribution with the assumed parameters is 5.2% ~~(2nd column, penultimate row)~~ ~~the lower portion of 1B under NFs (or taxable payroll)~~. ~~that 1B . . . % 1/4 one quarter . . . % or less than one-a-third than the PAYG rate by the third quarter of next decade.~~

Formatted

~~—In~~

~~our second~~ the first simulation of the intermediate cost, reported in Table 3 and Figure 3, we have set the initial contribution rate at 4.5% ~~— column (2)—~~, the highest level that

could be entirely covered by the government contribution—. In this case, the total receipts of -SS - (column: (4) to (8) - exceeds the receipts of -funds required - (column (3) - by a surplus — column (9) — which is essentially equal to the NF pensions - (column (6). The surplus is used ~~a~~to increase the Trust Fund -inherited from the past (- column 10)- to prepare for negative surpluses at a later time. By ~~the~~ year 15, the Fund reaches ~~nearly~~ over 40% -of wages. But beginning with year 16, the Government contribution ceases-. The Surplus -~~then~~ becomes equal to the Social Security Balance — column: (5)— - plus [NF pensions - column -(6)-] — less- the c-ontribution to NF- - column (2)]-. Both terms are negative as SSB already turns negative ~~already~~ The dynamics in -2014-, and NF pensions are below 4.5% until 2027. Hence the system experiences a substantial deficit causing the -Trust Fund- to decline -very quickly (-see chart 2) —until it reaches zero in 2033- and then -turns negative. However, we do not regard this event as a deadly blow to our approach, because the continuing rise of NF pensions ensures that the deficit is gradually reduced and -turned into surplus -it into a surplus—in ~~but~~ only five years. By that time (2038), the SS debt reaches a maximum of only but

5.6-% of -wages, which, with growing surplus is readily wiped out and can be readily repaid,- with accrued interest,- in 4 years (by 2042).

~~this case are no different from the stationary case; however, the pensions due are increasing over time and the SS scheme currently has a Trust Fund estimated at 20.8% of current wages (column 10). The SSA projects that the SS contributions will increase over time⁸ and hence the transition that we propose will need to take account of these aspects. The Trust Fund will be assumed to earn a 5% return; -However, as a fraction of taxable payroll, the growth of the Trust Fund will be impacted by the growth in the taxable payroll and inflation (column 12).~~

At this point, the continuing growth of the NF pensions would produce a growing surplus that could be allocated to the Trust Fund. But we have no reason to accumulate reserves for which we expect to have no use. The potential surplus can therefore be allocated to increase the contribution rate to the equilibrium value of 5.2% or to reduce the contribution to SS. Again we elect to do the first in order to accelerate the completion of

⁸ Column (4) reports the SSA projected contributions until year 2040. While the projected path increases thereafter, we modify these contributions to reflect the dynamics of the transition.

the transition. The increase is achieved in ~~at~~ the single year (2042) ~~and~~ and is maintained forever. From that date on, the rising NF is devoted to reducing the SS contributions according to the formula: $SS \text{ contribution} = \text{Pensions} - \text{NF Pensions} + \text{NF Contribution}$. This quantity declines in time – column (4) – as the level of pensions has stabilized, the NF contribution is constant while the NF continues to grow to maturity. When the transition is completed ~~with the NF reaching maturity~~, the NF Pensions ~~are precisely equal to pensions~~ would match the Pensions, and the required contribution to the system ~~indeed~~ ~~to~~ coincides with the NF Contribution or 5.2%. This final outcome is not visible in the Table or the eChart because the system reaches the full steady state only 58 years after the contribution to NF reaches the equilibrium value. Since this occurred in 2042, the steady state is reached in 20100, whereas our simulation terminates with the projections of the Report in 2075. But it can be seen that by that date the required contribution is $6\frac{1}{2}\%$, about ~~1/3~~ one-third that of PAYG.

Before concluding, we would like to summarize the outcome of a second simulation, reported in Table 4 and Figure 3. ~~It is~~ ~~obtained by the choice of a somewhat different path of the contribution to NF, and~~ ~~is~~, in our view, distinctly more “elegant” in that it avoids the system ever going into debt and also requires a much shorter time to reach the steady state.

≡

To avoid the debt, we lower the initial contribution to 4%, ~~which increases the surplus (or reduces the deficit)~~ for many years, thereby raising the Trust Fund. Thus by 2022, the Fund amounts to 50% instead of 30% in the previous simulation. At this point, we introduce a different criterion for ~~the switchi- of~~ ng the NF contribution to the equilibrium level of 5.2%. Earlier, we switched upon repaying the debt. Here, we propose a different criterion suggested by the consideration that the earlier we switch, ~~the~~ earlier we get to enjoy the fruits of full funding. However, ~~But~~ an earlier switch will cause a larger deficit thereafter, risking a negative Trust Fund. We therefore located, by trial and error, the earliest date for switching, ~~such that the Trust Fund at their lowest point~~ its minimum ~~were close to zero~~ would be as low as possible but still be positive. That date turned out to be 2022, as can be seen from the table and the echart.

