

5/25/79 [2]

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memo	From Heyman to Brzezinski (one page) re: U.S. vs. Hammarj /enclosed in Hutcheson to the President 5/25/79	5/14/79	A

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May 25, 1979

files

30 MAY 1979

To Ambassador Dick Kneip

Thank you for your letter which I received from Jack Watson. I deeply appreciate your kind words and also Nancy's invitation. Rosalynn joins me in sending our best wishes to you and your family.

Sincerely,

JIMMY

The Honorable Richard Kneip
American Ambassador
Singapore

cc and incoming to Tim Kraft (FYI)
cc: Jack Watson

JC:JMC:sef

Through NSC for dispatch via STATE pouch

THE WHITE HOUSE
WASHINGTON

5/25/79

joyce cook --

please draft presidential
to dick kneip, and return
for president's signature

thanks--susan clough

THE WHITE HOUSE
WASHINGTON

A personal letter to
the President from
Ambassador Kneip
(Singapore) -- he
used to be Governor
of South Dakota and
is a friend of ours
and enclosed this with
a letter to Jack.

Luv, P

f.y.i.

(dick kneip)



EMBASSY OF THE
UNITED STATES OF AMERICA
Singapore

Susan
"th"
LMS
J

May 3, 1979

The President
The White House
Washington, D.C. 20500

Dear Mr. President:

Nancy and I were talking just last night about how often people fail to say "thank you" for the opportunity of serving in one capacity or another. You gave us that opportunity, and we are truly thankful for the privilege of serving both you and our country.

I can't help but note that numerous people are taking their usual "pot shots" at you as President -- and that it is clearly evident that we are fast approaching election time. May I just mention, as one observer, that events are really no different than usual, and that your quiet approach to handling these situations is truly superb. I admire you for your patience, and wonder sometimes how anyone can possibly manage the tremendous responsibilities that are a part of your office.

Your accomplishments are many, Mr. President, and I hope your staff always remembers to be positive in addressing themselves to those events. Confidence in the issues and loyalty (complete loyalty) from that staff is tremendously important. The perfect example of true loyalty is Jack Watson, whom I chose to deliver this letter.

One last comment, Mr. President. I believe you should and will be re-elected. You are completely deserving of it, and I want to assist in any way possible. If that meant resigning my present position at an appropriate time, then I would be more than happy to accommodate you.

Please know that you are always in our thoughts and prayers. Our eight sons all say hello. And, Nancy

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-2-

told me to say that our guest room here in Singapore is always open should you want to get away for some free time.

Best wishes to Rosalynn and the family.

Respectfully,

A handwritten signature in cursive script, appearing to read "Dick", is written over a horizontal line.

Richard F. Kneip
Ambassador

Friday - May 25, 1979

7:30 Breakfast with Vice President Walter F. Mondale,
(60 min.) Deputy Secretary of State Warren Christopher,
Secretary Harold Brown, Dr. Zbigniew Brzezinski
and Mr. Hamilton Jordan - The Cabinet Room.

8:30 Dr. Zbigniew Brzezinski - The Oval Office.

9:30 Mr. Frank Moore - The Oval Office.

11:15 Mr. Charles Schultze - The Oval Office.
(20 min.)

11:35 Depart South Grounds via Motorcade en route
Sheraton Park Hotel.

11:45 Attendance at the Spring Meeting of the Democratic
National Committee.

12:20 Return to the White House.

1:15 Mr. Heath Larry, President, NAM, and Mr. Forrest
(10 min.) Rettgers, Executive Vice President. (Ms. Anne
Wexler) - The Oval Office.

1:45 Depart South Grounds via Helicopter en route
Camp David.

MEMORANDUM

THE WHITE HOUSE
WASHINGTON

25 May 1979

TO: THE PRESIDENT
FROM: RICK HUTCHESON *Rick*
SUBJECT: Memos Not Submitted

1. THE ATTORNEY GENERAL sent you copies of two of his speeches: before the National Conference of Christians and Jews; and before employees of the CIA.
2. FED CHAIRMAN MILLER sent you his speech on "The Evolution of our Monetary System."
3. BOB LIPSHUTZ & DAVID AARON MEMO letting you know that they have worked out satisfactory procedures with the Justice Department for disclosing classified documents in the criminal case of the US v. former FBI agents Felt, Miller and Gray.

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THE WHITE HOUSE

WASHINGTON

May 22, 1979

MEMORANDUM FOR DR. BRZEZINSKI

FROM: BOB LIPSHUTZ

RE: RHODESIA *BJ*

Following up our discussion at the staff meeting this morning, I am enclosing a copy of the "legislative history" which you already may have seen.

I particularly call your attention to the two items which I have emphasized. These appear on page 1877 and are subparagraphs (a) and (e).

Attachment

bcc: ✓ The President
Hamilton Jordan
Dick Moe

LEGISLATIVE HISTORY

P.L. 95-384

[page 29]

The House amendment did not contain a comparable provision.
The committee of conference adopted the Senate provision.

Ceiling on personnel

The Senate bill amended section 515(d) of the Foreign Assistance Act of 1961 to set a ceiling of 775 military personnel assigned overseas to perform security assistance management functions during fiscal year 1979.

The House amendment amended the same section to set the ceiling at 800.

The committee of conference adopted the Senate provision with amendment to set the ceiling at 790. The committee of conference supports the continued phaseout of military assistance advisory groups and expects the executive branch to thoroughly review the need for such groups in fiscal year 1980.

Assignment of additional defense attaches

The House amendment amended section 515(f) of the Foreign Assistance Act of 1961 to allow the President to assign an aggregate worldwide total of up to eight additional defense attachés to perform security assistance management functions in countries to which defense attachés were authorized to be assigned on December 31, 1977.

The Senate bill did not contain a comparable provision.

The committee of conference adopted the House provision.

Exemption for temporary assignments

The Senate bill amended section 515(g) of the Foreign Assistance Act of 1961 by adding "for fixed" before "periods of time." Section 515(g) provides exemptions from assignment prohibitions and numerical limitations for personnel performing services for specific purposes and periods of time on a fully reimbursable basis.

The House amendment did not contain a comparable provision.

The committee of conference adopted the Senate provision.

By adding the words "for fixed" the committee of conference intends to make clear that temporary reimbursable groups should not be in existence for extended or indefinite periods of time.

Promotional activity

The Senate bill amended section 515 by adding a new subsection that requires the President to continue to instruct U.S. missions abroad that their actions should not encourage, promote, or influence foreign country purchase of U.S. military equipment.

The House amendment did not contain a comparable provision.

The committee of conference adopted the Senate provision.

RHODESIA EMBARGO

The Senate bill prohibited the enforcement of sanctions against Rhodesia before fiscal year 1980 provided the President determines that (1) Rhodesia has committed itself to participate in, and negotiate at, an all-parties conference under international auspices; and (2) a government has been installed chosen by free elections in which all population groups have been allowed to participate freely, with international observation.

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SECURITY ASSISTANCE ACT

P.L. 95-384

[page 30]

The House amendment prohibited the enforcement of sanctions against Rhodesia after calendar year 1978 unless the President determined that a government had not been installed chosen by free elections in which all political groups had been allowed to participate freely.

The committee of conference adopted a compromise version which provides that the United States shall not enforce sanctions against Rhodesia after December 31, 1978, provided that the President determines (1) that the Government of Rhodesia has demonstrated its willingness to negotiate in good faith at an all-parties conference held under international auspices on a relevant issues; and (2) that a government has been installed chosen by free elections in which all political and population groups have been allowed to participate freely, with observation by impartial, internationally recognized observers.

In adopting the compromise version, it is the intent of the committee of conference that—

(a) the phrase "has demonstrated its willingness to negotiate in good faith at an all-parties conference" be interpreted to mean that the Rhodesian Government has committed itself to attend and participate in such a conference, if held, and that it is not necessary that the conference convene by December 31, 1978.

(b) the Presidential determination is obligatory and shall be made upon fulfillment of the conditions set forth in paragraphs (1) and (2).

(c) in making his determination on whether or not free elections were held, the President consider, among other factors, the extent of public participation in the elections. The committee further intends that any disruptions in the election process due to guerrilla activities shall not unduly prejudice an affirmative Presidential determination regarding participation in elections. By the same token, however, the possibility that many people may express their opposition to the internal settlement by voluntarily refraining from voting in the elections shall be taken into account in considering a negative Presidential determination.

(d) the phrase "all political and population groups" means that all the people of Rhodesia as well as all organized political groups have been given a fair opportunity to participate fully in the election without regard to their ethnic identity or political affiliation.

(e) "all relevant issues" to be considered at an all-parties conference include, among other things, the terms of majority rule, the protection of minority rights, the Anglo-American plan, and the terms of the Salisbury Agreement.

INTERNATIONAL MILITARY EDUCATION AND TRAINING (IMET)

Nicaragua and Paraguay

The Senate bill amended section 542 of the Foreign Assistance Act of 1961 to prohibit the use of fiscal year 1979 international military education and training funds for Nicaragua and Paraguay.

The House amendment did not contain a comparable provision.

The committee of conference adopted the House position.

For release on delivery
8:30 p.m. E.D.T.

THE EVOLUTION OF OUR MONETARY SYSTEM:
Adaptation in a Changing Environment

Remarks by

G. William Miller

Chairman

Board of Governors of the Federal Reserve System

before the

Annual Dinner

Graduate School of Business

Columbia University

New York, New York

May 7, 1979

For any American it would be a privilege to receive this W. Averell Harriman award. For me, it is a particular honor. As we have Americans and people from throughout the world, I have long admired Governor Harriman as a giant in his own time. His contributions have spanned the public and private sectors and stand as a unique model for the total concept of service. Many shall try, but few will be able to match his achievements.

Tonight, in recognizing the Harriman tradition, I would like to discuss with you an issue that is crucial to the continued success and growth of our economic system. It is an issue that has been brewing for some years, but is now becoming ripe for decision. How we resolve this issue will determine whether our financial system will continue to support the American economic aspirations or whether it will stagnate and give way to some undefined and ineffective substitute.

Our financial system has shown great resiliency over the past 200 years. It has adapted successfully to changing economic conditions. Our nation has already faced a series of watershed decisions in our financial history. We now face another: the challenge of up-dating our financial system to adjust to the technological, social and market changes that have occurred in the financial world over the last 30 years.

Simply put, the issues involve modernizing the nation's central bank and its relationships to all our financial intermediaries, establishing competitive equality among financial institutions, and assuring more effective tools for the conduct of monetary policy.

Like watershed decisions that were made in the past, the choice today is between reconciling ourselves to new realities and needs, or allowing the financial system to flounder in the status quo.

Let me recall briefly four episodes in the evolution of our monetary system when the choices that our nation faced were similar in magnitude to the choice we face today. In each of these cases, after major debates or minor ones, the resulting decision was for constructive change. In our democratic and diverse society, watershed decisions never come easily, and that is as true in 1979 as it was in past eras.

EARLY EXPERIMENTS

To recall those earlier milestones, we must start at the beginning of U.S. history. The issue of the proper form and substance for a monetary system was at the core of one of the very first major political controversies following the ratification of the Constitution in 1789.

Secretary of the Treasury Alexander Hamilton advocated, as necessary to the growth of American commerce, a strong central bank to manage the government's money and to regulate the country's credit. Secretary of State Thomas Jefferson was opposed, arguing that the Constitution did not specifically empower Congress to create a central bank. Hamilton responded that in order to carry out its constitutionally enumerated monetary and fiscal powers, Congress

could create a central bank as "necessary and proper" to the exercise of these responsibilities.

Hamilton prevailed, and the First Bank of the United States was created in 1791. It was a nationwide bank, headquartered in Philadelphia and run by 25 directors. The First Bank performed the basic banking functions of accepting deposits and issuing bank notes, and it supplied credit needed by business and government.

But the Bank's size and power made it unpopular with those who opposed a centralized control over money. A bill to recharter the Bank in 1811 failed by the margin of only a single vote. The theme in this battle was one that would recur in banking history up to the 20th century. Rural and urban values clashed, with the result that the institutions needed for a commercial society -- a common medium of exchange and a regulator of that medium -- were frequently greeted with hostility.

Indeed, a variation of that theme repeated itself when Andrew Jackson in 1836 successfully blocked renewal of the charter for the Second Bank of the United States, which had been established after the War of 1812.

From 1836, through the next quarter century, America's banking was carried on by a myriad of State-chartered banks with no Federal regulation. In some areas of the country this system functioned well, but in others banking was unstable, producing an overall picture of difficulty for the American economy.

NATIONAL BANKING ACT OF 1863

Consequently, it should come as no surprise that a second major watershed was crossed during the War between the States. At the time, there were several thousand different bank notes circulating in different sizes, shapes, and colors. The Federal government found itself unable to market securities to finance the war.

In 1863, Congress responded by passing the National Banking Act. Basically, the legislation provided for the creation of nationally chartered banks. And, by effectively taxing the State bank notes out of existence, the legislation in reality provided that only national banks could issue bank notes, these to be backed by U.S. government securities. To the surprise of many who had opposed and many who had supported the legislation, there was a particularly noteworthy result: state-chartered banks were able to survive and to prosper because the expanding use of checks was decreasing the importance of bank notes, and demand deposits -- checking accounts -- became a source of bank funds. Indeed, under this new "dual" system of banking the number of state-chartered banks increased. Perhaps there's a lesson for us today.

PERSISTENT PROBLEMS

The National Banking Act strengthened the banking system and created a national currency, but it did not provide the essentials of central banking. It did not provide a mechanism for regulating the flow of money and credit nor for assuring the security of the nation's financial system.

During ensuing years, America's finances were strained by two severe problems. First, the currency was inelastic. The national bank notes grew or contracted in response not to the needs of American enterprise but fluctuated according to the value of bonds held by national banks. With such inelasticity in the currency, the economy swung wildly between boom and bust.