~~At the time of the switch, the Trust Fund was very large but the surplus was -very negative and remained negative for many yearyears causing -the Trust Fund to fall;- until it almost hit zero -in 2040. However, -but by that time the deficit had disappeared, so the Trust Fund -never became negative.² But from that point on, the rising potential surplus could~~
~~d~~
~~-be used -to reduce the contribution rapidly. Thus by -2050,- participants are required to pay 7.4%- 40% less than now and 1/2-half as much as under PAYG. In this version, the steady state is reached -in 2022 + 58, or 2080. But that² is close enough to 2075,- so that our terminal figures almost coincide with the steady state-. The NF pensions have reached the amount of -PePensions and the required the-contributions just about equal the nNew Fund contributions of 5.2%-ew-FN-~~
~~-7.~~

~~In Table 3, we have assumed that the supplementary contribution to the NF is initially 4.5% and rises to 5.2% -column (2). The 4.5% supplementary contribution was chosen to be consistent with what could be financed from future budget surpluses as well as being reasonably close to the equilibrium contribution level. Column (3) which is the sum of columns (1) and (2) is the amount that must be contributed to the pension system in order to pay pensions and finance the NF. Initially, SS contributions are greater than pensions (column 5) and NF pensions are low (column 6). Hence the additional contributions needed, called either the incremental or transition cost (column 7), are less than 4.5%. To be consistent with proposals under consideration, we assume that these payments will be made until year 2015 and ceased thereafter.~~

~~By the year 2015, the NF flow is only 1.33% and SS pensions exceed contributions. As a consequence, the Trust Fund, which has grown to 48.2% of payroll, must be drawn down to finance the gap (column 9). Therefore, in year 2038, the Trust Fund is nearly depleted.~~

but by this time the NF pensions and the SS contributions have risen to the point where the sum of the NF pension (8.94%) and the contribution (11.33%) exceeds the funds required.

Again, once the transition burden disappears, the further increase in NF pensions can be used for two purposes: to reduce participants' contributions, or to increase the contribution to NF till it reaches the equilibrium level of 5.2%. In Table 3, we increase the contribution to the equilibrium level in year 2039 to ensure that the steady state is achieved in 2095 (approximately 40+18 years⁹ after the last adjustment in the contribution rate). Once this change is made the required participant contribution rate declines steadily from year 2041 on. By 2050, the contribution rate is 6.92% or 442 basis point below the PAYG level a decade earlier. By year 2075, it falls to 6.22% and by 2095 it reaches the equilibrium level. The path of the different variables over time are path of the different variables over time is provided in Figure 3. In this fashion, the transition can be made from PAYG to NF under the intermediate cost scenario. The average cost of the transition is 3.75% of payroll over approximately 15 years. This amount could easily be financed out of the portion the projected budget surpluses over the next 15 years that are being kept aside to support PAYG SS.

e) The transition to a funded system under the "low or high cost" assumptions

Under both these scenarios, different assumptions are made about population growth, productivity growth and life expectancy, but the mechanics are likely to be the same. The significant difference, as indicated by the names given to these simulations, is that the transition cost or incremental cost will either be higher or lower than the intermediate cost scenario detailed above. In addition, where population growth is non zero actuarial simulations rather than our model simulations are likely to be more accurate.

4. Possible innovations

It had been indicated above that the proposal herein lends itself to two important innovations: (i) private provision of retirement plans in competition with the public

⁹ Any new funded system reaches steady state in x number of years, where x = number of years of contributions plus life expectancy at retirement. In this case, life expectancy was assumed to be 18 years.

scheme, and (ii) ~~and~~ the ability to borrow some portion of the funds. We briefly describe design features that permit such innovations. By creating an individual-account, defined-benefit scheme ~~which~~ ~~that~~ is fully funded, both innovations are feasible. However, both innovations are better implemented in later stages of the reform and will be addressed in greater detail under separate cover.

Firms in the private sector can be permitted to offer competing schemes subject to the provision that the schemes that they offer be no worse than the public pension scheme. For example, companies may choose to offer their employees such a service and any asset management or insurance firm could provide investment products to these organizations. Alternatively, investment companies could offer such services directly and participants can maintain ~~there~~ their accounts with authorized firms. Institutions in the United States are already permitting employees to opt out of ~~SSSS~~, but under our scheme, there will be a minimum replacement rate they will need to ~~offer~~ offer for equivalent contributions. However, these firms will need to be licensed and regulated to ensure that they provide the guaranteed return necessary to assure a higher replacement rate and that the participants funds are not at risk of being depleted (through either market or credit risk). This will clearly require close monitoring and further the establishment of an agency that insures individuals against the risk of retiring poor. The United Kingdom has permitted private firms to compete with the public system, but there have been issues with mis-selling of funds that have threatened the further development of such an option. However, under many other reform proposals, the private sector would have been permitted to offer investment products to participants; under our scheme, the benchmark for the provision of such services will be transparent.

The more contentious proposition is permitting individuals to borrow against accumulated funds in their individual accounts as it can be argued that this could be detrimental to the poor and less sophisticated. However, such an option is likely to be valuable to those who are borrowing constrained and is likely to lower the cost of borrowing significantly to all participants. For example, the cost of borrowing under such a scheme would be the opportunity cost of funds or the guaranteed return plus some servicing fee which is likely to be substantially lower than the approximately 15%-18% charged by credit card companies. Already, participants have availed themselves of this feature in their 401(k)

plans and the extension to other retirement pools is trivial. Should such a feature prove appealing, the risk of default on such loans could be mitigated through strict repayment rules, penalties and even the development of insurance for such borrowings.

One would expect that other financial market innovations ~~wimightt~~ be fostered under such a scheme. For example, financial intermediaries would gradually find it attractive to facilitate guaranteed return swaps and guaranteed return bonds that would be purchased by firms that are hoping to compete with the public system.

5. Conclusions

Formatted

In this paper we have endeavored to show how the current Social Security structure of defined benefits, whose future is seriously threatened, can be permanently preserved by gradually replacing the current pay-as-you financing with a new, *fully funded, defined-benefits* system (the New Fund). This conclusion is supported by many considerations among which the following are crucial:

First, under PAYG the contributions, which are in effect compulsory saving, are used to finance the pensions and hence consumption. In the new funded system these savings are invested in financial assets that grow large by the time of retirement and produce a return which makes it possible to reduce the required cash contribution below the PAYG contribution by a large factor, typically $\frac{1}{2}$ to $\frac{2}{3}$. Second, PAYG is financially unsound and forever at risk of insolvency because the contribution required for the promised benefits is highly sensitive to variations in population structure and productivity growth. For example, by the middle of next century, the forecasted decline in growth will require raising the contribution by 50% above current level. With a funded system that contribution is largely invariant to either variable. It is sensitive to the rate of return on financial assets, but moderately in the relevant range. The funded NF would be gradually accumulating a large pool of assets of the order of $2\frac{1}{2}$ times wages. We recommend investing them in a strictly indexed portfolio of all marketable securities, managed, by private institutions. Such a portfolio has desirable efficiency properties and leaves no discretion to those in charge of the NF. We further advocate allocating the assets to

individual accounts, to eliminate the temptation of Congress to divert the NF assets to other purposes.

Unfortunately there are costs in the transition from the PAYG to the funded system as saving need to be boosted, at least temporarily, to fund the unfunded pension liability. We lay out an operational program for the transition in which these costs are shown to be transitory and contained within moderate limits, - something like an additional payroll levy averaging some 2% for some 25 years - but this is achieved at the cost of making the transition very long - many decades. But we argue that these costs can and should be absorbed by the Government by redirecting to the NF the share of the large budget surplus anticipated over the next 15 years, which the President wants to pledge toward saving the PAYG system.

We suggest that our permanent solution is preferable to that of the administration, which is but a temporary one, and also to the set of proposals that goes under the misnomer of Privatization of Social Security. These proposals generally involve only partial funding, and hence a substantially higher long run contribution rate. But, what is worse, they imply mandated contributions to individually managed accounts. These are not only much more expensive to manage, but also imply giving up the social welfare promoting principle of *defined benefits* in favor of a *defined contributions* approach with its serious risks - especially for poorer, less sophisticated participants - and high cost to government if a minimum outcome is guaranteed.

Conclusions

The pension reform debate has focused attention on either total or partial privatization of SS with the government guaranteeing certain minimum outcomes. This paper provides a funded, defined benefit scheme (NF) as a replacement for the existing PAYG SS and the advantages from moving to a funded, defined benefit scheme are numerous. This approach has the advantage of being more financially sound and sustainable over the long run. To counteract the fear that large pooled funds can be misused by the government, we also recommend a simple low cost investment alternative that insulates the SS funds against political risk. In addition, the nature of the new scheme is such that innovations such as permitting private firms to provide retirement plans in competition to the public scheme and permitting borrowings under a strictly regulated framework are feasible. However, this paper goes further by outlining a mechanism for transitioning from the current PAYG scheme to the NF. It is shown that that there will some costs to the transition and that these costs can be covered quite easily by the portion of the projected budget surpluses

~~which has already been pledged to support the PAYG system. We show that by appropriately re-deploying this resource, it would be possible to carry out the transition without any additional contribution in any form by the participants. The future gains to replacing the current PAYG scheme with the NF are significant and likely to outweigh any costs in the long run.~~