The second problem was immobile reserves, resulting from the structure established under the National Banking Act. There was no easy way to expand reserves and reserves could not be shifted easily to areas of the country where they were needed.

These weaknesses in the national banking system became increasingly critical as the 20th century approached and America's industrial economy grew and became more urbanized, while the banking system stood still. The booms and busts increased in amplitude. In 1893, a massive depression rocked the economy; money panics ensued, and by 1908 it was only too clear that the banking system was out of date and in need of major reforms. For 120 years, America had been taking slow steps toward the creation of a central monetary authority, but at each prior opportunity it had ultimately backed away from the decision.

THE FEDERAL RESERVE ACT OF 1913

THE FEDERAL RESERVE ACT OF 1913

A third great milestone -- a watershed decision -- was creation of the Federal Reserve in 1913.

The period of debate over the Federal Reserve Act is historically enlightening. It illustrates a classic textbook case of the fruits of skillful negotiation and compromise. The basic questions were: how much monetary control, by whom, under what kind of structure? Resolution among competing concepts required legislative, administration and financial leaders of great stature, good will and determination. And such leadership prevailed.

One issue that was not compromised was the principle of an independent monetary authority. That principle was recognized by Nelson Aldrich, Chairman of the preparatory National Monetary Commission; Carter Glass, who steered the legislation as Chairman of the House Banking and Currency Committee; and President Woodrow Wilson. They were aware of the need for integrity in the conduct of the nation's finances, as well as the case for insulating the central bank from political abuse. They knew the lessons of history and responded wisely and well.

Essentially, the structure and the responsibilities of the monetary authority -- the nation's central bank -- as we know it today were established in 1913. America was at last on the right path toward a reasonably stable financial system, with many of the problems of earlier periods resolved by this monumental reform. America had at last begun to guide the inevitable evolution of its financial system.

Before moving to our next historic watershed, let me call attention to a few of the catchwords that are associated with the

Federal Reserve Act and those benefits that bankers and the nation came to appreciate: safety and soundness; liquidity or mobility of reserves; monetary control. These concepts should be kept in mind; these are the very principles that are in danger unless we adapt to today's financial world.

THE GREAT DEPRESSION

Another great watershed for the U.S. monetary system came during the Great Depression.

Congressional reaction to the cataclysmic events of 1929 and the early 1930's largely set in place the financial system that we have today. The first priority of the Roosevelt Administration was to ensure the integrity of the dollar. Therefore, the Banking Acts of 1933 and 1935 contained measures to halt the rash of bank failures and prevent their recurrence. Federal deposit insurance was established. The Federal bank regulators were granted authority to impose interest rate ceilings on time deposits. Payment of interest on demand deposits was prohibited in order to prevent the destructive interest rate competition that was widely believed to have led to bank failures. A central credit facility for home financing institutions was established with the Federal Home Loan Bank Act of 1932. A system of Federally chartered and supervised savings and loan associations was created in 1933, with Federal insurance provided the next year.

Finally, the effectiveness and independence of the Federal Reserve was improved. Many believed the decentralized policymaking

structure of the Federal Reserve System had hampered its ability to deal with the financial crisis and the Great Depression. Hence, legislation was enacted centralizing policymaking in an independent Board of Governors. Independence of the Federal Reserve from the executive branch was strengthened at the insistence of Senator Carter Glass, who successfully urged that both the Secretary of the Treasury and the Comptroller of the Currency be dropped as members of the Board.

These landmark reforms of the 1930's -- deposit insurance, interest rate regulation, specialized housing lenders, the Federal Open Market Committee, and an independent Federal Reserve Board -- are the dominant features of the financial landscape today.

THE POSTWAR YEARS

Recovery from the Depression was slow, and achieved fully only with the onset of World War II. During the war years, independence of the Federal Reserve was subordinated to the war effort. Federal Reserve independence from the Executive was reasserted in 1951, however, when the Treasury-Federal Reserve Accord freed the Board from an obligation to support the government securities market at unrealistic interest rates. In contrast to the Depression, the 1940's and 1950's were years of relative financial tranquility.

However, pressures began to build in the economy at the end of the 1950's and throughout the 1960's -- pressures which now

increasingly challenge the adequacy of the financial and regulatory system in a rapidly changing world.

Banks began to be faced with new competition from other types of financial institutions. Inflation accelerated and interest rates became increasingly variable and reached new postwar highs at the peak of each interest rate cycle. Disintermediation periodically troubled financial institutions as investors chose to place funds directly into money-market instruments instead of in deposits. Regulations which for years had not constrained banks now became excessively binding.

INNOVATION IN THE FINANCIAL SYSTEM

Increasingly private financial institutions reacted to inflation, high interest rates, and increased competition in a regulated environment through innovation. Banks began switching to concentrating on liability management in addition to asset management in the late 1960's. New sources of funds were tapped by means of negotiable CDs, first offered in 1961; Federal funds; repurchase agreements; and Eurodollar borrowings. Banks began offering corporate customers "cash management" services, paying interest on funds placed overnight in instruments that were exempt from Regulation Q interest rate ceilings.

COMPETITION AND MEMBERSHIP

As banks have sought to adjust to the inflation and high interest rates of the 1970's, they have been faced with increased

competition that has eroded their previously unique charter for providing transactions accounts. Innovations have allowed thrifts to offer customers third-party payments services and interest on transactions balances. These have included the NOW accounts available at depository institutions in New England and New York, "bill-payer" services and telephone transfers, credit union share drafts, and remote service units allowing withdrawals from savings accounts by electronic means.

Finding themselves in highly competitive markets with high interest rates, non-earning monetary reserve balances, and consequent pressures on earnings, many banks have reacted by withdrawing from membership in the Federal Reserve System. The resultant shrinking of deposits under central bank cognizance is of grave concern at a time when more effective monetary control is essential to combat the clear and present danger of virulent inflation. Consider the trend: in 1945, member banks held 86 per cent of banking deposits. By 1970 this had dropped to 80 per cent. Now, in eight short years, it has plummeted to just over 70 per cent.

THE PRESENT WATERSHED

These events and trends have brought our monetary system to another critical juncture. The reformed system constructed in the 1930's has served us well, but it has become increasingly outmoded by technology and market-place innovations. Not only must we respond to the changes of the 1960's and 1970's, but also we must take this

opportunity to perfect a monetary framework that can serve the needs of our growing nation in the 1980's and the 1990's and into the 21st century.

OBJECTIVES OF REFORM

In moving to modernize and strengthen our financial system, there are several objectives which are of paramount importance.

First, the tools for monetary management must be improved. Our present instruments are too blunt to cope adequately with the battle against inflation which threatens our economic well-being. The continuing and accelerating decline in basic deposits subject to central bank reserve requirements has made implementation of monetary policy more uncertain and hence more difficult. It is not that we need more reserves; indeed, less reserves, properly structured, would suffice. But we do need a more certain fulcrum for our monetary lever so that applied action will have a predictable result in the growth or diminution of money and credit.

Second, there needs to be competitive equality among financial institutions. Free and fair competition is at the heart of our private enterprise system. The present structure places member banks at a competitive disadvantage because of the burdens of non-earning reserves. And there are other inequities that need to be redressed.

Third, attention should be given to improvement in the mechanism for assuring a sound payments system and appropriate financial liquidity.

THE SEARCH FOR SOLUTIONS

The underlying issue is by no means new. The Congress, the Federal Reserve, and the financial community have been wrestling with it for some years. The House Banking Committee, under the Chairmanship of Representative Reuss, has held extensive hearings. A bill was reported out of the House Banking Committee in the last Congress, and the Committee has been considering various legislative proposals for most of this year. In the Senate, the Banking Committee reported out related legislation in the 95th Congress and hearings on more extensive proposals were held late in 1978 and early this year.

In the meantime, the banking and thrift communities have devoted extensive time and effort to the subject matter, and have made valuable contributions toward focusing the issues and developing alternative solutions.

ELEMENTS OF A MONETARY IMPROVEMENT PROGRAM

While as yet a consensus has not emerged in favor of any specific proposal, there has been tremendous progress in narrowing divergent views. It seems to me that there is growing and widespread accord among the affected constituencies in favor of a Monetary Improvement Program that would encompass the following essential points:

1. Maintaining the concept of voluntary membership in the Federal Reserve, thus assuring a vigorous dual banking system.

2. Reducing substantially the amount of non-earning reserves required to be deposited by member banks with the Federal Reserve. Remaining reserve requirements should be uniform as to type of deposit -- rather than the present graduated system -- and should relate mainly to transactions accounts and their equivalent. This will reduce the financial burden of membership while retaining appropriate reserve levels for monetary control.

3. At the same time, providing that all financial intermediaries shall maintain reserves with the Federal Reserve with respect to their transactions accounts -- on the same basis as member banks. Such universal reserves on deposits related to the basic money supply will provide the fulcrum for effective monetary control and will assure greater competitive equality among depository institutions.

4. Instituting a policy of explicit charges for most Federal Reserve services -- rather than the present system of providing such services without any specific charges. Prices should be based on full costs and an appropriate return on employed capital, with due regard to competitive factors. This will contribute to more efficient payment and other services,

more opportunities for the private sector to provide the services, yet assure that a safe clearance system is always available.

5. Opening up access to borrowing from the Federal Reserve discount window and access to Federal Reserve services to all financial institutions subject to reserve requirements -- non-members as well as members. This will provide assurance of the liquidity necessary to keep the financial system working smoothly in time of adjustment or stress.

This is not to overlook or to underestimate the difficulties in gaining agreement on some important details. The exact reserve ratios, the specific deposits to be covered, the form and location of some part of the reserves, are some of the items to be settled. But if there is agreement on the need for modernization, the responsible leadership should be able to deal with these matters.

OTHER PENDING ISSUES

There are other critical issues facing our financial system. The present period of economic expansion, accompanied by high inflation and consequent high interest rates, has demonstrated anew the dangers of financial disintermediation when deposit flows are hampered by unrealistic interest ceiling rates, and the threat to financial institutions' viability when market rates are paid for deposits while

interest rates on loans are limited by law. Moreover, consumers have properly challenged as unfair a system of limiting interest rates on savings accounts for small savers.

And, recently a Federal Court of Appeals barred certain deposit and financial services, effective next January 1, with an express suggestion that the issues be addressed by Congress.

Thus, coincident or simultaneous with considering the Monetary Improvement Program, the Congress may be dealing with two other areas:

First, what if any additional powers should be extended to thrift institutions -- savings and loan associations, mutual savings banks, and credit unions -- to offer third-party payment accounts?

As a personal observation, it would seem to me worthwhile to consider authorizing all depository institutions to offer NOW accounts -- special savings accounts subject to negotiable orders of withdrawal which are much like checks -- for individuals, provided there was a uniform interest rate ceiling and uniform reserve requirements.

Second, should the system of interest rate ceilings on savings accounts and certificates dating back to 1966, and renewed periodically since, be altered?

Again, as a personal note there would seem to be merit in considering the phasing out of such ceilings over time -- say, phasing out of such five to ten years -- coupled with modification or removal of usury rate ceilings on mortgage loans and possible authorization of

variable rate mortgages. At the same time, it would seem appropriate to provide thrift institutions with some expanded asset powers for consumer lending.

CONCLUSION

So, at this particular watershed for our monetary and financial systems, the agenda is extensive and challenging. Such challenges often bring out the best.

The leaders who shaped the milestones of the past served our country well. As a result, our system has been second to none in its capacity to meet the needs of a growing and more complex society. It has contributed to attaining the highest standard of living for the most number of people.

Now, we again turn to the leadership -- in Congress, in the private sector, in Government -- to meet the challenge of change and to forge a watershed decision with the same wisdom, vision and devotion to the national interest that has characterized such decisions in the past.

It seems to me that the democratic process is working -- that the constituencies are responding -- that the leadership is shaping an historic decision.

It is timely. Economic issues are at the forefront. Our very security depends upon our economic strength -- on our ability to overcome inflation and to achieve our goals of full employment, price stability and a sound and stable dollar.

I am confident that we will succeed. The American people deserve nothing less.



Office of the Attorney General
Washington, D. C. 20530

May 15, 1979

MEMORANDUM FOR:

THE PRESIDENT

FROM:

GRIFFIN B. BELL
ATTORNEY GENERAL

Because it touches on Brown v. Board of Education, your approach to Civil Rights and SALT II, I enclose a copy of a speech I will give tonight in Jacksonville, Florida, at the request of our friend Emmet Ferguson.

Griffin B. Bell

attachment



Department of Justice

ADDRESS

OF

THE HONORABLE GRIFFIN B. BELL

ATTORNEY GENERAL OF THE UNITED STATES

BEFORE THE

NATIONAL CONFERENCE OF CHRISTIANS AND JEWS

1979 BROTHERHOOD AWARDS BANQUET

JACKSONVILLE CHAPTER

TUESDAY, MAY 15, 1979

7:30 P.M.

GULF LIFE TOWER

JACKSONVILLE, FLORIDA

I am honored to be your speaker tonight. There is probably no other organization that has worked more consistently for the vindication of human rights in this country than the National Conference of Christians and Jews. The Judeo-Christian ethic is one of the bedrocks of our entire constitutional and legal system, and your work has been to extend that ethic to all segments of our society.

The President learned that I was coming here tonight and sends his own personal best wishes and commendation for your good work. He solicits your prayers for his own work as our President and particularly in the struggle to bring peace and economic stability to this country and to the world. History will judge the result of his efforts and of this Administration. We face great problems and few are capable of resolution in the short term. As citizens, we must have patience and take comfort in the fact that the President is addressing the great problems.

James Madison wrote in the 51st Federalist Paper: "Justice is the end of government. It is the end of civil society. It ever has been and ever will be pursued until it is obtained, or until liberty be lost in the pursuit." The President and I both share this belief that the ultimate purpose of our government is to render justice.