Formatted

Table

1A

Pay-as-you-go Scheme Contributions - Cost								
Rate								
Retired Life - 16 Years					Retired Life - 18 Years			
	Real Productivity Growth				Real Productivity Growth			
	0%	1.00	1.40	2.00	0%	1.00	1.40	2.00%
	%	%	%	%	%	%	%	
Population Growth								
0%	20.00	15.40	13.4	11.00	22.50	17.2		
	%	%	0%	%	%	0%		
1%	15.06	11.70	10.4	9.00	16.77			
	%	%	0%	%	%			
2%	11.24	8.80	7.00	N/A	12.41			N/A
	%	%	%		%			

Table

1B

Funded Scheme - Contribution Rates for Different Scenarios								
Average Salary - 60%								
Replacement								
Working Life - 40 Years								
Retired Life - 16 Years					Retired Life - 18 Years			
	Real Productivity Growth				Real Productivity Growth			
	0%	1.00	1.40	2%	0%	1.00	1.40	2%
	%	%	%	%	%	%	%	%
Return on Assets								
0%	20.00	20.11	20.1	20.23	22.50	22.6	22.67	22.76%
	%	%	5%	%	%	2%	%	
1%	15.06	15.33	15.4	15.63	16.77	17.0	17.21	17.41%
	%	%	5%	%	%	8%	%	
2%	11.24	11.60	11.7	11.97	12.41	12.8	12.97	13.22%

	<u>%</u>	<u>%</u>	<u>5%</u>	<u>%</u>	<u>%</u>	<u>1%</u>	<u>%</u>	
<u>3%</u>	<u>8.33</u>	<u>8.70</u>	<u>8.86</u>	<u>9.10</u>	<u>9.12%</u>	<u>9.53</u>	<u>9.70</u>	<u>9.96%</u>
	<u>%</u>	<u>%</u>	<u>%</u>	<u>%</u>		<u>%</u>	<u>%</u>	
<u>4%</u>	<u>6.13</u>	<u>6.48</u>	<u>6.63</u>	<u>6.86</u>	<u>6.66%</u>	<u>7.04</u>	<u>7.21</u>	<u>7.46%</u>
	<u>%</u>	<u>%</u>	<u>%</u>	<u>%</u>		<u>%</u>	<u>%</u>	
<u>5%</u>	<u>4.40</u>	<u>4.80</u>	<u>4.93</u>	<u>5.14</u>	<u>4.84%</u>	<u>5.17</u>	<u>5.32</u>	<u>5.54%</u>
	<u>%</u>	<u>%</u>	<u>%</u>	<u>%</u>		<u>%</u>	<u>%</u>	
<u>6%</u>	<u>3.26</u>	<u>3.53</u>	<u>3.64</u>	<u>3.82</u>	<u>3.60%</u>	<u>3.78</u>	<u>3.90</u>	<u>4.09%</u>
	<u>%</u>	<u>%</u>	<u>%</u>	<u>%</u>		<u>%</u>	<u>%</u>	
<u>Approx</u>	<u>50%</u>	<u>41%</u>	<u>38%</u>	<u>34%</u>	<u>50%</u>	<u>41%</u>	<u>38%</u>	<u>34%</u>
<u>Replacement</u>								
<u>On final salary</u>								

[Automated Records Management System Hex-Dump Conversion]

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: David.Wilcox@do.treas.gov (David.Wilcox@do.treas.gov [UNKNOWN])

CREATION DATE/TIME:27-APR-1999 11:21:55.00

SUBJECT: individual non-withheld tax receipts -Reply

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

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

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

TO: David.Wilcox@do.treas.gov (David.Wilcox@do.treas.gov [UNKNOWN])
READ:UNKNOWN

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

TEXT:

Date: 04/27/1999 11:14 am (Tuesday)

From: David Wilcox

To: ex.mail("Douglas_W._Elmendorf@cea.eop.gov", "David.Wilcox",
"Janet_L._Yellen@cea.eop.gov", "Jeff_B._Liebman@opd.eop.gov")

CC: ex.mail("Douglas_W._Elmendorf@oa.eop.gov"),

Subject: individual non-withheld tax receipts -Reply

By our calculation, we're now roughly even with last year, trying to line up days of the week.

>>> ex.mail."Douglas_W._Elmendorf@cea.eop.gov" 04/27/99 11:07am
>>>

My sources suggest that these receipts have now picked up significantly.

(Yesterday's deposits were a new daily record, at \$27 billion.) The timing

of receipts this year is markedly later than usual, presumably because of slower work by the IRS. (This comparison involves years with the same day/date pattern; the "matching" year for 1999 is apparently 1993, when the

15th last fell on a Thursday.)

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Ryan D. Edwards (CN=Ryan D. Edwards/OU=CEA/O=EOP [CEA])

CREATION DATE/TIME:27-APR-1999 09:24:00.00

SUBJECT: Cleared up deal on Gov. Meyer & Japanese

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

READ:UNKNOWN

TEXT:

Hi Janet,

On the topic of one of my emails yesterday, Stan has cleared up the confusion. Apparently the Japanese had invited Gov. Meyer themselves; it wasn't something anybody else cooked up. Since they are NOT inviting spouses, I expect Gov. Meyer will decline. I've forwarded along to Dick Freeman what Stan told me.

-Ryan

**Clinton Presidential Records
Automated Records Management System
[EMAIL] and Tape Restoration Project [Email]**

This is not a presidential record. This is used as an administrative marker by the William J. Clinton Presidential Library Staff.

This marker identifies a responsive email, already made available within another collection.

Collection: 2014-0316-F

Bucket: CEA

Creation Date: 1999-04-27

Subject: final version of testimony

Creator: Joseph E. Aldy CN=Joseph E. Aldy/OU=CEA/O=EOP
[CEA]

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: nelson@tcf.org@INET@LNGTWY (nelson@tcf.org@INET@LNGTWY [UNKNOWN])

CREATION DATE/TIME: 4-MAY-1999 12:16:30.00

SUBJECT: revised agenda

TO: Janet L. Yellen@eop (Janet L. Yellen@eop [CEA])

READ:UNKNOWN

TEXT:

Attached is the revised agenda, incorporating George Perry's comments. I
apologize for sending so many emails. See you Monday.===== ATTACHMENT 1
=====

ATT CREATION TIME/DATE: 0 00:00:00.00

TEXT:

Unable to convert ARMS_EXT:[ATTACH.D13]ARMS24906183G.136 to ASCII,
The following is a HEX DUMP:

Steering Committee of The Century Foundation/Russell Sage Foundation
Sustainable Employment Project
41 East 70th St., New York City
May 10, 1999, 11:00 a.m. to 3:00 p.m.

Agenda

I. Discussion of the structure of the project--the role of the steering committee, timetable, communication among members, etc.

II. Discussion of possible topics and authors.

a. Macro suggestions to date

1. To what extent has the tight labor market caused wages to rise? (Krueger)
2. To what extent are forces external to the labor market--favorable price shocks, measurement changes, etc.--responsible for recent economic strength? (Krueger)
3. What role have "automatic stabilizers" played? (Krueger)
4. The role of stabilizing fiscal policy generally (Solow)
5. The Fed's role. (prospectus)
6. Refining the Taylor rule, targeting nominal GDP (Solow, Perry)
7. Changing relations between wage inflation and price inflation (Solow)
8. Do larger trade and capital flows lead to quicker transmission of inflation rates? (Solow)
9. Can the United States be an oasis of prosperity? (Blinder)
10. What is the potential impact of the European Monetary Union? (Krueger)

b. Micro suggestions

1. Disaggregating unemployment rates (by age, gender, race, skill level, etc.) (Solow, Blank, Blau)
2. Disaggregating labor force participation among different groups (Blank)
3. The impact of immigration (Blau)
4. The impact of the prison population on the labor force (Krueger)
5. Linking productivity changes to labor market changes within sectors (Blank)
6. Which government policies have helped, and which haven't? (Blank, Krueger)
7. The effects of the tight labor market on (Krueger)
 - a) crime
 - b) college attendance
 - c) teen pregnancy
8. The economic benefits of a low-employment economy (Perry)
9. The changed mix in long-term vs. short-term unemployment (Krueger)
10. Contingent and temporary workers as a safety valve (Krueger)
11. Changes in the job search process (Krueger)
12. Changes in job stability (tenure, quits, layoffs) (Blau)
13. The impact of declining numbers of workers with weak education (Nickell)
14. Have wages become more flexible within firms? (Nickell)

RECORD TYPE: PRESIDENTIAL (NOTES MAIL)

CREATOR: Ted.Truman@do.treas.gov@INET@LNGTWY (Ted.Truman@do.treas.gov@INET@LNGTWY [UNKNOWN])

CREATION DATE/TIME: 5-MAY-1999 13:36:25.00

SUBJECT: Remarks at Yale Reunion

TO: Janet L. Yellen@eop (Janet L. Yellen@eop [CEA])
READ:UNKNOWN

TEXT:

Date: 05/05/1999 12:59 pm (Wednesday)

From: Ted Truman

To: EX.MAIL."t.srinivasan@yale.edu"

CC: EX.MAIL."w.nordhaus@yale.edu", shafer, buiter, calvo, demacedo,
promisel, eichengr, EX.MAIL."yellen_j@a1.eop.gov"

Subject: Remarks at Yale Reunion

Dear T.N.

Attached is an expanded version of my remarks at the Yale Economics Reunion. You will note that I have labled them Not for Quotation Without Permission. That is because they were not thoroughly vetted within the US Treasury. I have no problem with their circulation, but with this caveat.

It was a fun gathering.