As Attorney General, it is my function to be the government's chief lawyer, and in that regard I am the person whose main function is to be at pains to ensure the delivery of justice.

One of the major concerns of the National Conference of Christians and Jews has been racial justice. The tragic history of the United States in race relations is too familiar for me to review here. Instead, let me recount how the law has enabled this nation to surmount the historic barriers of racism. In two days it will be the 25th anniversary of the landmark opinion in Brown v. Board of Education. No single case in this century has had more to do with the elimination of racial discrimination, and no case has dealt with a right more fundamental and more basic than the right to equal educational opportunity. As a result of this case and the hundreds of lesser-known cases that followed, the schools in the South have been desegregated. Education, the passport to the American dream, is available to all on an equal basis; at least in the South.

In retrospect, it seems strange that the black children in the Brown case were required to bring a suit to gain the right to attend the school nearest their home. That was the situation addressed in the school districts involved in the Brown case. Whites attended white schools.

Black children were required to pass white schools en route to black schools. The hope was to have just schools.

Under the leadership of Presidents Kennedy and Johnson, the first major civil rights laws since Reconstruction were adopted. These have enabled black Americans -- and others who have suffered from discrimination because of race, color, religion, or national origin -- to vote, to seek employment and housing, and to vindicate their other civil rights. Congress has repeatedly extended and expanded these laws to make certain that racial barriers will not stand in the way of equal opportunity for all Americans.

As a former federal judge, I cannot help but reflect that, in the main, the federal courts have historically taken a leading role in the protection of the rights of minority Americans. For example, the most basic statement of the law of equal protection under the Fourteenth Amendment was handed down by the Supreme Court in 1886 in Yick Wo v. Hopkins, involving racial discrimination against the employment of Chinese in San Francisco. And in Shelley v. Kraemer, the Supreme Court in 1948 held that restrictive covenants in regard to race were unconstitutional, thereby opening up housing opportunities previously unavailable to black and other minority Americans. These are but a few of countless examples of the American legal system rendering justice.

This Administration has been no less vigorous in pursuit of justice in its policies and practices. Within the Justice Department, we have an active Civil Rights Division, headed by Drew Days, who was formerly with the NAACP Legal Defense Fund. Mr. Days litigated many of the major school desegregation cases in the South and often appeared before me when I was a federal judge. He is the first black lawyer ever to head that Division. Although I offered him any job in the Department, he asked for that assignment and recently told me that he was glad he had taken it. Through his leadership and that of many other dedicated lawyers within our Department, we are safeguarding the rights of all Americans.

But it is not only within the Civil Rights Division that we are concerned with doing justice. Every lawyer and every employee within the Justice Department must be committed to that goal. There is an inscription on the rotunda of my own office which reads: "The United States wins its point whenever justice is done its citizens in the courts." We are less concerned with winning our cases than with the fair treatment of all Americans as we litigate and prosecute.

I have recently announced that, from now on, all Justice Department lawyers will be held personally responsible for the reasonableness and good faith of their

statements to the courts, both in briefs and in oral arguments. I have announced that we will initiate criminal prosecutions only if there is a probable winnable case, a standard somewhat higher than mere probable cause.

I have begun the examination of possible legislation to provide for the award of attorney's fees to those persons who prevail in litigation with the Federal Government if the government action was arbitrary, frivolous, unreasonable, or groundless.

I have had created within the Department an Office for Improvements in the Administration of Justice, whose sole task is to identify problems within our court and legal system and then to develop appropriate solutions to those problems. Our goal throughout all these efforts is to be sure our system of justice is available to all. And in that connection, the President, in appointing federal judges, is engaging in an affirmative action approach to make certain that the Federal courts are more representative of our society.

The Justice Department also has its role in the international arena in which President Carter has articulated his concern for human rights. We cooperate with the President through the use of the statutory authority of the Attorney General to parole those refugees whose human

rights are in jeopardy. This is in keeping with our historic tradition of offering a haven for the oppressed and the persecuted of the world.

And, again in cooperation with the State Department, the Justice Department is charged with monitoring and investigating charges of violations of the Helsinki Agreement on human rights. We use the resources of the Federal Bureau of Investigation and the Civil Rights Division to carry out this mission.

Another recent event was the exchange of two Soviet spies whom we had prosecuted and convicted, for five dissidents who had been imprisoned in the Soviet Union. It has been my belief that we can deter espionage in this country by vigorous and effective prosecutions. But to have had those two men serve their sentences in our prisons was not an end unto itself. The stakes in international diplomacy are far higher than that. The President and the Secretary of State were able through the exchange, to vindicate our policy of promoting international human rights by freeing five Soviet citizens who had been imprisoned for their outspoken criticism of their government.

But human rights can exist only where there are stable governments to protect those rights, and stability itself is dependent upon the assurance of international peace and security. It is in that sense that I want to mention the upcoming debate on SALT II, which is perhaps the most important pending issue in Washington. Following the summit meeting on June 15th for the signing of the Treaty, the Senate will again consider the ratification of SALT II.

I have been briefed on the proposed treaty by the President, the Secretary of State, and the Secretary of Defense. I am familiar with the process that was followed in reaching the agreement with the Soviets, and I am satisfied that the treaty is fair to our country and in our national interest. I am also satisfied that the compliance of the Soviets is verifiable, and that SALT II is an improvement for us over SALT I.

Once ratified or even before ratification, we will begin negotiating SALT III. These are steps that civilized nations should take, particularly nations that are world leaders. On a mutual basis, limits or ceilings should be placed on the types of strategic weapons included in the Treaty. Steps should also be taken to reduce the danger of their use in international conflict.

In closing let me say that our system is one of "ordered liberty." Our country was founded for a purpose - to enhance the individual and his or her rights. Our legal system is structured to guarantee and protect those individual rights. We have always treasured the freedom to act, to think, to speak, and to write. In that regard, I call your attention to the words of Jefferson inscribed on the Jefferson Memorial in Washington -- "I have sworn upon the altar of God eternal hostility against every form of tyranny over the mind of man."

But there are times when all citizens must recognize the need for personal sacrifice in the public interest. At such times, it is the duty of Americans to unite, to avoid pettiness, and fractious arguments. We have always done so out of a sense of sacrifice for the common good. It has been a form of national discipline.

We must now begin the transition into an era of energy conservation where personal sacrifices that were characteristic of our past will be needed. This is our energy predicament, and I have every confidence that the American people will do what is necessary.

In the end, the essence of our country is the indomitable will of our people. It is their spirit. As William Faulkner said in receiving the Nobel Prize for Literature, "The human spirit will not only endure; it will prevail."

In my experience, I have seen over 30 years of clear evidence that our laws are providing a more just and free society, vindicating individual rights but capable of responding to national challenges. I have faith in our country, and I hope we will all put a greater emphasis on the human spirit and civility. On the outer wall of the Kennedy Center in Washington facing the Potomac River, are these words:

"I look forward to an America which will not be afraid of grace and beauty I am certain after the dust of centuries has passed over our cities, we, ..., will be remembered not for victories or defeats in battle or in politics but for our contributions to the human spirit."

Thank you.

#



Office of the Attorney General
Washington, D. C. 20530

May 10, 1979

MEMORANDUM FOR: THE PRESIDENT
FROM: GRIFFIN B. BELL
ATTORNEY GENERAL

I attach the text of the speech I gave Tuesday to the employees of the CIA. As you asked me to do, I stated your strong support of the Agency and their function.

Griffin B. Bell

attachment



Department of Justice

ADDRESS

BY

THE HONORABLE GRIFFIN B. BELL
ATTORNEY GENERAL OF THE UNITED STATES

ON

FOREIGN INTELLIGENCE AND THE LEGAL SYSTEM

TUESDAY, MAY 8, 1979
CENTRAL INTELLIGENCE AGENCY
LANGLEY, VIRGINIA

Let me begin by saying that the CIA is a great institution. No agency in the government has a higher calling -- to enable the President to conduct foreign policy and to provide the information necessary to preserve our country and keep it strong. The complexity and pace of the world in which we live require people of the highest competence and dedication to interpret international intentions and events.

I am proud that Admiral Turner, your able director, invited me to be the first Attorney General to speak at the CIA in its distinguished history, originating with the daring achievements of the OSS in World War II. I must note that it was a lawyer, William J. Donovan, who drafted the first plan for a central intelligence agency at President Roosevelt's request in 1944.

The relationship between the Agency and the Attorney General is in many ways a symbol of the challenge of this era of American history. For the CIA, the challenge is

to collect intelligence with one eye cocked to spot legal issues that might have gone unquestioned in the past. For the Attorney General, the challenge is to handle those legal issues in a scrupulous fashion while trying not to impair the effectiveness of the agency.

Stan Turner and I are on the same path. We have been striving to make our agencies as independent as possible from political influence. If the Justice Department is to do its job, it cannot flinch from prosecuting the powerful or rendering detached, sometimes unpleasant legal advice and letting the chips fall where they may. If CIA is to do its job, it must be willing and able to tell policymakers some unpleasant truths with unflinching accuracy, providing dispassionate analysis of foreign events and intentions for those involved in the passions of domestic politics who may want to see the world differently.

Fortunately, we have a president with the vision to understand that it is in the long-term interest of his Administration and those that will follow to encourage independence in institutions like ours. Indeed, he instructed me to make the Department of Justice a non-political institution. This has been done. I often compare our role with that of the foreign intelligence community. Our justice system, like our foreign

intelligence system, must be guided by neutral principles in a nonpartisan spirit.

It is fitting to observe today that a statue of Captain Nathan Hale stands in front of the Justice Department as well as the CIA. Nathan Hale epitomized the ideal of service to which we should aspire as Americans. Following the American defeat at the Battle of Brooklyn Heights on August 27, 1776, General Washington became desperate for information about British plans and strength. Nathan Hale was the only officer to volunteer for the hazardous mission of gathering intelligence behind British lines. Stepping forward to volunteer for the mission which was to cost his life, Hale said: "I wish to be useful, and every kind of service necessary to the public good becomes honorable by being necessary." This ideal of service is a standard to which all of us in government should aspire.

Some of the most difficult and important problems I have encountered in government have been in the intelligence field. The DCI is not the only one whose life is complicated by wearing two hats. The Attorney General is both the legal adviser to the government and the administrator of a large department containing one of the government's premier intelligence agencies -- the Federal Bureau of Investigation. Often in making

decisions in a counterespionage case, I am pulled between the traditional law enforcement approach to Justice and the pure discipline of information monitoring and foreign intelligence analysis. As you know, I lean to the view that incarceration is a deterrent to spying. At the least, an attitude of prosecution might lead to a "spy detente."

The President has delegated certain duties to me in the counterintelligence area. I make daily decisions about authorizing the use of intelligence techniques that intrude into a sphere of privacy -- electronic surveillance of various forms, mail covers, and physical search. I have tried to exercise this authority with great restraint and care, especially when the rights of American citizens are at issue. I have also tried to stand up to the responsibility to use this authority vigorously whenever it has appeared that it would properly strengthen our nation's efforts to thwart or impede clandestine intelligence activity for a foreign power.

The Attorney General must also be a legal adviser and a litigator -- for the President and for other agencies in the government. When the CIA needs to bring a lawsuit or needs defense from a suit, that task falls to the Justice Department. The Snepp case is an example. It involved a dispute over fundamental principles. We have prevailed thus far. As a follow-up, I have recently directed a comprehensive review of the government's

security agreements. We need to design agreements that are narrowly tailored, easily understood and easily enforced.

Finally, the Attorney General provides general legal advice and assistance by participating in the drafting of legislation and regulations, and by interpreting many community-wide regulations of intelligence activity.

The guidelines and charter writing business is as delicate as open heart surgery. Our country cannot afford to allow regulators in any branch of government to become so entranced with the artistry of operating on an agency that they forget the goal -- to maintain a healthy and effective agency that has the confidence of the American people.

I have recently decided to create a new Office of Intelligence Policy and Review at the Justice Department to consolidate a number of intelligence-related functions. This office will provide the intelligence community with a resource for more timely and consistent legal advice and legislative assistance. The office will review compliance with Attorney General regulations and provide clear interpretation of those regulations. With this structure, we will be able to provide better legal assistance in the intelligence area without blurring the distinction between lawyers and intelligence operatives.

In a sense, this is the era of the "founding fathers" in the field of intelligence law. After all that we have been through in the recent past, there is a recognition on all sides that intelligence activity must be administered within the constitutional framework and that a legal system of accountability is needed.

We must strive to assure the people that their intelligence agencies will not be turned against them. Such fear is illustrated by the words of Sir Thomas Erskine May in 1873 in his Constitutional History of England:

"Men may be without restraints upon their liberty; they may pass to and fro at pleasure; but if their steps are tracked by spies and informers, their words noted down for crimination, their associates watched as conspirators, -- who shall say that they are free? Nothing is more revolting to Englishmen than the espionage which forms part of the administrative system of continental despotisms. It haunts men like an evil genius, chills their gaiety, restrains their wit, casts a shadow over their friendships, and blights their domestic hearth. The freedom of a country may be measured by its immunity from this baleful agency."

Our job as lawyers is to design a system of law in the intelligence field that reassures the American citizen and still works with you, not against you.

As Attorney General, I am here to discuss the intersection of our interests in certain legal areas. I would also like to wave the flag a bit. I think the American people are still distinguished by the heritage of the banners of the American Revolution. For example,

Lieutenant John Marshall, later to become Chief Justice of the United States, served as drillmaster for the Culpeper Minute Men, a celebrated Virginia battalion with the famous flag which bore a coiled rattlesnake with the motto: "Don't Tread on Me -- Liberty or Death." America must continue to carry that spirit into the international arena if we are to survive and prosper. This prevalent spirit assures me that the American people want a strong intelligence system and a strong CIA.