Ted===== ATTACHMENT 1 =====
ATT CREATION TIME/DATE: 0 00:00:00.00

TEXT:

Unable to convert ARMS_EXT:[ATTACH.D82]ARMS25243293V.136 to ASCII,
The following is a HEX DUMP:

“Are We in a Global Economic Crisis?”
Remarks at
The World Economy in the Twenty-First Century
Yale University Graduate School
Department of Economics Reunion
April 17, 1999

Following the Russian devaluation and default on August 17, 1998, and the associated near meltdown in international financial markets, President Clinton stated on September 14, “This is the biggest financial challenge facing the world in a half century.” Two weeks later (on October 1), Secretary Rubin reported on the cooperative effort to deal with that challenge, “In the short-term, the international financial community has worked aggressively to face the immediate tasks of limiting the damage from what is generally viewed as one of the most serious financial challenges of the last fifty years and helping the affected emerging markets return to stability and growth.” Allowing for a bit of Washington hyperbole, it is fair to say that the international financial system has faced a series of difficult challenges over the past two years, challenges that culminated last summer and fall with the Russian and Brazilian crises and at least risked a collapse in the global financial system and, more important, the global economy. It is also fair to say that viewed from the perspective of April 1999, the crisis passed, at least for the moment.

However, we have an uneasy sense that the international financial system is more crisis-prone today. One is tempted to speculate about the reasons. Is it because the world economy is more global and more integrated? Are the shocks different? Are markets behaving differently because of the influence of technology? Is the incidence of crises no different, but do market participants have shorter memories, not having benefitted from a solid grounding in economic history at Yale University? I do not know the answers to these questions, and I do not have the time or short-run mental capacity to suggest definitive conclusions, though I suspect that a reasonable answer is all of the above and probably more.

I do know that we have not been in a continuous crisis since the floating of the Thai baht on July 2, 1997; we have had a series of crises that have been more or less linked together -- a point to which I will return in a moment. Crises by definition have short time dimensions; we economists have borrowed the term from our medical colleagues and have tended to stretch it. The dictionary I consulted [*The American Heritage Dictionary of the English Language*, 1969] provides a reasonable definition, “an unstable condition in political, international, or economic

affairs in which an abrupt or decisive change is impending.” Kindleberger responded to criticism of the first edition of his *Manias, Panics, and Crashes: A History of Financial Crises* that his book lacked a definition of crisis by adopting the definition of one of his critics, Yale’s own Raymond Goldsmith, “a sharp, brief, ultracyclical deterioration of all or most of a group of financial indicators -- short-term interest rates, asset (stock, real estate, land) prices, commercial insolvencies and failures of financial institutions.” Kindleberger also noted that the Goldsmith definition “excludes foreign exchange difficulties as a necessary feature.” [page 3]

Nevertheless, unexpected changes in exchange rates are often considered to be an ingredient of financial crises, at least international financial crises, and arguably many, but not all, domestic financial crises today become international financial crises. My former colleague and fellow Yale PhD, Lewis Alexander, and his Federal Reserve associates have examined the question of the increased incidence of currency crises, defined as unexpected changes in monthly real exchange rates for 15 emerging market economies in Latin America and Asia in the 1980s and 1990s. They found no obvious upward trend in crises over the entire period. However, the period 1991 to 1996 was one of relative calm -- short memories again. In addition, they found that the recent experience is extreme in the sense that there has been an increased incidence of forecast errors for real exchange rates of more than two standard deviations.

One feature of our current condition is the macro-economic environment. Over the past fifty years, there have been three periods in which there has been a profound slowdown, but in no case a reduction, in global economic growth 1974-75, 1981-82, and 1998-99. Note that all three episodes have been in the last 25 years. Based on projections for 1999, the current period is marginally the second worst in terms of real GDP with annual average growth of 2.4 percent compared with 2.5 percent in 1974-75 and 1.0 percent in 1981-82. Excluding the United States, the differentiation is more pronounced: 2.1 percent growth projected for 1998-99, compared with 3.4 percent in 1974-75 and 1.3 percent in 1981-82. There are at least two important differences in the current period. First, the global inflation rate (consumer prices) is around 6 percent compared with 15 percent in the previous two episodes. Second, the volume of international trade is projected to continue to increase, albeit at a slower than normal rate of 3-3/4 percent, in contrast to small contractions that were experienced earlier. This different macroeconomic environment may have something to do with propagation mechanisms in the current episode, as well as with policy decisions, right or wrong, by national or international authorities. In particular, we have seen a profound, but not a record, downward adjustment in commodity prices.

This brings me to contagion, which might more appropriately be called propagation, because the phenomenon at one level is merely the manifestation of the integration of the international economy. Positive linkages are associated with positive, though dated terms, like “locomotives,” while negative linkages are associated with disease. What we know is that many linkages are real: When the Thai baht depreciated in the summer of 1997, it placed downward pressure on the currencies of Thailand’s neighbors because they jointly competed in each others’

and third-country markets. For a similar reason, the U.S. dollar came under downward pressure during the Mexican peso crisis of 1995. Moreover, the Russian episode last summer can be viewed, at least in part, as a consequence of the global decline in commodity prices associated with the global growth recession. It is a natural consequence of the emergence of problems in one country that international portfolio managers reassess the risks in their portfolios associated with assets in, or direct and indirect claims on, other countries. This is what financial supervisors want: risk management systems that are continuously stress tested in the laboratory and, preferably in a small way, in the real world.