Our path for strengthening the CIA lies in making certain that all its activities are channeled in law. In that sense, the law is our support. Current law, however, presents problems in some areas. One example is the so-called "graymail" phenomenon.

"Graymail" has become shorthand for the ability of a defense lawyer to use current legal procedures to gain leverage by seeking a court ruling compelling government disclosure of national security information. The government is then forced into the position of sustaining the damage of the disclosure or conceding a critical point or dropping the case altogether.

In cases involving classified information, there is an inevitable tension between the responsibility of the Director of Central Intelligence to prevent the compromise of intelligence sources and methods and the responsibility

of the Attorney General for vigorous enforcement of the criminal laws. That tension is exacerbated by "graymail" problems. It is ironic and unfortunate that espionage prosecutions brought to maintain necessary secrecy often pose risks of disclosing our secrets under the current system.

As Attorney General, I have vigorously enforced the espionage laws. You know the cases. I believe that such serious transgressions against this nation cannot go unpunished. I am convinced that such prosecutions are necessary to maintain a credible deterrent to future acts that would jeopardize national security. At the same time, I am sensitive to the need to minimize the security costs associated with such prosecutions. I have directed Justice lawyers to conduct meticulously our cases to guard against disclosure of sensitive materials and to work closely with the intelligence community to evaluate the costs of disclosures which appear to be necessary to bringing a case.

Although the same procedural problems exist in non-espionage prosecutions, the most serious consequences for the CIA and Justice occur when criminal law enforcement efforts yield to security concerns. Inevitably, there are claims that a prosecution was dropped at the urging of the intelligence community to avoid embarrassing

revelations of misconduct. Even more importantly, there is the danger that those associated with intelligence activities are treated or perceived as above the law. A system that fosters such perceptions undermines the public's confidence in intelligence activities and in the fair administration of justice.

My experience as Attorney General has convinced me that we may be able to solve most of the problem through prudent changes in existing law. I am joined in this view by others in the Executive branch, including the Director of Central Intelligence. Senator Joseph Biden's Subcommittee of the Senate Select Committee on Intelligence and Congressman Morgan Murphy's Subcommittee of House Intelligence have held hearings examining the "graymail" question. They are working with us to develop legislative solutions to the "graymail" problem.

Draft legislation has now been formulated at Justice in close consultation with the intelligence community and these Congressional subcommittees. Our legislative proposal would enhance the government's ability to discharge its prosecutorial and intelligence responsibilities without undermining a defendant's right to fair trial. It would produce a more systematic and predictable manner of handling cases involving classified information.

First, the proposal would create a procedure for pretrial rulings on whether classified information must be disclosed either at pretrial or trial proceedings. This will enable the government to receive a preliminary decision on whether national security information must be produced to a defendant and whether it may be used by a defendant in the trial. It would also prevent the premature and unnecessary abandonment of prosecutions in the face of "graymail" threats by allowing the government to obtain court orders barring the disclosure of inadmissible classified information. Where classified information is determined by the court to be admissible in evidence at the behest of a defendant, there would be a chance to seek alternatives to disclosure of particular information while preserving the prosecution. In sum, this procedure would equip the government to make an informed assessment, prior to trial, of the national security costs of continuing a prosecution.

Second, our proposal would authorize the government to take interlocutory appeals from adverse district court orders requiring disclosure of classified information. There is no effective provision for such appeals in the current law.

In addition to these two key provisions, the proposal includes an array of other procedural safeguards.

- It establishes a procedural mechanism for setting early timetables to resolve issues in criminal cases involving classified information.
- It requires protective orders to safeguard classified materials that may be ordered disclosed to defendants although not revealed in open court.
- It provides guidance on alternatives to disclosure of specific classified information to the defendant and provides other proof procedures at trial to avoid unnecessary disclosure.
- It establishes security procedures for safekeeping of classified information submitted to the courts.

I believe that such legislation will go a long way toward solving the "graymail" problem. I urge the appropriate committees of Congress to give expedited consideration to our proposals.

Another major area where there is a need for good lawyering in the intelligence field is in the development of charter legislation. I have worked for over two years on constructing a legal framework for the intelligence agencies and for systems ensuring accountability, control, and oversight for intelligence activities. This has involved drafting Executive Orders, Attorney General guidelines and now charters.

This experience teaches two truths. First, if charters will prevent intelligence agencies from performing their mission effectively, they are not worth the price. Second, if well-balanced charter legislation can be enacted, it would be a truly valuable and historic achievement. As James Madison put it in the Federalist Papers: "In framing a government which is to be administered by men over men, the great difficulty lies in this: you must first enable the government to control the governed; and in the next place oblige it to control itself."

If the charter process fails, our intelligence activities will continue and our regulatory system will remain intact, but there will be a loss. Without charters, the climate of suspicion will continue -- breeding unfounded conspiracy theories and Congressional interference in operational management decisions. Second, this atmosphere will be compounded by continued uncertainty about the law, tending to chill and deter decisionmaking and action by field operatives as well as those at headquarters who must decide what information to disseminate or what operations to authorize.

Neither the officer tracking espionage abroad nor the Attorney General who is faced with wiretap requests should have to worry about a different Congress or a different

administration retrospectively judging good faith decisions. Clear laws and judicial warrants should provide intelligence officers with relief from the threat of lawsuits which now hangs over their heads. By statutorily involving the judiciary, as they are already involved in criminal cases, in authorizing intrusive investigative techniques against Americans, a charter can provide greater certainty in the law.

At the same time, a sound charter would provide a mandate for proper intelligence collection. I want to emphasize that none of the benefits from such legislation could ever compensate for the damage that could be done by unnecessary restrictions that would be against the national interest. It would be better to do without charters than suffer such restrictions. I believe, however, that reason and good sense will prevail. The passage of the Foreign Intelligence Surveillance Act demonstrated that a proper balance can be struck between national security and civil liberties. I expect that Congress will act responsibly in the charter process as well.

One of my great surprises when I became Attorney General was to discover how much of my time was consumed with intelligence work -- from case-by-case decisions to framing sweeping intelligence policy. I now realize how enriching and important this work has been for me.

It presents many basic questions for our constitutional system. In my tenure, I have seen the men and women of the CIA perform with excellence in situations requiring great judgment as well as ability. You have a hard job to do in hard times. It has never been more important that you do it right. The Department of Justice is pledged to assist you.

You are our first line of patriots in war and peace. Our nation depends on you, for there can be no adequate foreign policy without an ample intelligence system. You are ennobled by the fact that you must perform without the reward of public recognition, often in the face of high risk. The President has asked that I thank you today on behalf of the American people for what you have done and for what you are doing.

THE WHITE HOUSE

WASHINGTON

#2961

May 14, 1979

MEMORANDUM FOR THE PRESIDENT

FROM:

BOB LIPSHUTZ *BL*
ZBIGNIEW BRZEZINSKI *ZB*

RE:

Disclosure of classified documents in
criminal case of the United States versus
former FBI agents (Felt, Miller, and Gray)

Attached is a memorandum from the Attorney General relative to this matter.

This agreement resulted from our discussions and negotiations with the Justice Department relative to the handling of these documents.

It is a procedure similar to that which was utilized in the recent "spy case" of United States v. Humphrey.

We are satisfied that this will meet the needs of the Justice Department in pursuing this case, relative to these particular documents, and at the same time will protect the national security interest relative to them. Further, we are satisfied it will not establish an unsatisfactory precedent relative to this and similar documents.

UNCLASSIFIED - ~~SECRET~~ Document Attached

WITHDRAWAL SHEET (PRESIDENTIAL LIBRARIES)

FORM OF DOCUMENT	CORRESPONDENTS OR TITLE	DATE	RESTRICTION
memo	From Heyman to Brzezinski (one page) re: U.S. vs. Humphrey /enclosed in Hutcheson to the President 5/25/79	5/14/79	A

FILE LOCATION

Carter Presidential Papers- Staff Offices, Office of the Staff Sec.- Pres. Handwriting File
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A.

1132 AM

THE PRESIDENT'S ATTENDANCE AT THE
SPRING MEETING OF THE DEMOCRATIC NATIONAL COMMITTEE

Friday, May 24, 1979
Sheraton Park Hotel

11:32 am The President boards motorcade on South Grounds.

MOTORCADE DEPARTS South Grounds en route
Sheraton Park Hotel.

(Driving time: 9 minutes)

11:41 am MOTORCADE ARRIVES Sheraton Park Hotel.

PRESS POOL COVERAGE
CLOSED ARRIVAL

The President will be met by:

Mr. Paul O'Neil, General Manager

The President proceeds inside Sheraton Park
Hotel en route offstage announcement area.

11:44 am The President arrives Park Ballroom offstage
announcement area and pauses.

Announcement.

The President proceeds inside Park Ballroom en
route podium for remarks to the Spring Meeting of
the Democratic National Committee.

OPEN PRESS COVERAGE
ATTENDANCE: 250

11:45 am Presidential remarks.

FULL PRESS COVERAGE

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for Preservation Purposes**

12:00 noon Remarks conclude.

The President thanks his hosts and departs
stage en route motorcade for boarding.

12:05 pm MOTORCADE DEPARTS Sheraton Park Hotel
en route South Grounds.

(Driving time: 9 minutes)

12:14 pm MOTORCADE ARRIVES South Grounds.

11:42 a.m.

THE WHITE HOUSE

WASHINGTON

DEMOCRATIC NATIONAL COMMITTEE MEETING

25 May 1979

11:45 A.M.

from: Tim Kraft

TK

The main business at this DNC meeting is the adoption of the Final Call to the 1980 Convention. The Call, which is virtually identical to the 1976 Call, was easily adopted at yesterday's Executive Committee meeting. Little controversy is expected at today's meeting, although some amendments may be introduced from the floor.

The DNC is also expected to pass a resolution praising the President's Mideast peace efforts.

Peter Kelly will be confirmed as DNC Treasurer, replacing Evan Dobbelle.

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11:30
2

B. Aronson
May 25, 1979

DNC Jokes

Chairman White, Our Distinguished Co-Chairs, Mayor Coleman Young and Carmela LaCayo; fellow Democrats

--I hope I have not kept you waiting. My car pool was late.

* --As you know, Congress has gone home on recess. I have personally assured the members of Congress that they will have enough gasoline to get home. Now for the trip back (Pause, Smile)...that is another matter.

* --This has been quite a week...struggling with the oil companies to pass my windfall profits tax, struggling with the hospital lobby to pass my hospital cost containment bill, struggling with the Congress to put together a gas rationing plan. So I wanted to get a few minutes of calm and join a group where there is harmony, unity, a spirit of cooperation, soft voices, and fellowship. That is why I came to this meeting of the DNC.

* --I am especially proud of John White. John has all the attributes of a great Chairman: he cares about our country; he is a strong Democrat; he is compassionate, intelligent, and committed. Now if he just was not so soft-spoken. If he would only learn to speak out, he would be perfect. (Note: White just gave a rip-roaring speech in support of the Administration).

--As you know, John comes from Texas, the home of the Killer Bees. If a majority of the Congress ever hides out, I think I will take a different tact than the Governor of Texas. I think I will let them stay. (Note: The " Killer Bees " were 12 members of the Texas legislature who hid recently to prevent a quorum from being called. The Governor sent out Texas Rangers and helicopters to find them, but failed to do so.)

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Joke: DNC

I have spent the last several weeks battling with the oil companies to pass my windfall profits tax, struggling with the medical lobby to pass my hospital cost containment bill; struggling with the Congress to pass a gas rationing plan. I wanted to take a few minutes to meet with a group where there is a spirit of unity, harmony, cooperation, soft voices and no friction. That is why I came to this meeting of the DNC.

More jokes to follow.

THE WHITE HOUSE

WASHINGTON

May 24, 1979

MEMORANDUM FOR THE PRESIDENT

FROM: JERRY RAFSHOON 

Attached are:

1. A statement for Friday's DNC meeting along the lines we discussed this morning. It should be read in a tough, combative manner, with force and vigor. We have bracketed two paragraphs which are possible deletions for length. However, I do like the rhetoric.
2. Talking points and answers to the three major questions: Energy, Inflation, and SALT. The latter is a short narrative of our themes but you have this down pat from your briefings.
3. An "answer" that can be worked into any question.

I will send you ^{1 more} ~~two~~ jokes for openers in the morning.

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SALT II

Q. Is SALT real arms control?

A. Yes. SALT has put real, verifiable limits on the strategic nuclear arms race and it has provided the U.S. and the Soviet Union with an important set of rules which lend stability and predictability to the strategic competition.

In both of these ways. SALT has and will continue to contribute to a safer world, with less tension between the U.S. and U.S.S.R. and with a reduced risk of nuclear war. Without SALT, each confrontation, each conflict, each crisis will take on an added dimension of danger for it would occur in an atmosphere of unbridled strategic competition and deteriorating strategic stability.

SALT I

--Banned construction of additional fixed ICBM launchers and froze the aggregate number of fixed ICBM and SLBM launchers.

--Soviets dismantled or destroyed 209 older SS-7 and SS-9 ICBM launchers over last seven years which they would have otherwise most likely maintained.

--Even now, the Soviets are dismantling launchers on relatively modern ballistic missile submarines in order to stay within the limits.

--SALT I limited the number of heavy missiles the Soviets have deployed to about 3/4ths of what we believe they were capable of.

--The ABM treaty halted a major deployment of destabilizing and expensive anti-missile systems.

SALT II

--Equal limits on number of strategic nuclear weapons launchers for the first time, both in total numbers and in important sub-categories, including the most potentially de-stabilizing, MIRV'ed ICBM's. The Soviets will be required to dismantle 250 launchers to stay within the limit. Without SALT, we believe they would increase to some 3000 by 1985. just continuing present trends.

--Limits on the qualitative arms race and on modernization. Limits on the number of warheads per missile. Their SS-18 heavy missiles will be limited to 10 independently targeted warheads, rather than potentially 20 to 30. That means 6000 less warheads targetted at our country.