What bothers us, I think, is the appearance of a herd mentality and phenomenon such as proxy hedges, for example, sales of Mexican pesos as a hedge against the depreciation of the Brazilian *real* because it is easier to short the peso than to short the *real*. The interesting question in this connection is whether the fault lies in Brazil, in Mexico, or in the functioning of the system as a whole. Again Lewis Alexander and his colleagues have done some interesting analysis and have found that the degree to which volatility in emerging markets spilled over to U.S. financial markets has varied during the 1990s. There was essentially no spillover following the Mexican devaluation in December 1994, perhaps, because the crisis was addressed rather quickly and the principal effects were felt on the U.S. economy and financial system which were and are relatively robust. Following Hong Kong's interest rate spike in October 1997, there apparently was modest spillover, though it enlivened the day, October 23, 1997, that two other Yale PhDs and I spent with Jim Tobin in Springfield, Illinois at a World Affairs Council conference. Finally, there were very substantial spillovers following the Russian default and devaluation in August of 1998. In that case, the shock to the system may have had more to do with the political dimension of political economy than the economic dimension.

It is useful to reflect for a moment on the recent sequence of crises. It is fair to consider them to be individual country crises with international linkages and some common features, but also with important individual characteristics. In the case of Thailand and Korea, the root cause of their crises, I think, lay in macroeconomic policy miscalculations. In both cases, the central banks ran out of foreign exchange, just as Mexico did in 1994. If one includes debt management, including asset management, as one of the dimensions of macroeconomic policy, which seems reasonable especially when a country has a fixed exchange rate regime, then these were crises brought about by failures in macroeconomic policy, even though there were other ingredients present, very weak financial systems in particular.

Indonesia is a more difficult case from a macroeconomic perspective because it maintained substantial international reserves throughout the summer and fall of 1997 and its exchange rate was relatively flexible. In retrospect, its exchange rate regime was not flexible enough *ex ante*, and, *ex post*, private sector Indonesian borrowers (and implicitly their creditors) found themselves with large unhedged foreign exchange exposures. However, in Indonesia most of the errors in macroeconomic policy came after the crisis hit as the authorities were unable or unwilling to implement a credible, consistent monetary policy.

The Philippines is an interesting case precisely because it has been relatively unscathed to date, but its currency did depreciate sharply.

Malaysia is also an interesting case because it has chosen to go the non-IMF route and last fall repegged its exchange rate (to the dollar!) and imposed controls on capital outflows. The jury is still out on the Malaysian experience, but it is important to remember three characteristics: First, Malaysia was relatively well positioned in terms of reserves and external debt when Thailand devalued. Second, Malaysia did allow the ringgit to depreciate sharply, indeed, one could make the case that it repegged its currency at an overly depreciated rate. Third, the controls on capital outflows were only imposed 14 months after the baht was floated, which hardly proves that they would have been effective if they had been imposed in July 1997. Moreover, since the imposition of those controls, which are intended to be temporary, the Malaysian authorities have moved relatively aggressively to restructure their domestic banking system. In other words, the controls have not been a device to slow down economic reform.

The scale of external adjustment in the Asian economies has been remarkable, and perhaps unprecedented. In Thailand and Korea, swings in current account balances scaled by GDP between 1996 and 1998 were 20 and 18 percent respectively: real GDP contracted about 8 and 6 percent. These adjustments are difficult for macroeconomists to explain because we do not find it easy to contemplate declines in gross investment ratios of 10 percent of GDP, combined with increases in gross savings ratios of 4 and 7 percent of GDP, as was the case in these two countries. Malaysia had a current account swing of 14 percent of GDP between 1996 and 1998, real GDP declined almost 7 percent in 1998, and there, too, the gross savings ratio rose. In Indonesia, the swing in the external balance was 7-1/2 percent, real GDP declined last year by 15 percent, and the gross savings ratio declined. The Philippines experienced the smallest external adjustment of the five countries between 1996 and 1998 and the smallest decline in real GDP, estimated at only 1/2 percent. I run through these data in part because I think they illustrate the point that economists have a lot to learn from and about the macroeconomic characteristics of these episodes.

I have already commented on the Russian situation. It had all the ingredients of a classic situation: a large fiscal deficit, mounting external debts, a fixed exchange rate regime, and declining international reserves. Nevertheless, the crisis might not have come in August of 1998, if the global macroeconomic environment had been less unfavorable. It is conceivable that the crisis could have been avoided entirely if the Russian authorities had more time to promote fundamental economic reform, but we will never know.