--A limit on new types of ICBMs. One for the Soviets Union rather than potentially four.

Verification

--Ban on interference with National Technical Means.

--Ban on concealment.

--Ban on telemetric encryption that impedes verification.

--Without SALT, the Soviets could camouflage their missile sites, they could cover their submarine construction facilities, they could interfere with our monitoring of their strategic testing and deployment, they could code telemetry that gives us vital information about the size, strength and range of missiles. The result would be far less certainty about Soviet capabilities and about our ability to maintain the strategic balance.

SALT III

--SALT provides us with the basis for further cuts and limitations which are vitally important at a time when technological advances threaten the stability of the strategic balance.

--At the same time, SALT II leaves open all of the options the United States may choose to pursue in order to maintain our deterrence in the face of Soviet advances and the potential vulnerability of our ICBM's.

--The SALT process means equality, stability and predictability in the strategic arms competition, and therefore reduces the risk of a nuclear confrontation.

3.

Q (You might respond to any question about the goals of your Administration and your commitment to the Democratic Party platform by challenging the DNC members to support the large number of initiatives which are before the Congress right now.)

We have a record of accomplishment these first 2½ years which we can be proud of:

- 8 million more Americans at work
- farm income up 40%
- civil service reform, airline deregulation, Inspector Generals, regulatory reform, war on waste and fraud etc.
- restored commitment to civil rights; EEOC reorganization; Eleanor Holmes Norton, Drew Days, Wade McCree; affirmative action support
- environmental record, strip mine bill, Alaska Lands
- Panama Canal; China; Middle East peace
- human rights
- kept the nation at peace

I need your strong support, your voice, and your efforts to help me continue the job

--to pass a tough, fair effective tax on windfall profits by the oil companies to fund mass transit, to aid the poor, and develop alternative energy supplies

--if you believe in a national health insurance program, give me your support for hospital cost containment to hold down most punishing inflation in health care and make that program possible

--help me pass my new civil rights legislation to put real teeth into federal efforts to end discrimination against minority groups in rental and sale of housing

--welfare reform legislation I sent to the Congress two days ago; to provide jobs for those able to work, decent income for those who can't ; reduce waste and abuse

--open up new markets to American products and produce, strengthen balance of trade, reduce inflation through MTN pact

--And I need your support for an issue which is beyond party politics; control nuclear arms race and preserve peace-SALT II

THE WHITE HOUSE
WASHINGTON

5/25/79

Q
/

Mr. President:

Your speech today before the
DNC was excellent; we got great
feedback from the DNC members.
The tough, fighting spirit you
expressed made everyone feel
like cheering, despite the
difficult problems you're
facing. Stay mad!

Respectfully,



Rick Hutcheson

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THE WHITE HOUSE

WASHINGTON

May 23, 1979

ADMINISTRATIVELY CONFIDENTIAL

MEMORANDUM FOR THE PRESIDENT

FROM: STU EIZENSTAT *Stu*
ANNE WEXLER *Anne*
JODY POWELL *Jody*

SUBJECT: Energy Meeting

We anticipate that the meeting with oil industry leaders will become known to the public. If this happens, we also anticipate that there will be criticism that we are "in collusion with" the oil industry and have not met with labor, consumers, environmentalists, and others who claim to have knowledge about the problems and their resolution. While the oil industry meeting must proceed, we believe we should decide now on how to deal with the possible accusations or requests for another meeting.

We have two options:

1. Wait and see if the meeting becomes public and there are accusations or demands for a subsequent meeting, which must be dealt with.
 - Pro: No subsequent meeting has to be planned.
 - Con: We get no credit for scheduling a subsequent meeting after a demand for a meeting.

more...

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2. Plan now for a subsequent meeting with non-oil industry types, perhaps centered around conservation so as to avoid debate about decontrol
- Pro: We get credit for consulting more widely and Jody could announce that we are having a series of meetings on energy.
 - Con: We would be scheduling an additional meeting with groups not really expert on the problem when one would not necessarily be required.

We recommend planning ahead by setting up the second meeting now. The invitations should be outstanding by the time that the first meeting is held.

Decisions:

_____ Wait until after the oil industry meeting is held to determine the reaction.

✓ _____ Proceed with second meeting. *1/2 hour for*

_____ See me.

me personally

THE WHITE HOUSE

WASHINGTON

25 May 79

Stu Eizenstat
Jody Powell
Anne Wexler

The attached was returned in
the President's outbox today
and is forwarded to you for
appropriate handling.

Rick Hutcheson

Jerry Rafshoon
Phil Wise
Fran Voorde

THE WHITE HOUSE
WASHINGTON

Mr. President:

Jody said he discussed this situation when the oil company leaders meeting was proposed.

Phil

	FOR STAFFING
	FOR INFORMATION
/	FROM PRESIDENT'S OUTBOX
	LOG IN/TO PRESIDENT TODAY
	IMMEDIATE TURNAROUND
	NO DEADLINE
	LAST DAY FOR ACTION -

ACTION
FYI

	ADMIN CONFID
	CONFIDENTIAL
	SECRET
	EYES ONLY

	VICE PRESIDENT
/	EIZENSTAT
	JORDAN
	KRAFT
	LIPSHUTZ
	MOORE
/	POWELL
	WATSON
/	WEXLER
	BRZEZINSKI
	MCINTYRE
	SCHULTZE

	ARAGON
	BOURNE
	BUTLER
	H. CARTER
	CLOUGH
	COSTANZA
	CRUIKSHANK
	FALLOWS
	FIRST LADY
	GAMMILL
	HARDEN
	HUTCHESON
	JAGODA
	LINDER
	MITCHELL
	MOE
	PETERSON
	PETTIGREW
	PRESS
/	RAFSHOON
	SCHNEIDERS
/	VOORDE
	WARREN
/	WISE

	ADAMS
	ANDRUS
	BELL
	BERGLAND
	BLUMENTHAL
	BROWN
	CALIFANO
	HARRIS
	KREPS
	MARSHALL
	SCHLESINGER
	STRAUSS
	VANCE

EYES ONLY

THE CHAIRMAN OF THE
COUNCIL OF ECONOMIC ADVISERS
WASHINGTON

May 24, 1979

MEMORANDUM FOR THE PRESIDENT

FROM: Charlie Schultze *CLS*
SUBJECT: Consumer Prices in April

Tomorrow (Friday, May 25) at 9:00 A.M., the Bureau of Labor Statistics will release the consumer price index for April. The total CPI rose 1.1 percent last month, compared with a 1.0 percent increase in March.

Energy

The step up in consumer price inflation in April largely reflected sharply rising energy prices. Gasoline prices increased 6 percent last month; prices of fuel oil and coal rose 4 percent (a little less than in March).

Food

We did not get the moderation of food prices last month that we had hoped for. While prices of fruits and vegetables declined again by 1 percent, about the same amount as in March, prices of beef and veal rose 4 percent further. Prices of sugar and sweets and fats and oils were both up more than 1 percent.

Other Items

Outside of food and energy, there is little to cheer about in the April consumer price statistics. The total for all commodities less food and energy rose 0.7 percent, the same as in March. Apparel prices did decline somewhat last month, but new car prices rose almost 1½ percent -- considerably faster than in March. This may reflect reduced discounts on fuel-efficient models, which are in short supply relative to demand. Mortgage financing costs continued to

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increase rapidly -- mortgage interest rates are still climbing around the country. Medical care prices rose by .6 percent for the third month in a row -- not great but better than it had been doing earlier.

The absence of moderation in the rise of food prices in April is disappointing. But it does not mean that hopes for a slower rise of food prices are lost. There is still reason to expect a more moderate increase of food prices later this year, but we will have to wait longer than we had hoped. For nonfood prices, there was no reason to expect a better performance in April, because there has been no sign of moderation as yet at the wholesale level. Markets for finished industrial commodities are still relatively tight, and prices have as yet shown no response to the slowing of economic growth.



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

3:15 PM

MEETING ON THE 1981 BUDGET
Thursday, May 24, 1979
3:15 P.M. (two hours)
The Cabinet Room

From: James T. McIntyre, Jr. 

I. PURPOSE

To discuss and develop guidance related to Phase I of the National Health Plan. Supporting materials are attached. OMB has devoted this budget session to continuing the discussion of May 17. Additional materials prepared by DPS will be transmitted separately.

II. PARTICIPANTS

The Vice President	Bert Carp
Stuart Eizenstat	Joe Onk
Charles Schultze	Bowman Cutter
Michael Blumenthal	Suzanne Woolsey
Ray Marshall	Nelson Ford
Joseph Califano	Sue Irving
Hale Champion	And Senior White House
Benjamin Heineman, Jr.	Staff
Daniel Brill	

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THE WHITE HOUSE
WASHINGTON

May 23, 1979

*State's preference?
NY report
AFDC determination
all → Fed?*

*All "medicare" eligible
Medicare improved?
What fees?
Expense of Phase II?
Spend down - 12:12?
Food stamps vs Health*

MEMORANDUM FOR THE PRESIDENT

FROM: JOE CALIFANO
STU EIZENSTAT *Stu*

SUBJECT: NATIONAL HEALTH PLAN

Last week, your advisors jointly submitted a memorandum outlining an NHP-Phase I proposal developed by HEW. That memorandum is attached, and you may want to review the first part, which describes the HEW plan.

This memorandum summarizes the major issues among your advisors on NHP-Phase I. While this memo summarizes all views, we are attaching a memo from Jim McIntyre, Charlie Schultze, Mike Blumenthal, and Fred Kahn which restates their fundamental concerns.

THE ISSUES

There are broad areas of agreement on NHP. All your advisors agree that

- Phase I should include a national eligibility standard and improved coverage for the poor, aged and disabled. *ok*
- All Americans should have protection against catastrophic medical expenses. *ok*

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- Any Phase I bill must also include important cost containment provisions (continuation of hospital cost containment, capital expenditure limits, and some form of physician reimbursement reform) as well as system reforms (including expansion of HMOs, promoting competition, more preventive services).

ok

There are four areas of disagreement: (A) total costs; (B) the role of the states and the future of Medicaid; (C) physician fee schedules; and (D) federal reinsurance.

A. Total Costs

18 + 5.2
2
\$ 21.2
net?

The HEW program entails federal budget costs of about \$18 billion in 1980 dollars, without offsets. 1/ It also imposes \$5.2 billion additional costs on employers and \$2 billion additional costs on employees for mandated premiums. (The employee premium costs are more than offset by a \$4 billion reduction in out-of-pocket expenditures.)

There are no programmatic disagreements with respect to the off-budget mandated coverage. There are, however, substantial disagreements with respect to the on-budget program. OMB would reduce the federal budget costs of the HEW program in the following areas:

1. Reduce spend-down from 2 for 1 to 1 for 1.
Savings: \$1.5 billion.

Thirty states now have a 1 for 1 Medicaid spend-down. OMB argues that a 1 for 1 spend-down is adequate to deal with the "notch" problem because medical expenses are

1/ The program no longer includes Medicare coverage for an additional 1 million aged -- a savings of \$1.6 billion.

unpredictable and thus will not serve as a work disincentive.

HEW counters that a 2 for 1 spend-down is superior because

- not very important* -- it provides greater protection for near poor families and enables us to help the working poor. It helps us politically because it is more liberal than the 1 for 1 spend-down in the Long-Ribicoff bill.
 - not important* -- the 2 for 1 spend-down will provide greater fiscal relief both to the states (substituting federal dollars for state medical dollars) and other counties and cities (by substituting federal dollars for charity care in these hospitals).
 - a problem* -- Under a 1 for 1 spend-down, recipients in the 30 states which now have such a spend-down will be worse off because these states provide more liberal deductions from income than the HEW plan. If HEW prevented "worse-offness" by permitting similar deductions, some of the savings of the OMB approach would be lost and the program would be more difficult to administer.
2. Change filing unit for Medicaid/HealthCare.
Savings: \$1-3 billion. 2/

OMB proposes to broaden the filing unit for those who would enter Medicaid/HealthCare from the nuclear family (children under 22 and parents) to include all relatives living together. They estimate that this would save several billion dollars by eliminating from eligibility for Medicaid/HealthCare several million people whose income when pooled with that of the relatives with whom they live is no longer below 55% of the poverty level. OMB points out that a similar broader filing unit is used in the food stamp program.

2/ OMB and HEW have not yet reached agreement on the amount of savings.

HEW believes that this broader filing unit is undesirable for health care purposes.

- a problem*
- Millions of very poor people covered by HEW would not be eligible to receive subsidized health care. These people are unlikely to receive significant assistance from relatives who have no legal responsibility for them.
 - It is in conflict with all current health insurance (public and private) and cash assistance practice. Attempts to move to such a broader filing unit in the administration's first welfare reform proposal met with stiff political opposition and were abandoned.
 - It creates a strong incentive for the breakup of low-income extended families who live together. To the extent the breakup occurs, the projected savings will be lost.
 - Since categorical eligibility would be retained for AFDC and SSI recipients regardless of the income of relatives with whom they live, the OMB filing unit would result in inconsistent treatment of people at equivalent income levels and add considerable complexity to the administration of the program.

Strategic Considerations

In deciding whether to reduce the HEW package, the following strategic considerations should be kept in mind. Unlike the issues of mandatory fee schedules, federalization of Medicaid or federal reinsurance (discussed below), the issue of costs does not raise either fundamental philosophical issues or the likelihood of massive interest group opposition. There is a fairly general consensus that the people covered by the HEW plan eventually require coverage and that all or most of the costs of that coverage must be borne by the federal government. Furthermore, it is highly probable that even if the Administration proposed an \$18 billion federal package, Congress would pass a far

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less expensive package. The real issue, therefore, is whether a \$18 billion package has more political disadvantages (because it appears inconsistent with the anti-inflation campaign and the effort to reduce the deficit, even though implementation would not be until 1983) than it has advantages (because of the amount of new benefits it provides, especially to the working poor, and its commitment to universality).

Options

Retain \$18 billion HEW package 3/ _____

Reduce HEW package

-- Use 1 for 1 rather than 2 for 1
spend-down. Savings: \$1.5 billion _____

-- Change filing unit. Savings:
\$1-3 billion _____

B. The Role of the States and the Future of Medicare

OMB contends that the HEW proposal moves this country's health system too much in the direction of full federal control. OMB believes that your NHP commitment can be met in phases while retaining a system in which responsibilities are shared to a greater degree among the federal, state and local governments and the private sector.

The HEW proposal merges Medicare and Medicaid into a new federal program for the poor and elderly -- HealthCare. OMB agrees with HEW's mandated improvements in Medicaid: free care for all Americans with incomes below 55% of the poverty level, a uniform benefit package similar to Medicare, and higher reimbursement rates. However, OMB does not believe that these benefits and eligibility improvements require federal administration (intake and claims processing) of Medicaid or a total change in the way Medicaid is financed.

The role of the states in providing for the health care of the poor can be divided into three areas:

3/ The \$18 billion figure includes \$300 million for a prevention program that is being developed. It is possible that such a prevention program may merit as much as \$1 billion. In addition, it may be necessary to increase the tax subsidy provided to small employers to offset the cost of mandated premiums.

1. Financing. At present, the federal government pays roughly 55% and the states 45% of Medicaid program costs. The federal share, which is determined by formula and is capped by law at 83%, now ranges from 50% to 77%. Under the proposed HEW plan, the states would continue to pay their current match for persons who enter HealthCare because they are categorically eligible, i.e., AFDC and SSI recipients. The federal government would pay 100% of cost for the new eligibles in the initial years. In subsequent years, HEW proposes that there be federal-state sharing for the incremental cost of the non-categorical newly eligible -- with the match varying by the state's success in holding down its health costs.

7
There is only one significant disagreement on financing. OMB believes that by paying 100% for all the newly eligible poor, HEW is rewarding those states that have kept benefits low and the eligible population small. Therefore, OMB would require that even in the first year states which now have small Medicaid programs would have to pay a modest amount of additional costs. HEW concedes that its plan does not require states with smaller Medicaid programs to pay a greater share of the costs of new eligibles (although it notes that the southern states spend more for Medicaid relative to state per capita income, than northern states). But HEW argues that it is politically impossible to get the poorer states, e.g., Louisiana, Mississippi, and Georgia, to pay significantly more for medical care to the poor and that it would be a mistake to attempt to jigger the existing matching rates.

2. Intake. At present, intake into Medicaid is handled by the states. HEW proposes that intake of all the newly covered persons would be handled by the federal government.

OMB argues that intake should continue to be carried out by the states. OMB points out that the states' welfare offices now provide intake for food stamps -- a 100% federally-financed program -- and that the intake procedures for food stamps and Medicaid/HealthCare would be largely duplicative.

HEW argues that

- A central goal of a universal, comprehensive health plan is to eliminate two class care in this country, that merger of Medicare and Medicaid and movement away from (although not complete elimination of) the tie between welfare and health care for the low-income population is essential, and that intake through food stamps defeats this vital goal.
- The food stamp program has the highest error rate of any assistance program.
- The eligibility requirements for the food stamp program and the health care program will be significantly different.
- Health care eligibility determinations should be handled by an office which also administers the other aspects of health care coverage.

3. Claims Processing. At present, states handle claims processing under Medicaid. HEW proposes to make claims processing and reimbursement functions federal -- but to contract out, on a competitive bid basis, to private industry. OMB argues that states should continue to process claims, and that there is no reason to assume that the federal government will do a better job. OMB emphasizes that the primary reason Medicaid's claims processing has been less efficient than Medicare's is because Medicaid is an income-tested program. OMB says that states could contract with HEW for claims processing if they wish, but should continue to have the option of finding the least expensive method of paying claims efficiently.

HEW responds that merging Medicare and Medicaid claims processing into one federal system, using the private sector, will increase efficiency, lead to more uniform, accurate data for utilization review and fraud and abuse detection programs, and make it easier to process claims of the 4 million Americans who are both Medicaid and Medicare recipients. HEW points out that it is very difficult to impose efficiency standards on state Medicaid programs or to obtain available data since any attempt to impose penalties on non-complying states is resisted in Congress. It notes that the EPSDT program has never been implemented in many states and that New York State, which accounts for 1/5 of all Medicaid expenditures, has not submitted an annual statistical report for its Medicaid program since 1972.

Strategic Considerations

The currents on Capitol Hill regarding HEW's proposal to create HealthCare are probably confused. While there is doubtless skepticism about an expanded federal role in a major social policy area, there is also widespread recognition that Medicaid is a very poor program, perhaps beyond redemption. HealthCare is also symbolic: from HEW's perspective, it is an important symbol of your commitment to a universal, comprehensive program that will ultimately eliminate two class care, while to OMB it represents an unwarranted extension of federal authority at the expense of the states.

It does not seem likely that the Administration would incur any significant political risks by proposing such a reform, since Senators Long and Ribicoff have introduced legislation federalizing Medicaid and Senator Kennedy also favors scrapping the present Medicaid system.

Options

1. Retain the present administrative structure of Medicaid _____
2. Retain the present administrative structure of Medicaid, and also require states which now have smaller Medicaid programs to pay something extra for new eligibles. _____
3. Adopt HEW's HealthCare proposal. _____
4. Adopt HEW's HealthCare proposal, but
 - leave intake responsibility with the states _____
 - and/or require states which now have smaller Medicaid programs to pay something extra for new eligibles. _____

C. Physician Fees

HEW originally recommended a national system of mandatory fee schedules for all physicians as a way of controlling costs and improving access for the poor and elderly. CEA and OMB argue that such an attempt to seek a "quick fix" will not work in the long run. They argue that unit price controls alone would not work since physicians respond to price controls by redefining and increasing services supplied. Mandatory fee schedules would lead inevitably to total federal regulation of an industry that is dramatically more complex than the airline and trucking industries. CEA and OMB, then, urge a completely different approach to limiting expenditures for physician services. They would highlight the elements of the bill that promote competition and do not recommend imposing fee schedules as a way of controlling costs.

HEW now recommends a modified system of across-the-board fee schedules. There would be mandatory assignment in the public programs, that is, physicians serving poor and elderly could not charge more than the schedule. In private programs, physicians would either be "participating" or "non-participating." (A participating physician accepts the reimbursement set by the fee schedule for all claims, while a non-participating physician does not.)

The problems with this approach are

- If there is mandatory assignment only in the public program, providers may refuse to treat the poor and the elderly.
- It is inconsistent with our position on hospital cost containment, where we have insisted that mandatory limits apply to both public and private programs.

A variant of this approach would apply fee schedules only to public programs. It would forgo mandatory assignment and rely solely on the "participating physician" concept. Such an approach would not be inconsistent with hospital cost containment, since it does not impose mandatory controls only in public programs. It would permit some system reform -- e.g., higher fees for primary care or rural physicians -- and would, if enough physicians were induced to "participate" in the public program, significantly help contain federal

budget costs. Inducements could include a guarantee of payment, no patient billing except 20% co-payments for the elderly, and simplified claims processing. In some communities there will be substantial consumer pressure for participation by doctors.

This approach complements the pro-competitive elements of the Phase I plan, which all your advisors support. These include:

- Making HMOs generally available to Medicare beneficiaries.
- Requiring employers to make equal contributions on behalf of their employees to competing insurers and to provide a cash rebate to employees who choose plans which cost less than employer contribution. This provision guarantees that employees have a financial stake in their choice of an insurance plan.
- Prohibiting physician control or domination of Blue Shield boards.

Strategic Considerations

Given strong provider and business opposition and the anti-regulatory bias of the Congress, mandatory fee schedules will face an uphill fight. The only reform that appears likely is the option of fee schedules for public plans with physician choice of participating. This could be our bottom-line position.

It is arguable, however, that a stronger position makes sense going in. The political benefit of HEW's current recommendation is that it will mute criticism from the left that new benefits without controls are inflationary. These political benefits could be limited, however, if the Finance and other committees rejected the mandatory program.

In addition, proposal of mandatory fee schedules might produce insurance and business opposition to hospital cost containment.

Options

Across-the-board fee schedules; mandatory assignment for public programs; participating physician for private programs

Fee schedules and participating physician for public programs only.

D. The Reinsurance Fund

HEW has proposed a reinsurance fund that will pool the risk of high expenses (any cost over \$25,000 per beneficiary). HEW argues that the Reinsurance Fund would help to equalize premium costs between high and low risk firms; would encourage self-insurance and improved cost containment efforts among businesses; would support development of HMOs and would help offset "windfall" profits insurance companies would make from the employer mandate. The fund will also set and enforce standards on private insurance plans seeking qualifications to meet the employer mandate. It provides much needed flexibility in assuming that the insurance companies comply with the standards set by NHP-Phase I.

CEA, DPS, and OMB oppose the Reinsurance Fund. They argue that

- There is no economic justification for the Fund. Large firms have adequate financial reserves to self-insure. There appears to be little evidence that small firms or HMOs have trouble buying reinsurance. If such a problem arises, it could be handled through a voluntary, rather than a mandatory, federal reinsurance program. HEW notes that pooling the premiums through the Reinsurance Fund is less costly than purchase of reinsurance through an optional program.
- There will be little equalization of premiums under the Fund because the expenses it covers are so high (\$25,000). HEW estimates a 5% equalization, although the equalization effect could be higher in high risk industries.
- The net increase in private insurance premiums, and in insurance industry profits, will not be very great, and do not constitute justification for an otherwise unjustifiable intrusion into the insurance industry.
- The Reinsurance Fund is not necessary to regulate private insurance. Standards can be enforced through favorable tax treatment or simply as a condition of complying with the employer mandate. DPS also notes that HEW can obtain separate authority to monitor high cost claims.

- The Reinsurance Fund will increase the cost of NHP-Phase I because the \$2.7 billion in outlays must be counted "on-budget" even though the revenues are derived from mandatory premium pooling. HEW argues that there are reasonable precedents -- like the Pension Benefit Guarantee Fund under ERISA -- for counting the Fund's outlays "off-budget."

Strategic Considerations

We may alienate the insurance industry by proposing the Reinsurance Fund. The insurance companies are not likely to oppose our plan strongly, in the absence of the Reinsurance Fund, and their relative neutrality will be an important factor working in our favor on the Hill.

HEW argues that we should propose the Fund as a going-in position. We will inevitably get involved in a bargaining situation with Senator Long -- and it is critical that we have something to give up. HEW believes that the Reinsurance Fund, which involves an industry that is close to Senator Long, is an excellent bargaining chip.

Options

Approve Reinsurance Fund _____

Disapprove _____

TABLE I

INCREASED EXPENDITURES UNDER PHASE I OPTIONS

	1980 Costs (\$ in Billions)						Difference
	Healthcare (HEW acctg.)		Healthcare (OMB acctg.)		OMB Approach (OMB estimates)		
	Federal	Private	Federal	Private	Federal	Private	
Aged and Disabled	1.4		1.4		1.4		
Poor	6.6-8.0		6.6-8.0		5.6-7.0		Program: In measuring income to determine who is poor, HEW counts the nuclear family as one unit, treats each child 22 or over (25 or over if student) as a separate income unit, treats subfamilies as a separate unit, and treats each other adult (or couple) as a separate unit. OMB counts all related persons in a household as part of the family income unit.
							<i>\$1bil difference</i>
Near Poor	5.1		5.1		3.0		Program: HEW approach provides 2 for 1 spenddown; OMB approach provides 1 for 1. Different definition of family also partly responsible.
Employed	1.6	5.2	4.3	5.2	.9	4.3	Prog./Est.: HEW accounting excludes the reinsurance fund from Federal costs, OMB accounting includes it. All accounting excludes mandated employee premiums of 1.8 (offset by lower out-of-pocket expenses) from private costs. OMB approach would not contain reinsurance fund, HEW approach includes it. OMB approach provides lower employee and employer subsidies. Lower estimates of costs of mandated workplace insurance built up from figures supplied by major private insurer.
"3N" (other persons)	.3		1.2		.3		Acctg.: OMB accounting includes premiums of 3N "buy-in." HEW accounting does not. OMB approach has provision for buy-in to State pools.
Prevention	.3		.3		--		Program: HEW approach includes separate prevention package, OMB approach does not.
Administration	1.5		2.7		1.2		Prog./Est.: Independent estimate of administrative costs of HEW approach is above HEW estimate. OMB approach administrative cost figure starts from this higher estimate and assumes ratio of administrative costs to benefits is the same in OMB approach.
Total	<u>17.5</u>	<u>5.2</u>	<u>22.3</u>	<u>5.2</u>	<u>13.1</u>	<u>4.3</u>	
	22.7		27.5		17.4		

Total 1983 Costs (\$ in Billions)

24.3	7.2	31.0	7.2	18.2	6.0
31.5		38.2		24.2	

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1980 Costs (\$ in Billions)							Difference
Healthcare (HEW acctg.)		Healthcare (OMB acctg.)		OMB Approach (OMB estimates)			
Federal	Private	Federal	Private	Federal	Private		

Offsets:

CHAP	-0.5	--	-0.5	--	-0.5	--	
Welfare Reform	-0.5	--	--	--	--	--	
Total Increase Net of Offsets	<u>16.5</u>	<u>5.2</u>	<u>21.8</u>	<u>5.2</u>	<u>12.6</u>	<u>4.3</u>	
	<u>21.7</u>		<u>27.0</u>		<u>16.9</u>		

Acctg:

OMB believes this largely double counts an offset already taken for welfare reform.