A more convincing case for potential crisis avoidance is Brazil: Absent the global economic slowdown of the dimension that has occurred and absent the Russian crisis, that country's obvious fiscal vulnerabilities might have been overcome with time and the Brazilian authorities might have been able to adjust their exchange rate regime more gradually. However, one should also note that the government had an opportunity to act decisively in 1997, and they started to do so, but did not follow through on their good intentions.

The lesson that I draw from the experience of the past two years is that macroeconomic policies (monetary, fiscal, exchange rate and debt management policies) do matter, which is not to say that they are the whole story, but they are a large part of it. Moreover, as Bill Brainard taught us more than thirty years ago, macroeconomic policy making involves decision making under uncertainty. In an uncertain world, vulnerabilities will come to the surface. Thus, policy makers have an obligation to stress test their policies, their financial systems, and their exchange rate regimes.

It is useful to consider the impact of the crises in the Asian economies and the global economic slowdown on countries that were not as severely affected. Consider Australia and Japan. Australia was more directly and adversely affected by collapsing Asian export markets and the decline in commodity prices. Both countries had flexible exchange rate regimes. Both currencies depreciated by about 5 percent in real effective terms [JP Morgan index] between June and December 1997. However, real GDP increased 4.7 percent in Australia over the four quarters of 1998 and declined 3 percent in Japan. What is the explanation for this difference? I am sure there are many, including the weakened condition of the Japanese economy and financial system as of the middle of 1997, but one principal difference is that in Australia there was scope to adjust monetary policy, and three-month interest rates declined by about 100 basis points between June and September, continuing a decline that began in late 1996, while in Japan there was little scope to adjust monetary policy further because three-month interest rates were already hovering around 30 basis points when the crisis broke.

It is also interesting, though perhaps a bit unfair, to compare Australia and Hong Kong, countries with two different exchange rate regimes. In Hong Kong, interest rates were not free to adjust because of their currency board system and the added pressure on the Hong Kong dollar's peg. In part as a consequence, real GDP is estimated to have declined 5 percent last year in Hong Kong and is generally projected to decline further in 1999. All this suggests additional grist for the PhD mills.

I would like to conclude with a few comments about international financial architecture. First, reform of the international financial system in the midst of an extended period of turmoil and a sequence of crises is a challenging endeavor. We are simultaneously trying to deal with the ongoing situation, to learn the lessons from that experience, and to lay the groundwork for a more resilient international financial system for the future.

Second, as I hope I have illustrated, macroeconomic policies matter. In particular, exchange rate policies and regimes matter. Informed opinion appears to be gravitating to the view that economies can only find sustainable regimes at the two extremes: floating rates or credible pegs with the latter preferably reinforced by currency boards, if not by the appropriation of another country's currency -- dollarization. What is true, I believe, is that a credible peg in today's integrated world economy and financial markets requires more discipline over policies, certainly macroeconomic policies and probably domestic financial policies as well, than used to

be the case. What is less clear to me is whether a country can effectively operate a regime in which it has a stable but adjustable exchange rate peg.

A third, related issue is the organization or lack of organization of international capital flows. It is fashionable in some parts of Asia and some parts of Washington, to blame the so-called Asian financial crisis on irrational capital flows and hedge funds. As someone who studied and taught at Yale in the 1960s and early 1970s, this explanation reminds me of the blame for the exchange rate crises during that period that was placed on the Euro-dollar market, footloose capital flows and the gnomes of Zurich. History repeats itself, it is true; markets do not allocate capital perfectly; and these are important matters. But the core issue, I believe, is not whether we should seek to manage capitals flows, it is whether we can assist markets to perform better with fewer crises, for example via increased transparency and disclosure, strengthened risk management systems in originating countries, and more robust financial systems in destination countries, in other words through prevention.

Fourth is the contentious issue of the role of the private sector, and associated concerns about moral hazard for creditors and debtors, when the inevitable crises occur. On this issue, as well as all other aspects of the international financial architecture, there are no silver bullets. If there were, we would have found and used them long ago. However, there is room for improvement as well as the need to strike the right balance, which very well may differ from case to case.

A few thoughts on this issue, by way of conclusion:

(1) There should be a strong presumption that borrowers will fulfill their obligations. Calvin Coolidge reportedly said, "You hired the money, you should be expected to pay for it." Nevertheless, at times, countries can not and should not meet their obligations on their original terms. The challenge is to try minimize the incidence of such problems and to promote their cooperative resolution when they occur.

(2) A priori, no one category of unsecured private creditors should receive priority over others, but pragmatism argues for ad hoc approaches based, at least in part, on considerations of maturity.

(3) The high yields on some of the sovereign obligations of some emerging markets economies suggest that the creditors expect some of those claims not to be paid in full or on time. The challenge is how to validate those expectations without undue disruption to the system as a whole.

(4) Once a crisis has occurred, in my view, the principal concern is not how to make the private sector bear part of the burden, though that is a relevant concern, it is how best to minimize the impact on other borrowers, again the issue of propagation to other countries and the system as a whole.