Receipts Generated
by NHP:

Reinsurance Fund Taxes	--	--	-2.7	--	--	--	
3N Premiums	--	--	-0.9	--	--	--	
Reduction in Tax Expenditures (Legislation)	<u>-1.0</u>	<u>--</u>	<u>-1.0</u>	<u>--</u>	<u>-1.0</u>	<u>--</u>	
Net Effect on Deficit	<u>15.5</u>	<u>--</u>	<u>17.2</u>	<u>--</u>	<u>11.6</u>	<u>--</u>	

Prog./Actg.:

OMB would not have reinsurance fund. OMB accounting treats HEW's fund outlays as part of costs.

Accounting:

OMB accounting treats all health care spending as costs.

3:15 PM

THE WHITE HOUSE

WASHINGTON

MEMORANDUM FOR THE PRESIDENT

FROM: STU EIZENSTAT *Stu*
DICK MOE

SUBJECT: NATIONAL HEALTH PLAN STRATEGY

The accompanying memoranda outline the differences between HEW and other agencies. Their length, unfortunately, obscures the broad range of agreement and the small number of issues in contention.

Secretary Califano and I have met with:

1. The Speaker, who said that while he favors the Kennedy proposal, he wants a NHI proposal that will pass and will support your proposal, if it contains substantial aid to the poor. He notes that it is critical that our proposal contain enough in terms of benefits for the poor to attract moderate and liberal support in the House.

2. Senator Long, who expressed a personal willingness to support a substantial increment of aid to the poor, in addition to his catastrophic coverage, probably in the range of the HEW proposal. He indicated that he could support federalization of Medicaid but had no strong feelings either way. He said that while he did not want to be "outfront" on the subject of additional cost controls, he saw merit to negotiated fee schedules. He was concerned about protecting small businesses against the additional burden of health coverage and suggested additional steps beyond our own.

However, Senator Long's key objective is clearly to achieve a consensus within his committee which will allow quick reporting of a bill to the Senate Floor. The danger is that this consensus will contain insufficient additional help for lower income people. If this is the case, there will be a major confrontation with Senator Kennedy which could imperil prospects for passage of any bill in the Senate. Alternatively, if the Finance Committee reports a very narrow bill and this bill does pass the Senate, it may be impossible to secure House action. The Speaker made it clear that liberals in the House would block a bill coming from the Senate which was insufficiently liberal.

In addition, Hale Champion has met with:

1. Chairman Ullman, who reportedly prefers strong cost controls, but lower spending totals; and

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2. Representative Rangel, the Ways and Means Subcommittee Chairman, who is reportedly willing to support the HEW measure. If Representative Rangel can be secured as the House sponsor of our proposal, it will help immeasurably with minorities and the liberal community, and we want to talk with him personally before making any final recommendations to you.

Key Issues:

From the point of view of national politics and securing enactment of the bill, there are clearly three overriding issues:

1. Total Costs: Since all parties are agreed that catastrophic insurance must be a part of any bill, this issue boils down to how much aid there will be for lower income people and the elderly. Our guess is that when estimating differences are ironed out the range of difference between HEW and OMB is not terribly significant, but a higher going-in figure is probably preferable from a legislative and political point of view.

2. Federalization of Medicaid. "HealthCare," which involves federalization of Medicaid, would in some measure improve program administration (although OMB and CEA disagree with this). However, given the prompt timelines needed for Congressional action and the complexity of legislation on this question, the question is whether a federalization of Medicaid is likely to be enacted in this session of Congress, and whether including it in the original proposal is too heavy a drag on the legislative process. It is not likely this will pass but there are advantages to proposing a major reform in the disastrous Medicaid program as an initial proposition. The current program is already so poor and so diverse -- with 50 different state plans -- that is is an inadequate structure on which to build a comprehensive program.

3. Price Controls on Doctors. HEW's limitations on physician fees undoubtedly would be popular with liberal members of Congress. Moreover, there are substantial needs for fee schedules given the increase in demand being put into the health system, with the consequent likelihood of greatly increased physician fees. However, virtually all observers agree that it cannot pass. If we propose it, Senator Kennedy and others will build it up as a fundamental and essential feature of any acceptable plan. Its loss may be considered a defeat both to you and to other supporters of our legislation. In addition, if we propose physician fee schedules, we may increase opposition to hospital cost containment.

On all these issues, we would request additional time to complete conversations with key Congressmen before we make final recommendations to you. In our judgment none of these issues (except enactment of hospital cost containment) are so fundamental that we should insist on them at the price of losing the bill. We must know whether its inclusion would imperil hospital cost containment.

Timing

A further complicating factor is Senator Long's firm determination, largely forced on him by a Finance Committee legislative schedule which includes MTN and the windfall profits tax, to finish markups on health insurance legislation before the end of June -- perhaps beginning work as early as June 15. While Senator Long personally is willing to support substantial aid to the poor, this schedule may result in legislation out of the Finance Committee which provides less in this area than will be acceptable to us. The schedule clearly dictates the need for fast Administration action.

Recommendation

I recommend that you not make a final decision now but permit us to complete our consultation. If you approve, by Tuesday we will submit our final recommendations. On Wednesday, with your approval, we will schedule meetings for you with Senator Long, and Representatives Ullman and Rangel. We will also recommend that you call the Speaker and Senator Kennedy. This schedule will permit announcement before June 8. It is very important to adhere to a tight schedule so HEW can complete its technical work. The agencies and OMB do not object to this approach.

Submit final recommendations by Tuesday

Agree Disagree

Schedule Congressional meetings Wednesday

Agree Disagree



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

May 23, 1979

MEMORANDUM FOR: THE PRESIDENT

FROM: Jim McIntyre, Jr. *Jim*
Charlie Schultze *CS*
Mike Blumenthal *WMB/mt*
Fred Kahn *Fred*

SUBJECT: Concerns with HEW's Approach to Phase I of the National Health Plan

Introduction

We outlined our major concerns with the HEW proposal for Phase I of the National Health Plan last Thursday. In this memorandum and our presentation tomorrow we will discuss four crucial problems that are the major points of contention between HEW and your economic advisors. We believe that there are preferable solutions for each which have not been considered by HEW, and which if included in the plan would not damage the universal nature of Phase I and would be consistent with the principles you announced last July 29.

Initially, we must emphasize the broad areas of agreement we have with Secretary Califano's proposals.

- ° We agree that Phase I should include a national eligibility standard and more uniform benefits for the poor.
- ° We agree that all Americans, including Medicare recipients, should have protection against catastrophic medical expenses.
- ° We agree that a universal spenddown is necessary to further protect the near poor from the high cost of health care.

In short, your advisors are unified in their recommendation that Phase I of the National Health Plan should be universal (providing all Americans with access to health insurance protection) and that additional Federal funds should be concentrated on those most in need: the poor and aged.

We disagree with four major elements in the HEW approach:

- Their proposal to merge Medicaid into Medicare to create a new entity called "Healthcare" pushes Federal financial and administrative involvement in providing health services for the poor far beyond the level necessary to reform the weaknesses in Medicaid and provides only an illusion of simplification.
- Their regulatory proposals, including fee schedules for all health care payments, will create a regulatory nightmare of unprecedented magnitude.
- Their proposal for a Reinsurance Fund is an eccentric approach to regulating the insurance industry; regulation can be accomplished in other ways.
- The total cost of their approach is considerably higher than the \$10-15 billion you had indicated. A Phase I plan can be designed which has substantially lower cost and retains universality of coverage.

Phase I will set the direction of change in the health sector for at least the next decade. Given the huge size and decentralized nature of the health sector, we believe it is crucial to maintain the system of shared responsibility, which encourages Federal, State and local governments to combine forces with consumers, providers and insurers to make the health system more efficient and effective.

The four disagreements described above really stem from one central issue: whether the National Health Plan principles announced last summer commit the Administration to a health system which is ultimately universal, comprehensive and under Federal control. HEW's Phase I plan, with the implementation of "Healthcare" and far-reaching regulatory proposals, sets the foundation for a health system in which, eventually, all resources for health care are closely controlled and distributed by the Federal Government. We believe that a fully federalized health system would not work, and that the four problems we see in HEW's Phase I plan are likely to create more problems than they cure. We do not believe that the principles announced last summer commit us to a fully federalized health system. Further, circumstances detailed below argue against including elements in your Phase I proposal which lead irrevocably to a federalized system.

The approach we propose provides roughly the same benefits as the HEW plan to those in need. However, our modifications allow the retention of the existing system of shared responsibility without making the difficult political decisions to federalize implicit in the HEW plan. In short, a Phase I plan with the modifications we recommend would be politically popular and would increase the likelihood that the efficiency of the health system would be improved when it is implemented.

Major Issues

1. The Federalization of Medicaid. HEW proposes to merge most of Medicaid and all of Medicare into a new Federal program for the poor and elderly -- "Healthcare." Medicare now is the uniform program for the aged. Currently, a single Medicaid program in each State handles all the health benefits which are provided to poor persons. Under the HEW proposal, "Healthcare" would provide some acute care services for the poor. Other acute services (e.g., drugs and dental) now provided through Medicaid would be provided by the States under current cost-sharing formulas although at State option they could be administered by "Healthcare." Long-term care currently provided under Medicaid would continue to be provided by the States under current Medicaid laws. Thus, under HEW's Phase I approach there could be as many as three programs in any given State providing health benefits to some 20 million of the poor. Under our approach, duplication would be limited to about 4 million aged and disabled poor receiving both Medicare and Medicaid.

We basically agree with the benefit and eligibility improvements mandated in HEW's Phase I approach: free care for all Americans with incomes below 55% of poverty, improved minimum benefits for the poor and elderly, and higher reimbursement rates for services to the poor. We do not agree with HEW's proposed alterations in the Federal role in Medicaid, particularly in financing and administration (the latter primarily consists of intake and claims processing).

The extent to which States will be our interested partners in planning and regulating the health system depends in large measure on their financial and administrative commitment. We believe that the benefit and eligibility improvements do not require Federal administration of care for the poor -- unless the ultimate goal is to control totally the health system from Washington. Therefore, we recommend that the Federal administration of "Healthcare" be dropped from our Phase I proposal and that responsibility for financing and administration of care for the poor be left to the States, with a set of universally applicable minimum Federal standards to improve the uniformity of the program.

Financing. The Federal Government pays roughly 55% of Medicaid program costs and States pay about 45%, with the Federal share ranging from 50% in nine States to 77% in Mississippi. HEW proposes that States continue

to share the costs for those who are now eligible for Medicaid because they receive welfare (the "categorically eligible"). The Federal Government, however, would pick up all health care costs for the poor and near poor not currently eligible for welfare.

While it may be politically necessary for the Federal Government to assume the lion's share of the Phase I costs for the poor and near poor, there are several reasons not to hold each State harmless for its added costs. The HEW approach to financing new coverage for this group:

- Implies that benefits for the newly eligible singles and childless couples are a complete Federal responsibility (and thus a higher priority than poor mothers, children and aged).
- Provides substantial incentives for States to distort non-health benefits. States usually spend more on Medicaid than on AFDC benefits. Hence, some States could save money by shifting people out of AFDC and onto general assistance. Although this shift would increase their cash assistance cost (as general assistance is 100% State funded), it shifts the Medicaid costs onto the Federal Government (as Medicaid for non-AFDC recipients will be 100% federally funded). Over time the State share of financing health care for the poor could be diminished to zero.
- Lowers States' interest in the efficient and effective management of health programs for the poor.

We believe it is critical for the States to have a financial interest in the subsidized services provided to every poor person. The political implications of distinguishing between "State poor people" and "Federal poor people" will create tremendous pressure for Federal assumption of the entire burden. In addition, "hold harmless" provisions which identify more "Federal poor" in the States that have kept Medicaid benefits low and the eligible population small will reward some States for failing to take care of their poor population and penalize other States with more adequate Medicaid programs.

Finally, HEW has proposed that the States' role in caring for the health needs of the poor be reduced to making a once-a-year financial contribution, a sort of reverse revenue sharing. It is not clear how States could be required to make these payments. However, if the States are reduced to writing checks to a Federal program, their incentives to improve the management of programs for the poor and to plan effectively on a State-wide basis also disappear. This inevitably leads to more Federal control in the health system. As virtually all major innovations in cost containment (hospital rate commissions and catastrophic insurance programs, for example) have been developed and refined at the State level before being adopted and disseminated by the Federal Government, a major source of ideas for program improvement would be lost.

Administration. Our problems with HEW's approach to the administration of health programs for the poor are more strictly pragmatic. HEW argues that the administrative efficiencies of Medicare can be transmitted to Medicaid programs with their approach. We believe this analogy is unsupportable given the complexities inherent in income-tested programs like Medicaid that are absent from age-tested programs like Medicare. Thus, the simplification expected from "Healthcare" may be illusory. Indeed, prior experience with similar programs indicates that substantial improvements in administration do not immediately follow federalization, and that locally based services are very difficult to manage centrally.

Administration is composed of two main functions: intake and claims processing. Several examples will illustrate the illusory nature of simplification in "Healthcare."

- The potential fragmentation in State health programs for the poor, could result in as many as 107 separate administrative entities providing benefits, rather than the existing 53 Medicaid programs.
- Currently, the States perform intake and eligibility determinations for food stamps under Federal guidelines. As there will be almost 100% overlap between food stamp eligibility and eligibility for free health care in Phase I, there is no reason to duplicate the existing determination processes with a new group of Federal employees. We estimate 30,000 new Federal employees would be necessary. !
- Experience shows that private insurers, when competitively bidding for the work, pay claims more efficiently than government. Given this history, there is no reason to assume that better claims payment follows from Federal assumption of the claims payment process.

The Proposed Alternative. We believe that States should continue to run Medicaid, under a set of universally applicable Federal standards for benefits, eligibility and reimbursement minimums. States should be generally involved in financing the care for newly eligible persons, but the Federal Government should not expect the States to pick up the massive new costs mandated in the first year. In subsequent years, the States should be increasingly at risk for Medicaid costs if State planning efforts do not moderate the general increase in health expenditures. Thus, Federal cost-sharing would extend to reasonable costs, with States able to reap the savings if they achieve cost containment, but also at risk if their medical costs rise excessively.

With respect to intake, we believe that existing mechanisms, including the food stamp eligibility process, could be used. We should make certain that additional intake systems which complicate our efforts to improve access to needs-based programs are not part of our Phase I plan.

While we have no objection to States contracting with HEW for claims processing, States should continue to have the option of finding the least expensive way of paying claims efficiently.

2. Fee Schedules and the Regulation of the Private Sector.

The Existing Situation. Medical care expenditures are increasing rapidly because: the existing system of fee-for-service and hospital "cost" reimbursement actively promotes waste and dilutes the incentive to cut costs; patients with extensive health insurance demand more services and have little incentive to exercise restraint; insurance companies lack leverage to decrease patient demand; and existing tax subsidies further weaken rewards for economizing. In an attempt to cope with rising costs, many Medicaid programs have instituted State-wide fee schedules and Medicare also reimburses for services based on State or sub-State area standards.

HEW's Proposal. In order to control the general growth in health expenditures, HEW has proposed that all insurance payments, both public and private for all health expenditures, be subject to federally mandated rates and provider standards. Physicians and others would be required to accept federally mandated fees as full payment for their services.

The system proposed by HEW will lead to Federal regulation of every level of detail in the health industry. Mandatory fee schedules will lead physicians to protect their incomes by providing more services. Thus, the establishment of fee schedules will fail to control costs -- HEW already anticipates this -- and regulators will be led to even more complex regulatory schemes. It is difficult to conceive the enormous complexity involved in regulating prices, quantity and quality in a system as diverse as the health industry. But it is fair to say that, the task would make regulating the airline, trucking, and energy industries look like child's play.

While it is certainly tempting to seek a "quick fix" through fee schedules, there are ways, including improving competition, eliminating monopolistic practices and restructuring the tax subsidies, in which the inefficiency of the health care system can be attacked before we resort to total Federal control of every last dollar. If you think closing a PHS hospital is difficult, you can imagine the problems of having HEW set doctors' fees in each of the 50 States.

HEW agrees that encouraging competition and choice is a good idea, but in the HEW plan as presented, competition is just one item in a list of miscellaneous health system reforms. Furthermore, the HEW plan is contradictory: it combines a major anti-competitive device -- fee schedules -- with a few pro-competitive provisions. Extending competition and choice must, we believe, be at the heart of the proposal.

Alternatives to HEW's Proposal. Fee schedules for public programs now exist and, while not ideal, can be improved for more effective management of public sector programs. Thus, we accept fee schedules for Medicare and Medicaid and support efforts designed to raise the number of physicians who accept assignment under these programs, but we believe that States should take responsibility for setting Medicaid fees above a Federal minimum standard. In addition, States can be encouraged to develop and improve their own cost control mechanisms such as hospital cost containment programs and improved health planning. Continued State administrative and financial involvement at the margin in Medicaid helps preserve State incentives to do this.

For the private sector, and to the extent we can in Medicare and Medicaid, there are other important alternatives which will improve the efficiency of the health system

- ° Enhancing Competition. According to recent evidence, competition can reduce the dominance of the traditional model of medical care, and thus can significantly lower the cost of health care. It is not a magic "quick fix," but unlike the imposition of fee schedules it would limit -- not exacerbate -- the overutilization of health services.

Therefore, to make better use of market forces, a national health plan should encourage competition among health care packages -- such as HMOs and traditional insurance plans -- and remove incentives that lead to the purchase of unneeded insurance. The HEW plan contains two good provisions (which we have modified slightly) to improve the incentives faced by households:

-- It requires all employers to offer available prepaid, comprehensive health care packages (like HMOs) and low-option plans as alternatives to more traditional packages and high-option plans. This provision is an extension of a provision already in the HMO Act.

-- It requires employers to contribute the same dollar amount on behalf of an employee, whether that employee picks a prepaid package, low-option insurance, or high-option insurance. If *pick none? →* an employee picks a plan costing less than the employer contribution, the employee would receive a cash rebate. This provision guarantees that employees have a financial stake in their choice of a health package.

A commitment to increased competition for cost containment also requires a commitment to systematically changing provisions -- no matter how small each appears -- that restrict the choice of lower-cost options. For example, HEW has traditionally supported changing a number of provisions in current law which (1) restrict

the ability of Medicare and Medicaid patients to buy into prepaid health plans like HMOs, (2) prevent reimbursement for outpatient surgery under Medicare, and (3) restrict more direct reimbursement for nurse practitioners.

- ° Ending Monopolistic Practices. Enhancing competition in health care markets also requires dismantling the existing barriers that prevent the entry of new plans and maintain the monopolistic position of organized medicine. Several anti-trust measures are available to the FTC under the Sherman Anti-Trust Act and, therefore, do not require new legislation.

These options are being examined by your Health Anti-Inflation Task Force and by the FTC. However, making reference to them in Phase I could give impetus to these actions and improve their potential effectiveness. These measures include ending control of local Blue Shield plans by local medical societies and preventing those societies from boycotting physicians who join or who take referrals from HMOs.

Fostering competition is not a single dramatic action like the imposition of mandatory fee schedules. However, it is a long-term solution to a long-term problem. Fee schedules look like a short-term solution, but they eliminate the effectiveness of the long-term answers and they further distort the health care market. Good short-term "quick fix" solutions simply do not exist. We must try to make a basic change in the structure of this market -- and we must be prepared to pursue this change for the long haul.

The emphasis on private sector involvement in health cost containment should be coupled with an explicit challenge to the private health sector to bring the growth in health costs under control. However, it is unclear that such a challenge will create the desired change. If, after a reasonable interval, the vigorous efforts to improve competition introduced in Phase I have failed to produce increased efficiency in the health market, the option of Federal control remains open. The failure of the private sector to manage itself could signal the necessity for shifting our policy towards the centrally managed approach of other Western nations.

3. Reinsurance Fund. HEW has presented the reinsurance fund as a way to enforce standards on private health insurance, to pool the risk of high expenses, and to tax away "windfall profits" of the insurance industry. We believe the arguments HEW makes for the Reinsurance Fund are either unsupportable or that the intended effects can be accomplished much more simply in another way. For example:

- ° The fund is not necessary for the regulation of private health insurance. If Federal control in addition to existing State regulation is necessary, it could be done through other means. For example, favorable tax treatment now available could be

granted only to "approved plans." Similarly, only the purchase of an "approved" or "qualified" plan would constitute compliance with the employer mandate.

- There is no evidence that the Federal Government needs to guarantee access to reinsurance. Private insurance companies sell complete coverage for high medical expenses. Large firms do not need reinsurance and special reinsurance packages are widely available to small firms through the private sector.
- It looks as if we are "out to get" the insurance industry. Why do this if evidence suggests that in fact they are better at the insurance business than we are?

On the Hill, this idea may raise doubts about the seriousness of the rest of our Phase I plan and is best deleted from consideration now.

4. Total Costs. We have several basic concerns about the cost implied in the HEW proposal. First, the Federal financing implied will have a major impact on the Federal budget. Payments to individuals have increasingly squeezed out all other pressing national needs in the last decade, and any major expansion of payments to individuals will create further inflexibility in the total Federal budget. By adding to the Federal expenditures for health with the implementation of Phase I, we further increase the most rapidly rising uncontrollable portion of the Federal budget (Medicare and Medicaid are now doubling every five years). While we have indicated we support implementing substantial new benefits and eligibility, we have severe resource constraints in FY 1983. Therefore, as your economic advisors, we are more cautious than HEW in proposing new costs.

Second, there are still major questions about the estimates of the HEW plan. The cost estimates are very rough and most components are still unverified. We cannot accurately assess the costs of HEW's plan. The combination of scarce resources and uncertain cost estimates should make us extremely cautious about what we add to the budget for this program.

We believe that a universal Phase I plan can be developed with additional Federal expenditures of \$10 billion in 1980 dollars (or \$15 billion in 1983). If we decide to add \$15 billion in 1983 to Federal programs for the poor and aged, this would be the largest single-year increase in outlays resulting from a permanent, new program that the Federal Government has ever made -- larger than any weapon system, highway program, or other social program, including Social Security.

Table I presents a preliminary comparison of the costs of HEW's Phase I approach and the plan as we propose to modify it. Cost estimates for the plan resulting from modifications proposed by OMB, CEA, and Treasury are as rough as HEW's, as they depend largely on the modeling HEW has

done over the previous two years. However, while the absolute costs themselves are not precise, the differences should be indicative of the differences between the plans.

The major programmatic differences between the HEW plan as proposed and the HEW plan as modified by us are:

- Using an "all-related individuals living under the same roof" filing unit for Medicaid eligibility which removes seven million persons living in non-poor households from HEW's estimate of new beneficiaries eligible for free care, and also reduces the number of people getting free care through the spenddown. Most persons removed by this change are non-employed young people living at home. (Initial tentative estimate is savings of about \$3 billion, 1980 dollars, from the HEW plan.)
- Not extending Medicare to those aged -- largely Federal, State, and local government retirees -- who have not paid Social Security taxes. Many of these people currently have better coverage than Medicare. Others in this group would be newly covered by Medicaid. All would be able to spenddown into Medicaid and would be guaranteed the opportunity to purchase catastrophic coverage. (According to HEW, saves \$1.6 billion, 1980 dollars, from their plan.)
- Instituting a 1-for-1 spenddown, rather than the 1-for-2 spenddown supported by HEW. HEW proposes that all persons be permitted a \$1 for \$2 spenddown (each dollar of out-of-pocket medical expenses reduces income counted for health care eligibility by \$2). HEW feels that a spenddown is necessary to eliminate the "notch" effects and that a \$1 for \$2 spenddown is preferable because it diminishes high marginal tax rates. A spenddown is clearly necessary to eliminate the "notch," but analysis suggests that the analogy of high marginal tax rates in welfare programs does not apply to health programs because medical expenses are unpredictable and are almost wholly unrelated to work effort. (According to HEW, saves \$1.5 billion, 1980 dollars, from their plan.)

*only
1 for 1
or 1 for 2 -
nothing
else
possible?*

Other significant differences between the costs of the economic advisors' approach and the plan presented by HEW are: lower cost for required new catastrophic coverage, less upgrading of Medicaid fees, and lower subsidies for others in the modified plan. These changes lower the total cost of the plan we would recommend to \$18 billion, with Federal expenditures of \$12 billion in 1980. If those costs are projected to 1983, using the current rates of increase, the comparable figures, shown in Table I, are about \$25 billion and \$15 billion.

You should note that there is a basic policy difference between your economic advisors and HEW about the most appropriate way to reduce the Federal cost of this plan. Rather than cut various benefits, OMB, CEA, and Treasury propose to scale back certain design elements, but retain

the concept of universality. The most notable example is in changing the filing unit for Medicaid eligibility. This approach lowers the number of potential recipients substantially without excluding singles and childless couples.

Conclusion

In conclusion, we believe that you can be presented a plan which meets our serious concerns if you make three decisions:

- ° That changes in benefits, eligibility, reimbursements, and administration for the aged and poor be made through the existing Medicare and Medicaid programs.
- ° That Federal expenditures be set at \$15 billion in 1983.
- ° That the Federal Government not attempt to regulate the health system through controlling reimbursement in the private sector.

TABLE I

INCREASED EXPENDITURES UNDER PHASE I OPTIONS

	1980 Costs (\$ in Billions)						Difference
	Healthcare (HEW acctg.)		Healthcare (OMB acctg.)		OMB Approach (OMB estimates)		
	Federal	Private	Federal	Private	Federal	Private	
Aged and Disabled	3.0		3.0		1.4		Program: HEW approach extends Medicare to the approximate 1 million now without it. (Largely government workers, they lack Social-Security-covered employment.) OMB approach does not.
Poor	8.0		8.0		5.0		Program: In measuring income to determine who is poor, HEW counts the nuclear family as one unit, treats each child 22 or over (25 or over if student) as a separate income unit, treats subfamilies as a separate unit, and treats each other adult (or couple) as a separate unit. OMB counts all related persons in a household as part of the family income unit. HEW approach eliminates all State Medicaid limits on covered services and moves Medicaid fees to 100% of Medicare level.
Near Poor	5.1		5.1		3.0		Program: HEW approach provides 2 for 1 spenddown; OMB approach provides 1 for 1. Different definition of family also partly responsible.
Employed	1.6	5.2	4.3	7.0		5.8	Prog./Est.: HEW accounting excludes the reinsurance fund from Federal costs and excludes mandated employee premiums from private costs. OMB accounting includes these items. OMB approach would not contain reinsurance fund, subsidies for employer buy-ins, or expanded earned income tax credit (EITC). HEW approach includes these items. Lower estimate of cost of mandated workplace insurance built up from figures supplied by major private insurer.
"3N" (other persons)	.3		1.2		1.2		Acctg.: OMB accounting includes premiums of 3N "buy-in." HEW accounting does not.
Prevention	.3		.3		--		Program: HEW approach includes separate prevention package; OMB approach does not.
Administration	1.5		2.7		1.2		Prog./Est.: Independent estimate of administrative costs of HEW approach is above HEW estimate. OMB approach administrative cost figure starts from this higher estimate and assumes ratio of administrative costs to benefits is the same in OMB approach.
Total	<u>19.8</u>	<u>5.2</u>	<u>24.6</u>	<u>7.0</u>	<u>11.8</u>	<u>5.8</u>	
	25.0		31.6		17.6		

Total 1983 Costs (\$ in Billions)

<u>27.5</u>	<u>7.2</u>	<u>34.2</u>	<u>9.7</u>	<u>16.4</u>	<u>8.1</u>
34.7		43.9		24.5	